BEFORE THE
TENNESSEE PUBLIC UTILITY COMMISSION

PETITION OF
LIMESTONE WATER UTILITY OPERATING COMPANY, LLC
TO INCREASE CHARGES, FEES AND RATES AND FOR APPROVAL OF A GENERAL
RATE INCREASE AND CONSOLIDATED RATES

TPUC DOCKET NO. 24-00044

DIRECT TESTIMONY
OF
CLARK D. KAML

RATE BASE, CIAC AMORTIZATION
AND RATE CONSOLIDATION

ON BEHALF OF THE
OFFICE OF THE TENNESSEE ATTORNEY GENERAL

December 19, 2024

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I. INTRODUCTION

Q1. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION FOR THE RECORD.

A1. My name is Clark D. Kaml. My business address is 2624 Mistwood Ct., Grand Forks, ND, 58201. I am a Utility Consultant contracted with the Consumer Advocate Division of the Tennessee Attorney General's Office ("Consumer Advocate").

Q2. PLEASE PROVIDE A SUMMARY OF YOUR BACKGROUND AND PROFESSIONAL EXPERIENCE.

A2. I received a Bachelor of Science Degree in Economics from the University of North Dakota in 1987 and a Master of Arts Degree in Economics from the University of North Dakota in 1988. I have more than 30 years of experience working in the regulated utilities industries including electric, natural gas, telephone, and water. I have worked for various agencies including the Public Service Commission of North Dakota, the Kansas Corporation Commission, the Minnesota Public Utilities Commission, the Minnesota Office of the Attorney General, and the Grant County Public Utility District. In addition, I have worked with private companies, municipalities, and served on a Rate Committee.

Q3. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION ("TPUC" OR THE "COMMISSION")?

A3. Yes. I filed testimony in the Tennessee-American Water Company recent Rate Case, TPUC Docket No. 24-00032.

Q4. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A4. I am addressing the following issues in Limestone Water Utility Operating Company, LLC's ("Limestone" or the "Company") rate increase proposal:

- Acquisition Premium Recovery
- Land Prices
- Acquisition Transaction Costs
- Contribution in Aid of Construction ("CIAC")
- Financial Security Escrow Accounts
- Depreciation Rates (Depreciation Rates Calculation)
- Rate Base
- Rate Consolidation

Q5. HOW LONG HAS LIMESTONE BEEEN OPERATING IN TENNESSEE?

A5. Limestone is the Tennessee operating affiliate of Central States Water Resources, LLC ("CSWR"). CSWR provides the "financial, technical, and managerial expertise and services to each of the group's utility operating affiliates."[1] CSWR is the only company that has employees and is the only affiliate that provides services to Limestone.[2]

Limestone filed its first petition with the Commission on March 14, 2019.[3] Limestone's second acquisition petition was the first one approved by the Commission at its September 2020 TPUC Conference, which involved Aqua Utilities Company, LLC.[4]

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[1] *Joint Application of Limestone Water Utility Operating Company, LLC, and Bridget J. Wilhite as Administrator CTA of the Estate of Glenna Newport, For Approval of the Acquisition of and to Operate the Newport Resort Water System, and to Transfer or Issue a Certificate of Public Convenience and Necessity*, p. 6, TPUC Docket No. 24-00034 (May 8, 2024).

[2] *Id.*

[3] *Joint Application of Cartwright Creek, LLC, and Limestone Water Utility Operating Company, LLC, For Authority to Sell or Transfer Title to the Assets, Property, and Real Estate of a Public Utility and for a Certificate of Public Convenience and Necessity*, TPUC Docket No. 19-00035 (March 14, 2019). The Joint Applicants eventually withdrew this Petition which was granted by the Commission. *Order Approving Withdrawal of Joint Application and Closing Docket*, TPUC Docket No. 19-00035 (Nov. 8, 2019).

[4] *Order Approving Sale of Assets, Property, and Real Estate and Certificate of Public Convenience of Aqua Utilities Company, LLC Subject to Conditions and Requirements of the Tennessee Public Utility Commission,* TPUC 19-00062 (Dec. 7, 2020). Aqua Utilities was both a water and wastewater utility.

Q6. WHAT CUSTOMERS ARE IMPACTED BY THIS PROPOSAL?

A6. Limestone has 10 water and wastewater systems in Tennessee.[5] More specifically, Limestone provides service to approximately 573 water connections served by 2 water systems and 1,914 wastewater connections served by 8 wastewater systems.[6]

Q7. ARE THESE AREAS LOCATED NEAR EACH OTHER AND INTERCONNETED?

A7. They are not. The 10 water and wastewater systems are geographically dispersed from West Tennessee to East Tennessee.[7] Limestone's systems identified in this Petition are located the following counties: Campbell, Hardeman, Hardin, Marshall, and Williamson.[8] Since the filing of the Petition, the Commission approved[9] another acquisition by Limestone which includes one wastewater system[10] in Decatur County. At the time of this testimony, Limestone has two acquisitions[11] and one CCN amendment[12] pending with TPUC.

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[5] *Petition of Limestone Water Utility Company, LLC to Increase Charges, Fees and Rates and for Approval of a General Rate Increase and Consolidated Rates*, p. 1, TPUC Docket No. 24-00044 (July 16, 2024).

[6] *Direct Testimony of Mike Duncan* at 4 (July 16, 2024).

[7] *Direct Testimony of Todd Thomas* at 6, Exhibit TT-1.

[8] *Direct Testimony of Mike Duncan* at 4.

[9] *Order Approving Revised Stipulation and Settlement Agreement*, TPUC Docket No. 23-00037 (Sept. 30, 2024).

[10] The wastewater system serves Riverstone Estates and the permit issued by TPUC is assigned Permit NPDES No. TN0078379. *Joint Application of Limestone Water Utility Operating Company, LLC, and Integrated Resource Management, Inc. d/b/a IRM Utility, Inc., For Approval of the Acquisition of and to Operate the Wastewater System of Integrated Resource Management, Inc. d/b/a IRM Utility, Inc., and to Transfer or Issue a Certificate of Public Convenience and Necessity*, Ex. 16, TPUC Docket No. 23-00037 (May 24, 2023).

[11] The two pending acquisition applications are TPUC Docket Nos. 23-00070 and 23-00077. It should be noted that Limestone intends to withdraw its third acquisition application. *Status Update Letter*, TPUC Docket No. 24-00034 (Dec. 12, 2024).

[12] The pending CCN Amendment is TPUC Docket No. 24-00020, which, if approved, will add to the current wasteload of the Grasslands system. *Application of Limestone Water Utility Operating Company, LLC to Expand Its Certificate of Convenience and Necessity to Serve the Adley Subdivision*, p. 5, TPUC Docket No. 24-00020 (Apr. 12, 2024).

II. ACQUISITION PREMIUM AND COSTS

Q8. WHAT IS AN ACQUISTION PREIMUM?

A8. An Acquisition Premium is the payment in excess of net book value that accrues to the selling utility. The Consumer Advocate previously addressed, at length, the issue of "Goodwill" and acquisition premium in TRA Docket No. 15-00042. More specifically, the Consumer Advocate's witness Ralph Smith stated:[13]

> Amounts paid to acquire a utility or a utility access that are in excess of the selling utility's depreciated cost are referred to as "Goodwill" or an acquisition premium, and are typically not allowed in rates. Public policy against allowing Goodwill amounts in rates has evolved over the years and is intended to prevent rate increases related to marking-up or inflating the cost of the assets that are used to provide public utility service by buying and selling or transferring utility assets to a different owner. In essence, the mere transfer of utility assets from one owner to another, even if it occurs at a higher cost, would not be sufficient to justify rate increases for the utility service being provided.

Q9. WHY ARE COSTS ASSOCIATED WITH ACQUISITIONS BEING ADDRESSED IN THIS RATE CASE?

A9. The Commission has been consistent in deferring the issues of acquisition premium recovery and acquisition transaction costs to Limestone's first rate case following each acquisition.

Q10. ARE THERE SPECIFIC EXAMPLES?

A10. Yes. In a recent decision, the Commission stated:[14]

> In the course of several dockets, the Commission has ordered Limestone not to book a regulatory asset for acquisition adjustments or for legal and regulatory costs associated with the acquisition of assets. . . . A strict application of accounting principles to such requirements would create a presumption of recovery for issues that have not yet been heard by the

[13] Corrected Direct Testimony of Ralph C. Smith at 9:6-14, TRA Docket No. 15-00042 (Aug. 11, 2015).

[14] *Order Requiring Revisions to the Proposed Stipulation and Settlement Agreement*, pp. 16-17, TPUC Docket No. 23-00037 (Aug. 6, 2024).

Commission, and indeed, on issues that the parties have agreed to defer until Limestone files a future rate case.

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As the Commission has consistently ordered in Limestone's prior utility acquisition cases, and consistent with the Parties' agreement filed in this docket, the panel found the determination of the recoverability of any future proposed acquisition adjustment and regulatory and transaction costs associated with this case will be deferred to Limestone's initial case involving Riverstone

Furthermore, as the Commission has consistently ordered in Limestone's prior utility acquisition cases, the panel found that Limestone shall not be authorized to book regulatory assets for any future proposed acquisition adjustment or for any potential recovery of regulatory and transaction costs associated with this case, but it may account for these items either in the calculation of earnings or in nonutility accounts.

Q11. WHAT ARE THE ACQUISTION PREMIUMS THAT LIMESTONE HAS PAID IN TENNESSE ACQUISITIONS?

A11. The Company indicated that it has paid $2,191,569 in Acquisition Premiums.[15] Company witness Mr. Theis stated that the following represents acquisition adjustments associated with five Limestone acquisitions:[16]

Acquisition	Wastewater	Water	Total
Aqua	323,487	386,816	710,303
Candlewood		59,322	59,322
Cartwright Creek	1,240,278		1,240,278
Shiloh Falls	150,519		150,519
DSH	31,147		31,147
Total	**1,745,431**	**446,137**	**2,191,569**

Q12. WHAT IS THE SOURCE OF THE DIFFERENCE BETWEEN THE TOTAL VALUES?

[15] *Direct Testimony of Brent Theis* at 13:12-17.
[16] *Id.*

A12. It seems to be Limestone's writeup of the land and land right values for some of the properties. Regardless of whether the price is treated as an Acquisition Premium or a writeup on the land value, the payment should be treated the same. This will be addressed below.

Q13. IS LIMESTONE REQUESTING THAT IT BE ABLE TO RECOVER THE ACQUISITION PREMIUMS?

A13. Yes. The Company is seeking recovery of acquisition adjustments for five of its systems: (1) Aqua Utilities, (2) Cartwright Creek, (3) Shiloh Falls, (4) Candlewood Lakes, and (5) DSH – Lakeside Estates.

Limestone's proposal includes the acquisition adjustments for all five transactions in rate base. Mr. Theis stated:[17]

> Limestone has not included the acquisition adjustments in rate base. Rather, the Company is seeking to include such items in rate base and has included them in its revenue requirement calculation.

Q14. DOES THE COMPANY INDICATE HOW THE TREATMENT OF THE AQUISITION PREMIUM OF THESE PROPERTIES WILL INFLUENCE RATES?

A14. Yes. Mr. Theis explained that Acquisition Premiums influence rates in two different ways: (1) One through inclusion[18] of the Acquisition Premiums in rate base; and (2) The other through amortization[19] resulting in an amortization expense being added to the cost of service.

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17 *Id.* at 14:1-2, FN11.
18 *Id.* at 19:10-11.
19 *Id.* at 19:5-6.

Applying Limestone's acquisition cost and proposed cost of capital, the return on the Acquisition Premium would increase the annual required return by $266,490.[20] Limestone stated that this is a monthly average bill impact of $7.63 for wastewater customers and $7.56 for water customers.[21]

With a twenty-year amortization period, the Acquisition Adjustment amortization expense would be $109,578.[22] Limestone estimated that this would result in an average monthly rate impact of $3.17 for wastewater customers and $3.14 for water customers.[23]

The total revenue impact would be $376,068, for an approximate average monthly increase of $10.80 for wastewater customers and $10.70 for water customers.[24]

Q15. DOES THE COMMISSION HAVE ANY POLICIES PROVIDING DIRECTION REGARDING ACQUISITION PREMIUMS?

A15. Yes, it does. As noted by the Company, Rule 1220-04-14-.04 discusses factors that the Commission may consider when determining whether any acquisition adjustment[25] should be incorporated into the acquired rate base. The Commission may order an acquisition adjustment if it determines the adjustment is warranted and will not result in unjust or unreasonable rates and charges for the acquiring utility or for customers. The rule states that the Commission may consider the following six factors:[26]

(a) Cost savings or increases resulting from consolidation of the selling utility's system into the acquiring utility's operations;

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[20] *Id.* at 19:11-12.
[21] *Id.* at 19:12-14.
[22] *Id.* at 19:7-8.
[23] *Id.* at 19:8-9.
[24] *Id.* at 19:15-16.
[25] It should be noted that TPUC's rule uses the term "acquisition adjustment" rather than the term "acquisition premium." The terms are treated as interchangeable in this testimony.
[26] TENN. COMP. R. & REGS. 1220-04-14-.04(2) (Nov. 2021).

(b) Improvements in public utilities services resulting from the acquisition;

(c) Remediation of public health, safety and welfare concerns of the selling utility's system resulting from the acquisition;

(d) Incentives for acquisition of a financially or operationally troubled system, which may be demonstrated by bankruptcy, receivership, financial distress, notice of violation, order of abatement, or inability to continue as a going concern of the selling utility;

(e) Amount of any assets contributed or donated to the selling utility included in the proposed acquisition transaction; and

(f) Any other measurable benefits, costs, or service changes affecting acquired and/or existing customers resulting from the acquisition.

Q16. DOES THE CONSUMER ADVOCATE HAVE CRITERIA THAT IT RECOMMMENDS BE USED TO DETERMINE WHETHER A PORTION OF THE GAIN ON THE SALE SHOULD BE ASSIGNED AS A BENEFIT TO UTILITY CUSTOMERS?

A16. The Consumer Advocate has previously proposed that the following factors should be considered when determining the portion of the Gain on Sale that should be assigned to ratepayers:[27]

1. Will the related Acquisition Premium be recoverable from ratepayers?
2. Has the selling utility provided quality service to ratepayers?
3. Has the selling utility invested necessary capital into the system?
4. Will rates increase as a result of the proposed transaction?

Q17. HOW DO THESE CRITERIA PRODUCE REASONABLE RESULTS?

A17. Rates should be set based on original cost, not on the acquiring price. The Commission has relied on original cost information in prior decisions[28] with the most recent in TRA

[27] *Direct Testimony of David N. Dittemore* at 15:4-12, TPUC Docket No. 19-00062 (Apr. 2, 2020).

[28] *B&W Pipeline, LLC v. Tennessee Regulatory Authority*, No. M2016–02013–COA–R12–CV, 2017 WL 5135977, at*7 (Tenn. Ct. App. Nov. 6, 2017) citing *Re: United Cities Gas Co.*, No. U–84–7333, 1985 WL 1213311 (Tenn. P.S.C. June 10, 1985) (footnote omitted). *See also In Re: Petition of Chattanooga Gas Co. to Place into Effect A Revised Natural Gas Tariff*, No. 97–00982, 1998 WL 35628746 (Tenn. P.S.C. Oct. 7, 1998) (rejecting the utility's request to include acquisition costs in rate base upon determining that additional benefit to customers came from

Docket No. 15-00042.[29] Setting rates on the purchase price encourages transactions that may increase rates without benefits to ratepayers, resulting in excessive rates and excessive returns.

Commissions can be presented with transactions where an Acquisition Premium is paid by the buyer from a poor performing seller. In such a situation, the Acquisition Premium rewards the seller for poor performance. It is important to balance ratepayer impacts with the desire to have service provided by a new operator who may be willing to invest capital. Without the opportunity to assign the Gain on the Sale to ratepayers, the seller could reap the benefits of the Gain on the Sale.[30] In a transaction with a system poorly operated by the seller, if the Commission approves the transaction with recovery of an Acquisition Premium, an amount corresponding to the Gain on the Sale should be assigned to captive ratepayers.

Utilities that do not finance capital improvements, but instead rely on prefunded ratepayer contributions such as the utilities acquired by Limestone, should not then retain Gain on the Sale proceeds.

If the Commission determines that an Acquisition Premium recovery is appropriate, then the transaction will result in cost increases for ratepayers without any direct benefit. In such a situation, ratepayers should receive the benefit of the Gain on the Sale to offset the increased costs resulting from the transaction.

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subsequent investments in plant system that were already incorporated into rate base). A copy of this opinion is attached as Exhibit CDK-1.

[29] *Final Order Setting Rates, In re: Petition of B&W Pipelines, LLC for an Increase in Rates*, 15, TRA Docket No. 15-00042 (March 10, 2016).

[30] The Consumer Advocate's witness David N. Dittemore addressed the issue of the Gain on the Sale in his testimony in a previous Limestone acquisition docket. *Direct Testimony of David N. Dittemore* at 13:17 – 18:14, TPUC Docket No. 19-00062 (Mar. 31, 2020).

Q18. IS THE ARGUMENT THAT THE ACQUISITION PREMIUM IS NECESSARY FOR THE TRANSACTION JUSTIFICATION FOR RECOVERY OF THE ACQUISITION PREMIUM?

A18. No. There are other methods that can be utilized to encourage the sale if it is necessary or in the public interest.

Q19. DOES THE COMMISION HAVE A PRECEDENT FOR ASSIGNING THE GAIN ON THE SALE OF ASSETS TO RATEPAYERS?

A19. Yes. On at least two occasions the Commission has assigned the Gain on the Sale of utility assets to ratepayers: (1) Order on Remand, In re A+ Communications, Inc., TPUC Docket No. 92-1398 (May 18, 1994); and (2) Order, In re Kingsport Power Company, TPUC Docket No. U-84-7308 (November 15, 1984).

Q20. DO YOU HAVE A RECOMMENDATION REGARDING THE ACQUISITION PREMIUMS?

A20. Yes. I recommend that the Commission disallow the $2,191,569 acquisition premium into rate base. If the Commission allows the acquisition premiums to be recovered in rate base, then it should also allocate the Gain on the Sale to rate payers.

Q21. WHAT IS YOUR RATIONALE FOR RECOMMENDING THAT THE ACQUISITION PREMIUM NOT BE RECOVERED IN RATE BASE?

A21. There are several factors. A fundamental premise of utility rate regulation for a monopoly is the use of original cost for rate setting. Utility owners are provided an opportunity to earn a return on and of prudent investments. The owners are not entitled to enrichment once they sell their assets to a new owner. The captive utility ratepayers provide financial

security for the utility owners. Therefore, any Gain on the Sale resulting from the sale of a rate regulated monopoly should benefit the ratepayers. It should not result in a rate increase.

In addition, Limestone did not include the premiums in its original revenue requirement. Thus, allowing the acquisition premium would be an increase in the Company's proposed revenue requirement.

Q22. ARE THERE ANY ADJUSTMENTS THAT NEED TO BE MADE IF THE ACQUISITION PREMIUM IS NOT ALLOWED INTO RATE BASE AND RATES?

A22. No. Limestone did not originally include the acquisition premium in rate base; nor was it reflected in the revenue requirement.

Q23. ARE THERE OTHER COSTS ASSOCIATED WITH THE ACQUISITIONS THAT ARE OF CONCERN?

A23. Yes. There are two other costs that are cause for concern. Limestone has increased price related to land and has transaction costs, such as regulatory and legal fees.

III. LAND PRICE

Q24. WHAT ARE THE LAND AND LAND RIGHTS VALUES PROPOSED BY LIMESTONE IN THIS PROCEEDING?

A24. Limestone's Exhibits BT-10.1 and BT-10.2 report Land and Land Rights for wastewater (account 353.000) as $988,170[31] and Water - Land and Land Rights for water (account 303.000) as $133,458.[32] Combined, the value is $1,121,628.

[31] *Direct Testimony of Brent Thies* at Exhibit BT-6.1.
[32] *Id.* at Exhibit BT-6.2.

Q25. ARE THESE VALUES THE ORIGINAL BOOKED COSTS FOR THE LAND AND LAND RIGHTS?

A25. They are not. The values proposed by Limestone are higher than those reported in other sources, which was confirmed in Limestone's response to discovery.[33] Limestone increased the land and land rights from the selling companies' books by the following amounts:[34]

[redacted]

Q26. WHAT IS THE ISSUE WITH THESE VALUES?

A26. A fundamental premise of rate base rate of return regulation is the use of original (historical) cost. This limits rate base to the cost of acquiring assets, less depreciation, rather than current market value or replacement cost.[35] This straightforward and transparent approach ensures that customers pay for costs incurred by a service provider only once, and that the cost paid is the actual cost incurred.

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[33] Limestone's Response to the Consumer Advocate DR No, 2-7, File <DR 2-7 Land – Confidential.xlsx>.

[34] *Id.*

[35] "Tennessee is an 'original cost' jurisdiction. Under our system of regulation, utility plant is 'worth' only its present net book value (original cost less accumulated depreciation). The comparison between net book value and the cost of building new plant has no significance for rate-making purposes because it ignores the ratepayers' contribution to the existing plant." *Order Upon Reconsideration*, TPSC Docket No. U-84-7333 (Aug. 11, 1985). A copy of this order is attached as Exhibit CDK-2.

Q27. WHAT IS THE BASIS FOR YOUR ASSESSMENT THAT THE PAYMENT RELATED TO THE ACQUISITION OF LAND AND LAND RIGHTS IS EXCESSIVE?

A27. The Company has not provided any information to suggest that there are alternative uses for the land other than the operation of the utility. Since there is no alternative use for the property other than the provision of utility service, there is no basis to acquire the property for an amount in excess of its book value. The proposal to writeup the value of the land is essentially an Acquisition Premium, and a Gain on the Sale for the selling utilities. If allowed, it will result in increased rates simply due to the transfer of ownership.

Q28. DO YOU VIEW THIS AS SIMILAR TO AN ACQUISITION PREMIUM?

A28. The Company claims that this is not an Acquisition Premium. However, an Acquisition Premium is defined as the amount of purchase price over the net book value. The fact that the land was on the books, at cost, does not reflect an inherent account error from previous owners. In the alternative, it is a writeup without any actual capital investment, in which case there should not be an increase in value.

Q29. DID THE COMPANY PROVIDE ANY SUPPORT FOR ITS DECISION TO INCREASE THE LAND VALUES?

A29. No.

Q30. DID THE COMPANY RELY ON ANY APPRAISALS TO INCREASE THE LAND VALUES?

A30. No. The Consumer Advocate requested all appraisals used for values in the rate base, but Limestone responded that it did not use appraisals for value included in rate base.[36]

Q31. WHAT ARE YOUR CONCLUSIONS REGARDING THE LAND VALUE AND LAND RIGHTS INCREASE?

A31. The portion of the land value and land rights exceeding the booked cost at the time of purchase is excessive and should be removed from rate base.

Q32. WHAT IS THE IMPACT OF EXCLUDING THE WRITEUP IN LAND VALUES?

A32. It will decrease the rate base by the amount of the writeup. The revenue requirement will be reduced by the cost of capital multiplied by the writeup amount.

IV. TRANSACTION COSTS

Q33. WHAT ARE TRANSACTION COSTS?

A33. They are costs that are incurred as part of an acquisition proceeding. In general, these are expenses that would not have existed but for the acquisition that are separate from the purchase cost itself. These might include costs that occur prior, during, or after an acquisition.

Q34. HOW DO TRANSACTION COSTS IMPACT RATES?

A34. Like acquisition premiums, acquisition adjustments impact the revenue requirement in two ways. Limestone requested to include the acquisition premiums in rate base. This would be reflected in the revenue requirement calculation through the financing required for the

[36] Limestone's Response to the Consumer Advocate DR No. 2-7, File <DR 2-7 Land – Confidential.xlsx>.

investment, thus increasing the overall revenue requirement. They would also be amortized; the resulting amortization expense is added to the cost of service.

Q35. ARE TRANSACTION COSTS NORMAL IN AN ACQUISITION?

A35. Yes. Like most business transactions, there are costs associated with an acquisition, such as employing experts and professionals to participate in the process. Some of these costs are pre-transaction. These costs provide a benefit to the acquiring company, allowing it to estimate the amount of capital that will be required to operate and maintain the system, discover legal defects to the title, and understand the operational issues specific to the target system. The acquiring company gains valuable information regarding whether it would be beneficial for the Company to proceed with the transaction.

Q36. ARE THERE UNIQUE ACQUISITION COSTS ASSOCIATED WITH REGULATED UTILITIES?

A36. Yes. For a rate regulated utility, the question of how the cost will be recovered is not completely within the control of the business and the market. For a rate regulated utility, the final decision of cost recovery, including if and how the costs will be recovered, is made by a regulatory body. These are the same regulators that generally rely on original-cost ratemaking and are tasked with ensuring that rates are just and reasonable. Thus, a rate regulated utility will often assess the likelihood that regulatory recovery will be necessary and authorized.

Q37. WHAT TRANSACTION COSTS HAS THE COMPANY PROPOSED TO INCLUDE IN RATE BASE?

A37. The table below summarizes the transaction costs, by acquisition, that Limestone has incurred and which it seeks to include in rate base. The total is $544,454 with $426,354 for wastewater and $118,100 for water:[37]

Acquisition		Transaction Cost
Aqua	$	40,523
Cartwright Creek	$	198,892
Chapel Woods	$	40,516
DSH	$	94,278
Shiloh Falls	$	66,556
Candlewood Lakes	$	103,690
Total	**$**	**544,454**

Q38. DID LIMESTONE EXPLAIN THE ORIGINS OF THESE COSTS?

A38. Not entirely. Mr. Thies provided a general description and explained that transaction costs include:[38]

Real Estate related legal costs
Regulatory legal costs
System Mapping
Engineering Analysis

Q39. WHAT WERE LIMESTONES' LEGAL COSTS FOR THESE AQUISITIONS?

A39. Limestone provided the legal fees associated with each acquisition in its discovery responses. Those costs are reflected below:[39]

[*Intentionally Blank, Confidential Table on Next Page*]

[37] *Direct Testimony of Brent Thies* at 21:1-6.
[38] *Direct Testimony of Brent Thies* at 21:13 – 22:21.
[39] Limestone's Response to Consumer Advocate DR No. 1-26.

[redacted]

Q40. HOW MUCH OF THESE COSTS IS LIMESTONE SEEKING TO RECOVER?

A40. The actual amount that Limestone is seeking to recover is unclear. The legal costs are bundled with four types of expenses represented as transaction costs. Limestone's affiliate in North Carolina also sought "due diligence" and other transactional costs in excess of $300,000, but the Commission only allowed recovery of $10,000 in the acquisition docket.[40] The Commission held:[41]

> that these costs provide a benefit to Red Bird allowing it to estimate the amount of capital that will be required to operate and maintain the system, discover legal defects to the title, and understand the operational issues specific to Etowah. Additionally, Red Bird gains valuable information regarding whether it would be beneficial for the Company to proceed with the transaction. If the transaction is consummated, the Commission acknowledges that ratepayers may also benefit from incurrence of these costs to the extent they are reasonably and prudently incurred and depending on the portion ratepayers must bear.

[40] *Notice to Parties of Recommended Order*, p. 28, NCUC Docket Nos. W-933, Sub 12 & W-1328, Sub 0 (Feb. 7, 2024). A copy of this Recommended Order is attached as Exhibit CDK-4. The Commission did allow for the Limestone affiliate the opportunity to provide detailed evidence supporting its request for $300,000 in the Company's next rate case, but Staff would audit such a request. The Limestone affiliate subsequently withdrew its application. *Notice of Dismissal and Withdrawal of Application*, NCUC Docket Nos. W-933, Sub 12 & W-1328, Sub 0 (March 1, 2024). This NCUC docket can be accessed at https://starw1.ncuc.gov/NCUC/page/docket-docs/PSC/DocketDetails.aspx?DocketId=2257a2df-9424-4397-8c98-2db4c3571cf8.

[41] *Id.* at 27.

Q41. DID THE COMMISSION GIVE LIMESTONE ANY ASSURANCE THAT IT WOULD BE ABLE TO OBTAIN RATE RECOVERY FOR THESE COSTS?

A41. No. As stated above, the Commission deferred these issues to Limestone's first rate case[42]. In TPUC Docket No. 21-00055, Shiloh Falls, the Order states in part:[43]

> 6. . . . Further, Limestone does not have authorization to book and above-the-line regulatory asset for any amount where the purchase price exceeds
>
> 7. Any issues related to the disposition of regulatory and transactions cost are deferred and shall be addressed in Limestone's initial rate case. In its initial rate case, Limestone is restricted from requesting recovery of legal expenses in excess of 50% of the amount paid to local legal counsel.

Also, in review of historical Commission orders, Limestone would be aware of the Commission's position on ratepayers shouldering the burden of due diligence costs:[44]

> The majority of the panel reasoned that while due diligence costs are not costs associated with the delivery of water services, such costs may be incurred to safeguard the assets of the Company, thus protecting the interests of the shareholders and ratepayers. To allow recovery of a cost incurred to benefit shareholders but funded solely by ratepayers is unacceptable.

Q42. CAN YOU ELABORATE ON THE STATEMENT "THE LIKELIHOOD THAT REGULATORY RECOVERY WILL BE NECESSARY AND AUTHORIZED?"

A42. Each acquisition is unique, and assessments must be based on the specific circumstances that exist for the specific transaction, including price, synergies, service areas, and other factors. In some cases, the costs of an acquisition are such that the transaction would not proceed without some assurance of cost recovery. In other cases, a company determines

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[42] *Order Requiring Revisions to the Proposed Stipulation and Settlement Agreement*, pp. 16-17, TPUC Docket No. 23-00037 (Aug. 6, 2024).

[43] *Order Approving Settlement Agreement and Transfer of Systems and Granting Certificate of Convenience and Necessity*, p. 5, TPUC Docket No. 21-00055 (Dec. 2, 2022).

[44] *Order Approving Purchase Agreement, Franchise Water Agreement and Certificate of Public Convenience and Necessity*, p. 21, TRA Docket No. 12-00157 (Oct. 15, 2013).

that an acquisition is worth pursuing without assurances of cost recovery from a regulatory body.

Q43. PLEASE EXPLAIN HOW A COMPANY CAN BE ASSURED, OR BE CONFIDENT, THAT IT WILL RECEIVE COST RECOVERY APPROVAL FROM A REGULATORY BODY?

A43. A common approach is for a company to request pre-approval as part of the authorization for the acquisition. Another is to review the law, policies, and historical behavior of a Commission. In the case of pre-approval, there is very little risk, with the risk usually associated with some conditions or performance metrics.

In the second situation, there is a calculated risk. By reviewing previous Commission decisions and comments, a company determines whether the benefits, including the likelihood of regulatory approval of cost recovery, outweigh the costs or risks.

Q44. IS THE ASSURANCE OF COST RECOVERY RELEVANT IN THIS PROCEEDING?

A44. Yes, it is. Limestone did not receive approval to receive acquisition cost recovery prior to proceeding with the acquisitions in this case. Limestone was also aware of this Commission's position regarding the treatment and requirements regarding approval of cost recovery in rates. Furthermore, based on testimony and settlements, Limestone should be aware of the position of the Consumer Advocate. Although Limestone did not have pre-approval and was aware that the Consumer Advocate was likely to object to any acquisition premium or acquisition cost recovery in approved rates, Limestone chose to proceed with the acquisitions. Based on Limestones actions, it is reasonable to conclude the regulatory

rate recovery approval was not one of the most important factors when deciding to proceed with the acquisitions.

Q45. DO YOU HAVE A RECOMMENDATION REGARDING RECOVERY OF THE TRANSACTION COSTS?

A45. At this time, the Consumer Advocate is not convinced that there are direct benefits to consumers that would justify allowing those expenses into rates. The specific amounts and services associated with each of the expenses are not clearly identified. Furthermore, although Limestone is requesting recovery of these transaction costs, the Company has not included theses costs in the original revenue requirement calculation. Thus, the original filing understated the actual request. If Limestone was requesting recovery of these expenses, they should have been included in the original revenue requirement statement.

Q46. DOES EXCLUSION OF THESE TRANSACTION COSTS IMPACT THE REVENUE REQUIREMENT FOR LIMESTONE?

A46. Since they were not included in the original revenue requirement statement, exclusion would not modify that original revenue requirement. Mr. Thies stated:[45]

> Much like the acquisition adjustments, the Company has not included these transaction costs in rate base. Rather, Limestone Water requests that the Commission allow it to include these transaction costs in rate base. Once approved, the Company proposes that the acquisition costs would be depreciated over the same depreciable life as the underlying assets.

V. CONTRIBUTIONS IN AID OF CONSTRUCTION

Q47. WHAT ARE CONTRIBUTIONS IN AID OF CONSTRUCTION ("CIAC")?

[45] *Direct Testimony of Brent Thies* at 21:1-2, FN 12.

A47. CIAC is non-refundable money or property provided by third parties. Because it is not investor-supplied capital, it is not part of rate base.[46] An example is a main extension beyond the free footage allowance into a development. The portion beyond the free footage may be funded by a developer or some other entity. The fee should be to the cost of the assets and labor required to provide the extension to the new development. The excess extension fee should be accounted for as CIAC. CIAC balances are calculated at the end of the test period and reflected in Petitioner's rate Exhibits BT-12.1 and BT-12.2.

[46] *Order Approving Sale of Assets, Property, and Real Estate and Certificate of Public Convenience of Aqua Utilities Company, LLC Subject to Conditions and Requirements of the Tennessee Public Utility Commission,* p.7, TPUC 19-00062 (Dec. 7, 2020).

Q48. WHY IS CIAC AN ISSUE IN THIS PROCEEDING?

A48. Limestone explained that Cartwright Creek CIAC balances had not been amortized.[47] The CIAC balance remained on the Cartwright Creek books at the original level, creating mismatches between the value of the assets supported by the CIAC and the CIAC balances.[48]

Limestone stated that the fact that Cartwright Creek stopped recording any amortization or depreciation expense on its books created difficulty in determining the proper balance of CIAC and accumulated depreciation associated with the Cartwright Creek assets.[49]

Q49. IS LIMESTONE PROPOSING THAT THE CIAC BALANCES MATCH THE CARTWRIGHT CREEK ASSETS?

A49. Yes. Limestone proposed to utilize an average amortization rate of 5 percent based on the utility plant assets on the books of Cartwright Creek on the day of acquisition by Limestone.[50]

Q50. IS THIS A REASONABLE APPROACH?

A50. Yes. From the perspective of an average life basis, this is reasonable.

Q51. BASED ON THE CIAC BALANCES, WHAT IS THE PRO FORMA CIAC CREDIT THAT YOU ARE RECOMMEDING?

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47 *Direct Testimony of Brent Thies* at 29:5-6.
48 *Id.* at 29:6-9.
49 *Id.* at 29:14-17.
50 *Id.* at 29:18-22.

A51. Based on the CIAC balances and amortization rate of 5%, I am recommending a Pro Forma CIAC amortization, credit expense, of $14,896 for water and $293,174 for wastewater. These adjustments are set out in Confidential Workpaper CDK-11.

VI. FINANCIAL SECURITY ESCROW ACCOUNT TERMINATION

Q52. WHAT ARE FINANCIAL SECURITY ESCROW ACCOUNTS?

A52. Generally, they are escrow accounts created to ensure that there is sufficient capital available to meet capital improvement requirements. The Commission has promulgated a rule on escrow accounts, which states in part:[51]

> Reserve/escrow accounts established by a public wastewater utility shall be limited to paying for or reimbursing the utility for extraordinary expenses of the utility or for necessary capital projects, unless otherwise permitted by the Commission. Extraordinary expenses are those resulting from events which are infrequent and unusual in nature, and unrelated to the utilities' routine service or business activities.

Q53. WHY DOES LIMESTONE HAVE FINANCIAL ESCROW ACCOUNTS?

A53. In its acquisition of the Cartwright Creek systems, Limestone assumed the obligation to maintain the financial security escrow account.[52] In its acquisition of the DSH system, Limestone agreed to maintain a similar, and separate, escrow account specific to DSH operations.[53]

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[51] TENN. COMP. R. & REGS. 1220-04-13-.07(7) (Dec. 2018 Revised).

[52] *Order Approving Settlement Agreement and Transfer of Systems and Granting Certificate of Convenience and Necessity*, Exhibit 1, Part II. Settlement Terms, ¶ 4.i-ii, TPUC Docket No. 21-00053 (Jan. 24, 2022).

[53] *Order Approving Settlement Agreement and Transfer of Systems and Granting Certificate of Convenience and Necessity*, p. 7, #12, TPUC Docket No. 23-00016 (Dec. 26, 2023).

Limestone noted that it has also has open acquisition requests in which Limestone will have escrow accounts. These include IRM and the Cumberland Basin Wastewater Systems.[54]

Q54. WHAT IS LIMESTONE PROPOSING?

A54. Limestone has proposed to terminate or waive escrow account payments from customers for Cartwright Creek and DSH, and to close the existing escrow accounts.[55]

Q55. WHY IS LIMESTONE PROPOSING TO ELIMINATE THE ESCROW ACCOUNTS?

A55. As stated above, generally, financial security escrows are created to ensure that sufficient capital would be available to fund capital projects. Limestone argued that unlike Cartwright Creek and DSH, Limestone is well capitalized. CSWR has invested close to $11,000,000 in Limestone's Tennessee operations.[56] Improvements at Cartwright Creek and DSH were funded by investor contributions, without accessing escrow accounts.[57]

Q56. WHAT IS NECESSARY FOR THE ESCROW ACCOUNT PAYMENTS TO BE TERMINATED OR WAIVED?

A56. The Commission has promulgated rules addressing financial security of public wastewater utilities holding or seeking a Certificate of Convenience and Necessity ("CCN").

Section (6) states:[58]

> Upon the filing of an initial CCN application, a determination shall be made regarding the establishment of a reserve/escrow account. The Commission may review the financial condition of any public wastewater utility at any time to

[54] *Direct Testimony of Brent Thies* at 32:4-24.
[55] *Id.* at 32:22 – 33:2.
[56] *Id.* at 37:16-19.
[57] *Id.* at 37:20 – 38:2.
[58] TENN. COMP. R. & REGS. 1220-04-13-.07(6) (Dec. 2018 Revised).

> determine whether a reserve/escrow account balance is adequate or an account should be established. The requirement for a public wastewater utility to maintain a reserve/escrow account shall be determined by the Commission on a case-by-case basis.

Section (7) states in part: [59]

> Reserve/escrow accounts established by a public wastewater utility shall be limited to paying for or reimbursing the utility for extraordinary expenses of the utility or for necessary capital projects, unless otherwise permitted by the Commission. Extraordinary expenses are those resulting from events which are infrequent and unusual in nature, and unrelated to the utilities' routine service or business activities. The utility must first receive authorization from the Commission via approved petition or, in emergency situations, authorization in writing from the Chairman of the Commission upon written request by a representative of the utility to use such funds.

Q57. WHAT ARE THE CURRENT BALANCES FOR THE FINANCIAL SECURITY ESCROW ACCOUNTS MAINTAINED BY LIMESTONE?

A57. As of May 31, 2024, the balances in the escrow accounts are:[60]

Acquisition	Escrow Balance Ending 5/31/2024
Cartwright Creek	$603,003.97
DSH-Lakeside Estates	$50,853.08
Total	**$653,857.05**

Q58. WHAT IS THE IMPACT OF TERMINATING THESE MONTHLY ESCROW CHARGES?

A58. DSH customers would have a reduction in their monthly bills by $10.24 per month.[61] Cartwright Creek customers would see a reduction equal to the tap fees and the Capital Improvement Surcharge**.**

[59] *Id.* at 1220-04-13-.07(7).
[60] *Direct Testimony of Brent Thies* at 33:3-8.
[61] *Id.* at 38:21 – 39:1.

Q59. WHAT DOES LIMESTONE PROPOSE TO DO WITH THE EXISTING ESCROW FUNDS?

A59. Although Limestone stated it is open to guidance from the Commission, the Company posited that the most expedient and reasonable solution would seem to close the escrow account with the funds retained by Limestone.[62] The funds would be treated as CIAC and used as an offset to rate base.

Q60. WHAT IS YOUR RESPONSE TO THIS PROPOSAL?

A60. With regard to existing funds, they should be used for projects in the service areas where the funds were collected. This proposal is based on fundamental fairness, using the funds to provide improvements in the area from which they were obtained. The funds will not be returned to all the customers who made the contributions. However, it would be returned to the service areas and purposes for which it was collected. Having been used for capital projects, the funds would appropriately be reflected as CIAC and in the appropriate service area.

Q61. ARE THERE ANY ADJUSTMENTS THAT SHOULD OCCUR IF LIMESTONE IS ALLOWED TO RETAIN THE FUNDS?

A61. If Limestone is allowed to retain the funds, rate base should be reduced by the amounts in the escrow, totaling $653,857. The Revenue Requirement should be decreased to reflect the reduction in the cost of capital and decreased by an additional $32,692 in depreciation credit of the CIAC.

[62] *Id.* at 39:7-11.

Q62. WHAT IS YOUR RESPONSE TO THE PROPOSAL TO TERMINATE EXISTING ESCROW PAYMENTS?

A62. There may be a reason to terminate the escrow payments. In approving Limestone's acquisitions, the Commission indicated that Limestone appeared to have sufficient financial resources to operate and maintain the systems.[63] Limestone stated it has access to sufficient capital to make necessary repairs, improvements, and expansions without the need to rely on financial escrows for that purpose.[64]

Q63. DO YOU AGREE THAT IF THE ESCROW PAYMENTS ARE TERMINATED, THE TERMINATION SHOULD APPLY TO NEW ACQUISITIONS?

A63. No. The individual acquisitions should be reviewed independently. Each system is different. Just as rates, rate base, and other characteristics of a system are unique, the purpose for which, and method by which, an escrow is collected may vary. As such, the individual acquisitions should be reviewed before making such changes.

VII. PRINCIPLES OF RATE DESIGN

Q64. ARE THERE GENERAL GUIDING PRINCIPLES OF RATE DESIGN?

A64. There are several basic principles of rate design that are generally accepted in utility regulation. The principles that are discussed often draw from those outlined by James Bonbright in Principles of Public Utility Rates:[65]

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[63] For example, the Commission held that "[b]ased on the evidentiary record, the Hearing Panel found that Limestone has the requisite managerial, technical, and financial capabilities to operate the water system and wastewater system in Hardin County serving Points of Pickwick, The Preserve, and Northshore (Phases 1, 2, and 3) now owned by Aqua." *Order Approving Sale of Assets, Property, and Real Estate and Certificate of Public Convenience of Aqua Utilities Company, LLC Subject to Conditions and Requirements of the Tennessee Public Utility Commission,* p.7, TPUC 19-00062 (Dec. 7, 2020).

[64] *Direct Testimony of Brent Thies* at 37:16-19.

[65] BONBRIGHT, JAMES, PRINCIPLES OF PUBLIC UTILITY RATES, p. 291 (1961).

- Practical attributes of simplicity, understandability, public acceptability, and feasibility of application;
- Freedom from controversies as to proper interpretation;
- Effectiveness of yielding total revenue requirements under the fair return standard;
- Revenue stability from year to year;
- Stability of rates themselves, minimal unexpected changes seriously adverse to existing customers;
- Fairness of the specific rates in the apportionment of total costs of service among different consumers;
- Avoidance of "undue discrimination" in rate relations; and
- Efficiency in discouraging wasteful use while promoting justified types and amounts of use:
  - In control of total amounts of service; and
  - In the control of relative uses of alternative types of service.

Q65. ARE THERE OTHER PRINCIPLES OF RATE DESIGN?

A65. Those listed by Bonbright are the most common. Following the publication of his work, there have been numerous other principles that have been offered depending on policies and goals. Some examples are:

- Cost causation: the price of utility service should reflect the economic cost of providing service to the customers who cause the utility to incur the expense.
- Offer customers multiple rate options.
- Engage with stakeholders during the process.
- Design customer-centric rates.
- Provide value of service pricing.

Q66. WHAT ARE SOME OF THE DIFFICULTIES IN APPLYING THESE PRINCIPLES?

A66. Bonbright noted that the list is important in reminding rate makers of the multitude of considerations.[66] However, there are ambiguities, overlapping character, and failure to offer any rules of priority. As such, it may not be possible to produce a single rate design which is simple, fair, and free of controversy.

VIII. LIMESTONE WATER'S OPERATION

Q67. WHAT IS LIMESTONE'S CURRENT OPERATIONS IN TENNESSEE?

A67. Limestone currently provides water service to approximately 573 water connections being served by 2 water systems and wastewater service to approximately 1,914 wastewater connections being served by 8 wastewater systems. As noted by Mr. Duncan, Limestone's Tennessee service area is geographically dispersed.[67] A map of the areas was attached as Petitioner's Exhibit TT-1 to the direct testimony of Limestone Witness Senior Vice President Todd Thomas.

Q68. WHAT ARE LIMESTONE'S OBJECTIVES WITH REGARD TO RATES IN THIS FILING?

A68. Limestone wants to increase rates. It also seeks to unify the terms of service and consolidate rates statewide in a manner that streamlines and simplifies the Company's tariff and supports the economies of scale and related benefits that Limestone offers.

Limestone proposed an increase annual revenue requirement for the water operations of $649,455.[68] Recognizing that adjusted current revenues are $198,894, this represents an

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66 BONBRIGHT, JAMES, PRINCIPLES OF PUBLIC UTILITY RATES, p. 292 (1961).
67 *Direct Testimony of Mike Duncan* at 4.
68 *Direct Testimony of Brent Thies* at 8:20 – 9:1.

annual increase of $450,561.[69] Similarly, for its wastewater operations, Limestone is seeking a total annual revenue requirement of $2,410,952.[70] Current adjusted revenues are $1,187,678. Therefore, Limestone is seeking an annual increase for wastewater operations of $1,223,275.[71]

The specific elements of the revenue requirement, and how the revenue requirement was derived, is discussed in detail in the direct testimony of Brent Thies.

IX. DEPRECIATION RATES

Q69. DID YOU REVIEW LIMESTONE'S DEPRECIATION RATES?

A69. Yes. I reviewed the Depreciation Expense Summaries and the Schedule of Depreciation Rates (Limestone Exhibits BT-6.1, BT-6.2, and BT-6.3).

Q70. DO YOU HAVE ANY COMMENTS?

A70. Yes. The calculations are accurate. However, the values for the Depreciation Expense Summary have been rounded to the full percent. As such, the depreciation rates on those schedules are not accurate and do not produce the Adjusted Test Year Depreciation in the schedule.

Q71. ARE THE LIFE EXPECTANCIES REASONABLE?

A71. In general, the Average Service Life values appear reasonable. However, I do have some concerns with the life expectancies for Supply Mains (account 309.001) and Hydrants

[69] *Id.* at 9:8-13; Exhibit BT-1.2.
[70] *Id.* at 9:2-4.
[71] *Id.* at 9:12-13; Exhibit BT-1.1.

(account 335.00). For each of these, Limestone used an average service life of 10 years. Both of these are long-lived items with life expectancies closer to 50 years or more.

Q72. DO YOU HAVE ANY RECOMMENDATON REGARDING THE DEPRECIATION OF THESE TWO ACCOUNTS?

A72. Not at this time. However, they should be looked at more closely in the future, with Limestone providing support for these life expectancies.

X. RATE BASE

Q73. DO YOU HAVE ANY ADJUSTMENTS TO THE RATE BASE?

A73. Yes. The recommendations above have two adjustments to rate base. My recommendation to exclude the Land and Land Rights writeups reduces the test year rate base by $677,359. The recommendation to require the Financial Security Escrow Accounts to be used for projects increases CWIP by 653,857, reducing the rate base by an equivalent amount. The resulting test year Rate Base is reduced from $3,272,328 to $1,941,112.

XI. RATE CONSOLIDATION

Q74. WHAT ARE LIMESTONE'S OBJECTIVES WITH REGARD TO RATES IN THIS FILING?

A74. Two of Limestone's proposals are to:

1. Increase authorized revenue requirement and rates;[72] and
2. Unify the terms of service and consolidate rates statewide.[73]

Q75. WHAT IS MEANT BY RATE CONSOLIDATION?

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[72] *Direct Testimony of Mike Duncan* at 12-13.
[73] *Direct Testimony of Aaron Silas* at 24:18-23.

A75. As proposed in its filing, Limestone's rate consolidation is an averaging of cost recovery and applying the same rates and rate structure for each customer class across multiple systems. Under that consolidation proposal, all Limestone customers would be charged the same statewide rate for water or wastewater service.[74]

Q76. WHY IS THE COMPANY PROPOSING TO CONSOLIDATE RATES?

A76. Company witness Mr. Duncan stated that by consolidating rates across its two water systems and across its eight wastewater systems, Limestone can mitigate the rate increases experienced by some customers.[75] He argued that some benefits of consolidated rates are:[76]

- Encouragement of the acquisition of small, troubled water and wastewater systems;
- Mitigation of rate impacts and promotion of affordability;
- Management of operations to the same quality standards;
- Increased level of regulatory, administrative, and billing efficiency;
- Perceived inequities associated with system subsidization will be short-lived and will eventually balance out; and
- More consumer friendly than a dozen different rate sheets.

Q77. CAN RATE CONSOLIDATION CREATE CONCERNS AMOUNG CUSTOMERS?

A77. Yes. Mr. Duncan admits that consolidated rates require customers serviced by the better systems to support the cost of improvements being made in some of the worst systems.[77] This is likely to cause concerns of fairness by customers, particularly from those seeing rate increases.

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[74] *Direct Testimony of Mike Duncan* at 15.
[75] *Id.* at 14-15.
[76] *Id.* at 15-16.
[77] *Id.* at 17. Mr. Duncan reasons that eventually the better-situated systems will eventually require investments, so this imbalance will right itself over time.

Q78. DO YOU AGREE WITH MR. DUNCAN'S STATEMENT THAT AVERAGE COST PRICING AND STATE-WIDE RATES ARE THE RULE RATHER THAN THE EXCEPTION?

A78. Not necessarily. As support for his position, Mr. Duncan referred to electric and gas utilities, noting that electric and gas utilities have uniform rates for all customers within each rate class for decades.[78]

Although there are similarities among the provision of water service, natural gas services, and electric service, there are also significant differences. All three of these services are natural monopolies that benefit from economies of scale and the provision of the service by one company rather than multiple companies that are competing with one another.

However, there is a fundamental difference. Natural gas provision and electric service are, for the most part, a nationwide, integrated system. In theory, natural gas can move from any source point to any point of consumption on the system anywhere in the country, regardless of ownership structure of the service provider (municipality, investor-owned company, or cooperative). Likewise, electricity from any source on the system can be delivered to any customer on the system anywhere in the United States. Due to this interconnection, there are many common costs that support the entire system and the provision of service to all customers regardless of the location of the customer, the location of the investment, or the structure of the service company.

In addition, there are alternatives to natural gas such as propane and electricity. Natural gas companies tend to only extend service to areas with sufficient population density, or

[78] *Id.*

demand, to justify the capital cost. There are large portions of the country that do not have natural gas service due to various factors including the serve to those areas and the existence of alternative energy sources.

Another difference is that for the most part, electricity needs to be consumed at the same time it is generated. While there have been advances in storing electricity, electricity storage is still a capital-intensive endeavor. For commercial storage capacity using battery technology, the estimated capital cost of capital for 4-hour delivery exceeds $2,000 per kW, the fixed operation and management cost is estimated to be approximately $49 per kWh per year,[79] and losses associated with the storage are estimated to be approximately 20 percent.[80]

Q79. ARE THERE DIFFERENCES IN THE COST OF PROVIDING NATURAL GAS AND ELECTRIC SERVICES IN GEOGRAPHIC AREAS OR BASED ON POPULATION DENSITIES SUCH AS URBAN VS. RURAL AREAS?

A79. Yes, there are. The cost of providing natural gas or electricity to any area can vary based on factors such as location, population density, and terrain. Increased distance between customers can increase the cost of service. A prime example is the provision of service to a multifamily facility vs a single-family home. In the case of the multifamily facility, the same service line can be used to serve several customers. With several meters located in the same area, or a few feet of each other, there are cost savings.

[79] National Review Energy Lab, Annual Technology Baseline, Commercial Battery Storage available at https://atb.nrel.gov/electricity/2024/commercial_battery_storage.

[80] U.S. Energy Information Administration, Utility-scale batteries and pumped storage return about 80% of the electricity they store (February 12, 2021) available at https://www.eia.gov/todayinenergy/detail.php?id=46756.

Q80. ARE THE COSTS TO SERVE DIFFERENCES DEMONSTRATED IN SERVICE OR RATES?

A80. Yes. One of the most obvious differences is the lack of natural gas service in areas of low population densities. To address decreasing population densities, a utility is often designed with parameters identifying a maximum free footage allowance for mains and service lines. Additional fees or rates often apply to the specific customer or customers for extensions beyond the free footage allowance.

Another example can be found in the Rural Electrification Administration (currently called Rural Utilities Service or "RUS") with loans that supported the creation of cooperatives and the electrification of the rural (farming) America.[81] Its goal is to provide service to areas where investor-owned utilities were reluctant to invest. More than 800 co-ops continue to provide service to this day. Similarly, in recent years, RUS has provided loans and grants to support broadband in rural communities on the basis that these areas are more costly to serve and would otherwise have insufficient access to the internet.

Q81. DOES LIMESTONE'S ARGUMENT THAT RATE COSOLIDATION HAS ALREADY OCCURRED IN SOME AREAS IN OTHER STATES JUSTIFY RATE CONSOLIDATION?

A81. No. In the case of the Cartwright Creek systems, the Company has not provided any analysis or information explaining why rates were consolidated. Nor has Limestone provided any analysis that demonstrates that the conditions in the Cartwright Creek systems are applicable to the entire state.

[81] Information about the RUS can be accessed at its website at https://www.rd.usda.gov/about-rd/agencies/rural-utilities-service.

The same applies to decisions in other states. Without an analysis of the specific conditions of the approvals and the actual decisions related to those cases, a comment of the applicability of those situations to those in Tennessee is only policy or outcome driven, rather than fact based.

Q82. DOES THE EXCERPT FROM THE KENTUCKY COMMISSION PROVIDE THE NECESSARY SUPPORT?

A82. It does not. Mr. Duncan stated:[82]

> The Commission supports the principle that utility rates should be cost based, and that in most circumstances each class of utility ratepayers should pay the costs which the utility incurs to provide that class with utility service. The majority of Bluegrass Water's customers are in the residential class. A separate rate for each geographically distinct merged system of Bluegrass Water would create unreasonable and undue hardship to individuals in some areas served by Bluegrass Water.

The statement indicates that the Kentucky Commission supports cost-based rates. The Kentucky Commission then deviates from that concept with a subjective statement. Again, there is no documentation of the actual cost of service, what constitutes unreasonable and undue hardship, the rate impact on customers, or any other factors that need to be considered.

Q83. DO YOU AGREE THAT ECONOMIES OF SCALE EXIST IN THE PROVISION OF WATER SERVICE?

A83. There can be economies of scale in the provision of water service. However, many of the economies of scale are related to the provision of service under one company and could

[82] *Direct Testimony of Mike Duncan* at 18-19.

exist without consolidating rates. However, the potential for economies of scale does not ensure that they will be captured.

Q84. HAS LIMESTONE PROVIDED ANY ESTIMATES OF ECONOMIES OF SCALE THAT MIGHT RESULT FROM CONSOLIDATING RATES?

A84. It has not.

Q85. IS THE COMPANY'S PROPOSAL INCONSISTENT WITH ANY RATEMAKING PRACTICES?

A85. Yes. The proposal is inconsistent with some rate principles including rate stability, rates based on cost causation, acceptability, and possibly fairness and views of undue discrimination.

The proposed changes run into questions of public acceptability, and, absent a cost to serve analysis in each zone justifying the change, may raise questions of fairness. A practice in rate-making is to consider cost recovery from those that cause the cost to be incurred. For each rate class, Limestone has proposed to group all rate zones for a given rate class into one common classification, without demonstrating that the actual cost to serve each of the zones is similar to the cost of serving all other zones.

Q86. DOES THE CITATION FROM THE ARIZONA COMMISSION JUSTIFY RATE CONSOLIDATION?

A86. No. The quote from the Arizona Commission is a policy statement supporting the consolidation of small, fragmented systems.[83] Consolidation of systems is not the same as consolidation of rates. The general policy that the practical benefits from allowing rate

[83] *Direct Testimony of Mike Duncan* at 19.

consolidation involving small water and wastewater utilities outweigh the benefits of a strict adherence to the principle of cost-based rate does not address basic questions. Without addressing the specifics of an individual case, the questions of when to apply the general policy vs principle and how to design rates remain.

Q87. WHAT IS LIMESTONE'S PROPOSED RATE DESIGN?

A87. The Company is proposing:

- For wastewater, a single flat charge multiplied by the appropriate equivalent residential unit ("ERU") multiplier.[84]
- For water, a combination of a base rate and volumetric charge for usage.[85]
- A pass-through charge for one service area (Aqua), which purchases wholesale water for distribution to individual connections.[86]

The Proposed Flat rate charges dependent on meter size starting at $50.62 per month for a 5/8" meter with a proposed usage rate of $4.52 per month.

For the pass through, the rate is $4.95 per thousand gallons adjusted for a water loss of 18.45 percent.

For wastewater, the proposed rate design is $86.64 pr month.

Unmetered customers are charged a flat rate reflecting an average bill utilizing 2,958 gallons of water.

For Aqua Utilities, Limestone purchases water from Savannah Utility Department. Limestone could have rate changes for that source and propose a passthrough.

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[84] *Direct Testimony of Aaron Silas* at 17:24 – 18:3; 19:19 – 20:18.
[85] *Id.* at 18:4-6; 21:12 – 22:2.
[86] *Id.* at 18:6-8; 22:14.

The following is from Petitioner's Exhibit AJS-5:

Proposed Water Rates

Meter Size		Monthly Fate rate	Proposed Usage
5/8-METER		$ 50.62	$ 4.52
3/4-METER		$ 32.25	$ 4.52
1-METER		$ 53.75	$ 4.52
1.5-METER		$ 107.50	$ 4.52
2-METER		$ 172.00	$ 4.52
3-METER		$ 344.00	$ 4.52
4-METER		$ 537.50	$ 4.52
6-METER		$ 1,075.00	$ 4.52

Q88. HOW WILL THE CONSOLIDATION OF RATES IMPACT CUSTOMERS?

A88. The proposed rates differ from existing rates for both meter size and volume of use. As a result, there is not a consistent impact across all customers and customer classes. Petitioner's Exhibit AJS-6 Rate Comparison indicates that water rates for average customers could increase between 68.7 percent to 621.32 percent:

Category	Meter Size		Present Rate	Proposed Rate	Proposed $ Increase	Proposed % Increase
Aqua Utilities	3/4" & 5/8"	*First 1,000 gallons*	$19.65	$50.62	$ 30.97	157.63%
		Each 1,000 gallons	$3.05	$ 10.55	$ 7.50	246.05%
		Average Bill (3,000 gallons)	$ 25.75	$ 82.29	$ 56.54	219.56%
Aqua Utilities	1"	*First 1,000 gallons*	$19.65	$63.28	$ 43.63	222.04%
		Each 1,000 gallons	$3.05	$ 10.55	$ 7.50	246.05%
		Average Bill (3,750 gallons)	$ 28.04	$ 102.86	$ 74.82	266.87%
Aqua Utilities	1.5"	*First 1,000 gallons*	$19.65	$253.12	$ 233.47	1188.16%
		Each 1,000 gallons	$3.05	$ 10.55	$ 7.50	246.05%
		Average Bill (15,000 gallons)	$ 62.35	$ 411.44	$ 349.09	559.89%
Aqua Utilities	2"	*First 1,000 gallons*	$19.65	$405.00	$ 385.35	1961.05%
		Each 1,000 gallons	$3.05	$ 10.55	$ 7.50	246.05%
		Average Bill (24,000 gallons)	$ 89.80	$ 647.75	$ 557.95	621.32%
Candlewood Lakes	Unmetered	*All*	$40.00	$67.50	$ 27.50	68.75%

The Exhibit indicates that wastewater customers could see rate changes anywhere from a reduction of 11.93 percent to an increase of 332.54 percent.

Category	Customer Type		Present Rate	Proposed Rate*	Proposed $ Increase	Proposed % Increase
Aqua Utilities	Residential	*First 1,000 gallons*	$19.65	$86.64	$ 66.99	340.90%
		Each 1,000 gallons	$3.05	$ -	$ (3.05)	-100.00%
		Average Bill (3,000 gallons)	$ 25.75	$ 86.64	$ 60.89	236.46%
Shiloh Falls	Residential	*First 1,000 gallons*	$8.90	$86.64	$ 77.74	873.46%
		Each 1,000 gallons	$3.71	$ -	$ (3.71)	-100.00%
		Average Bill (3,000 gallons)	$ 20.03	$ 86.64	$ 66.61	332.54%
Grassland	Residential		$42.00	$86.64	$ 44.64	106.28%
Arrington Retreat	Residential		$55.25	$86.64	$ 31.39	56.81%
Hideaway	Residential		$55.25	$86.64	$ 31.39	56.81%
Hardeman	Residential		$55.25	$86.64	$ 31.39	56.81%
Chapel Woods	Residential		$29.00	$86.64	$ 57.64	198.75%
Lakeside Estates	Residential		$43.37	$86.64	$ 43.27	99.76%
Grassland	Commercial	*Base*	$37.00	$86.64	$ 49.64	134.16%
		Each 1,000 gallons	$8.75	$ -	$ (8.75)	-100.00%
		Average Bill (3,000 gallons)	$ 63.25	$ 86.64	$ 23.39	36.98%
Arrington	Commercial	*Base*	$37.00	$86.64	$ 49.64	134.16%
		Each 1,000 gallons	$8.75	$ -	$ (8.75)	-100.00%
		Average Bill (3,000 gallons)	$ 63.25	$ 86.64	$ 23.39	36.98%
Hideaway	Commercial	*Base*	$37.00	$86.64	$ 49.64	134.16%
		Each 1,000 gallons	$8.75	$ -	$ (8.75)	-100.00%
		Average Bill (3,000 gallons)	$ 63.25	$ 86.64	$ 23.39	36.98%
Hardeman	Commercial	*Base*	$37.00	$86.64	$ 49.64	134.16%
		Each 1,000 gallons	$8.75	$ -	$ (8.75)	-100.00%
		Average Bill (3,000 gallons)	$ 63.25	$ 86.64	$ 23.39	36.98%
Lakeside Estates	Commercial	*Base up to 300 gallons per day*	$68.37	$86.64	$ 18.27	26.72%
		Each addt 100 gallons per day	$15.00	$ -	$ (15.00)	
		Average Bill (450 gpd)	$ 98.37	$ 86.64	$ (11.73)	-11.93%

Q89. ARE THESE RESULTS UNUSUAL?

A89. When consolidating rates over multiple systems where customers from various rate schedules are moved to the same, new, rate schedule, it is not unusual to see variations in the rate impacts to different customer groups.

Q90. CAN YOU COMMENT ON THE PREMISE THAT RATE CONSOLIDATION IS A SOLUTION TO A COMPANY HAVING NUMEROUS TARIFFS WITH DIFFERENT TERMS AND CONDITIONS?

A90. Having tariffs for each service area that are similar can produce benefits in efficiencies and may reduce confusion. However, the tariffs can be similar without having the same rates. Thus, I support the idea of using the same tariff format, but not the same rates.

Q91. DID LIMESTONE ARGUE THAT THE COST TO SERVE A GIVEN CUSTOMER CLASS IS SIMILAR REGARDLESS OF THE ZONE SERVED?

A91. It did not. The Company recognizes that rates may vary by system. Mr. Duncan noted that it would be cost prohibitive to provide services to many small systems if rates are established on a system-by-system basis.[87] He stated that if wastewater rates were established on a system basis for Aqua Utilities, the monthly rates would be $149.82 as opposed to $83.83.[88]

Q92. DO YOU AGREE THAT ECONOMIES OF SCALE EXIST IN THE PROVISION OF WATER SERVICE?

A92. There can be economies of scale in the provision of water service. However, many of the economies of scale could exist through the consolidation of companies without consolidating rates.

Q93. IS THE COMPANY'S PROPOSAL INCONSISTENT WITH ANY RATEMAKING PRACTICES AND PRINCIPALS?

A93. Yes. The proposal is inconsistent with some rate principles including rate stability, rates based on cost causation, acceptability, and possibly fairness and views of undue discrimination. Limestone has not demonstrated that the costs to provide service in the various service areas are similar. In addition, stability of rates themselves is viewed as

[87] *Direct Testimony of Mike Duncan* at 14.
[88] *Id.*

minimal unexpected changes seriously adverse to existing customers. The rates should be reasonably stable and predictable. Limestone's proposal is not predictable and is not stable:

- As demonstrated above, Lakeside Estates will see a decrease of 11.93 percent in wastewater rates;
- The average customer in Shiloh Falls will see a 332.54 percent increase in wastewater rates;
- The average Candlewood Lakes customer will see 68.75 percent increase in water rates;
- The average Aqua Utilities customer with a 2-inch meter will see an increase of 621.32 percent.

The proposed changes cause questions of public acceptability, and, absent a cost to serve analysis in each zone justifying the change, may raise questions of fairness. A practice in rate making is to consider cost recovery from those that cause the cost to be incurred. For each rate class, Limestone has proposed to group all wastewater rate zones for a given rate class into one common classification, without demonstrating that the actual cost to serve each of the zones is similar to the cost of serving all other zones.

Q94. DO YOU AGREE WITH THE STATEMENT THAT THE PRIMARY BENEFIT OF CONSOLIDATED RATES IS THAT COSTS ARE RECOVERED OVER A LARGER CUSTOMER BASE?

A94. Not necessarily. If the larger customer base is creating economies of scale that reduce the average cost to customers, it is a benefit. However, if the larger customer base is not producing any cost saving and simply averaging rates, there is no real economic benefit. A larger customer base, and recovery of capital expenses over that larger base, can exist without rate consolidation.

Q95. ARE THERE OTHER CONCERNS WITH LIMESTONE'S RATE CONSOLIDATION PROPOSAL?

A95. The Company's arguments for consolidated rates are based primarily on policy. They do not justify rate consolidation from a cost perspective. Limestone made general, and to some extent rhetorical, policy arguments in support of rate consolidation. It did not provide evidence supporting an argument that the cost to serve the existing zones is the same or similar. It did not identify any cost savings, and there is no evidence that it would result in just and reasonable rates for customers.

Q96. WHAT IS YOUR RECOMMENDATION REGARDING RATE CONSOLIDATION?

A96. The recommendations regarding the Rate Consolidation Proposal in this proceeding should not be considered a general policy or establishing a precedent. The recommendations are based on the specific facts and conditions of this proceeding.

XII. VEGETATION MANAGMENT

Q97. WHAT IS VEGETATION MANAGEMENT?

A97. Generally, vegetation management is the control or elimination of vegetation growth. It can be weeds, brush, trees, or any other vegetation that might impact the target area. Vegetation management is a common issue in utility operations due to the impact that unwanted plants can have on the provision of utility service.

Q98. IS THE COMMISSION FAMILIAR WITH THIS TOPIC?

A98. Yes. The topic plays an important role in the provision of utility service. Therefore, the Commission sees the issue in various proceedings.

Q99. DOES THE COMMISISON HEAR ABOUT THIS ISSUES FROM OTHER SOURCES?

A99. Yes. At the September TPUC Conference, Britton Dotson with the Tennessee Department of Environment and Conservation ("TDEC") provided a presentation about non-compliance at on-site wastewater systems which use drip dispersal.[89] The presentation provided an overview of TDEC's recently issued *Report on the Performance of Wastewater Systems Utilizing Drip Dispersal in Tennessee – June 7, 2024* (the "Report"). The Report and the transcript of the presentation to TPUC discussed the importance of controlling vegetation.

On page 6 addressing "Anticipated Performance," the Report states:

> The land application area should be accessible, well-defined, and not overgrown with vegetation in support of maintainability, operability, and inspections by both the permittee and the Division.

On page 8, the Report states:

> Division staff inspectors utilized ArcGIS Survey123 to record their observations. The observations related to the performance of the land application area and matters that impacted those observations. For example, typical observations included whether the land application area was well defined, well-maintained or overgrown, and whether it was accessible to support walk-through. These types of observations go toward establishing that the inspection was being made at the correct location.

On p. 20 of the transcript, Mr. Dotson stated that some systems were:

> [s]o overgrown we couldn't do anything with it. That's not okay. They're supposed to be managed in such a way as to facilitate inspections [by TDEC personnel and system operators]; that sort of thing.[90]

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[89] The presentation provided an overview of TDEC's *Report on the Performance of Wastewater Systems Utilizing Drip Dispersal in Tennessee – June 7, 2024* ("Report"). A copy of this Report is attached as Exhibit CDK-3. The Report may also be accessed on TDEC's website at

[90] *Transcript of Commission Conference September 9, 2024* at 20:8-11.

Q100. IS OVERGROWTH A COMMON PROBLEM?

A100. After inspecting these systems across Tennessee, TDEC found that one quarter of the sites 360[91] permitted land application systems had "notable performance issues" such as wastewater runoff from land application areas to neighboring properties, drainageways or to surface waters.[92] One-fourth of systems exhibited less severe, but still non-compliance issues, such as localized saturation or ponding, and vegetation overgrowth preventing evaluation.[93]

Q101. HOW DOES THE TOPIC OF VEGETATION MANAGEMENT APPLY IN THIS PROCEEDING?

A101. In the Company's filings in this Docket, there appears to be some inconsistencies on the role and importance of vegetation management.

Mr. Jacob discusses, at length, the importance of controlling vegetation growth in his explanation of improvements for Genesis Village. He stated:

> Controlling vegetation growth on the site is important to maintain proper operational access to all equipment and to prevent damage to fencing and equipment. Currently, some portions of the Genesis Village site are inaccessible due to uncontrolled vegetation. Limestone will clear the site and **implement a vegetation control process** on the site.[94] (emphasis added)

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[91] In January and February 2024, TDEC conducted a survey of 40 land application areas support 374 land application systems. "Fourteen of the 374 permitted land application systems were either no in use or had not been constructed." TDEC personnel conducted site observations on the remaining 360 land application systems. TDEC's *Report on the Performance of Wastewater Systems Utilizing Drip Dispersal in Tennessee – June 7, 2024* at p. 1.

[92] *Id.*

[93] *Id.* For example, another utility, Tennessee Wastewater Systems, Inc., has received at least two Notices of Violation at its facilities regarding vegetation management: (1) One on August 2, 2024, regarding Permit #SOP-01028, stating "lack of proper vegetation maintenance; and (2) Another on October 24, 2024, regarding Permit #SOP-00019 stating "This area was inaccessible due to vegetation during the August 5 inspection. Copies of these Notices of Violation are attached as Exhibits CDK-4 and CDK-5.

[94] *Direct Testimony of Jacob Freeman* at 13:1-6 (emphasis added).

However, in its discovery response, Limestone does not appear to view the issue of vegetation management as important as Mr. Jacob stated in his earlier written testimony. The Consumer Advocate issued discovery requesting details regarding the O&M Contractor's, Clearwater Solutions, charge for mowing.[95] Limestone stated that mowing is "an out-of-scope, non-routine task as outlined the Clearwater Solutions contract." It added that "Clearwater Solutions does not currently have a contract with A&M Landscaping. A&M is hired by Clearwater Solutions as needed."[96] Limestone further explained that the service provided by A&M Landscaping include "quarterly brush hogging to clear dense vegetation, grass mowing every two and a half weeks, and spraying or mowing around the five lift stations."[97]

Q102. WHAT ARE YOUR CONCERNS WITH THIS RESPONSE?

A102. As Mr. Freeman stated, vegetation management is an important part of the operation and maintenance of these systems. As such, this type of routine work should be within the scope of work for the O&M contractor.

Q103. DO YOU HAVE ANY RECOMMENDATIONS REGARDING LIMESTONE'S VEGETATION MANAGEMENT PRACTICES?

A103. Yes. My recommendation is that in future proceedings, this topic be given a closer look to ensure that Limestone is including this type of important, routine maintenance within the scope of work of its O&M contractor.

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95 Limestone's Response to Consumer Advocate DR No. 2-23.
96 *Id.* at 2-33a.
97 *Id.* at 2-33b.i.

XIII. RECOMMENDATIONS

Q104. WHAT ARE YOUR RECOMMENDATIONS IN THE PROCEEDING?

A104. I recommend:

- To not allow the $2,191,569 acquisition into rate base;
- Exclude the portion of the land value and land rights exceeding the booked cost at the time of purchase;
- To not allow the transaction costs associated with the acquisitions to be included in rate base;
- Approve Limestone's request to amortize the Cartwright Creek CIAC at a rate of 5 percent;
- Allow Limestone to terminate financial escrow collections from Cartwright Creek and DSH;
- Require Limestone to use the financial escrow accounts for capital expenditures in the service areas from which they were collected;
- Reduce rate base by $653,857 to reflect the financial escrow accounts;
- That in future proceedings, the topic of vegetation management be given a closer look to ensure that Limestone is including this type of important and routine maintenance within the scope of work of its O&M contractor; and
- Deny Limestone's request to consolidate rates.

Q105. DOES THIS COMPLETE YOUR TESTIMONY?

A105. Yes, it does. However, I reserve the right to incorporate any new data that may subsequently become available.

IN THE TENNESSEE PUBLIC UTILITY COMMISSION
AT NASHVILLE, TENNESSEE

IN RE:	)	
	)	
PETITION OF LIMESTONE WATER UTILITY OPERATING COMPANY, LLC TO INCREASE CHARGES, FEES AND RATES, AND FOR APPROVAL OF A GENERAL RATE INCREASE AND CONSOLIDATED RATES	)	**DOCKET NO. 24-00044**

AFFIDAVIT

I, Clark Kaml, on behalf of the Consumer Advocate Division of the Attorney General's Office, hereby certify that the attached Direct Testimony represents my opinion in the above-referenced case and the opinion of the Consumer Advocate Division.

CLARK KAML

Sworn to and subscribed before me
this 19th day of December, 2024.

NOTARY PUBLIC

My commission expires: December 21, 2027

JORDAN MILLER
NOTARY PUBLIC
STATE OF COLORADO
NOTARY ID 20234047506
MY COMMISSION EXPIRES DECEMBER 21, 2027

2017 WL 5135977

SEE COURT OF APPEALS RULES 11 AND 12
Court of Appeals of Tennessee,
AT NASHVILLE.

B&W PIPELINE, LLC
v.
TENNESSEE REGULATORY AUTHORITY, et al.

No. M2016–02013–COA–R12–CV
|
August 24, 2017 Session
|
FILED 11/06/2017

Appeal from the Tennessee Regulatory Authority, No. 15–00042

Attorneys and Law Firms

Patricia Head Moskal and Henry M. Walker, Nashville, Tennessee, for the appellant, **B&W Pipeline**, LLC.

Kelly Cashman–Grams and Ryan McGehee, Nashville, Tennessee, for the appellee, Tennessee Regulatory Authority.

Herbert H. Slatery, III, Attorney General and Reporter; Andrée Blumstein, Solicitor General; Vance L. Broemel, Senior Counsel; and Daniel P. Whitaker, III, Assistant Attorney General, for the appellee, the Consumer Protection and Advocate Division Office of the Tennessee Attorney General.

Thomas R. Frierson, II, J., delivered the opinion of the court, in which D. Michael Swiney, C.J., and W. Neal McBrayer, J., joined.

OPINION

Thomas R. Frierson, II, J.

B&W Pipeline, LLC ("**B&W**"), a public utility that owns a gas pipeline in three Tennessee counties, filed a petition with the Tennessee Regulatory Authority[1] ("the Authority") seeking a rate increase. As part of the rate increase request, B&W sought to include in the rate base $2.6 million in acquisition costs that it had incurred when it purchased the pipeline and several oil and gas wells in 2010. A contested case hearing took place on September 14, 2015. Following deliberation, the Authority denied B&W's proposed acquisition adjustment and instead utilized a 2008 federal income tax return filed by the pipeline's previous owner to establish the pipeline's value for the purpose of determining the rate base. The Authority issued its final order on March 10, 2016. B&W timely filed a motion for reconsideration. The Authority denied the motion for reconsideration with respect to the value of the pipeline while granting the motion for reconsideration with respect to certain due diligence and other costs B&W incurred in the acquisition. After the submission of briefs, the Authority affirmed its decision to exclude the additional acquisition costs. The Authority issued a final order concerning reconsideration on August 4, 2016. B&W filed a timely petition for review with this Court on October 3, 2016. Discerning no error, we affirm the Authority's decision.

I. Factual and Procedural Background

***1** B&W is a public utility that owns a natural gas pipeline located in parts of Pickett, Morgan, and Fentress counties in Tennessee. The pipeline was originally built in the 1980s. The pipeline has one primary customer for regulated service, Navitas TN NG LLC ("Navitas"). B&W delivers natural gas to Navitas, which, in turn, distributes gas to a number of residential and commercial customers in Tennessee and Kentucky.

Prior to 2010, the pipeline and the distribution system were both owned and operated by Gasco Distribution Systems, Inc. ("Gasco"). As part of Gasco, the pipeline operated pursuant to Gasco's certificate of convenience and necessity ("CCN"), granted by the Authority. In 2010, Gasco, while in bankruptcy, sold the local distribution system to Navitas, and Gasco's CCN was transferred to Navitas. Gasco subsequently sold the pipeline and ninety-six oil and gas wells to Highland Rim Energy, B&W's parent company, for $2,633,085.00. The pipeline and wells were later assigned to B&W. B&W presented testimony that the pipeline and wells, many of

which were inactive, were a "package deal," such that B&W was "stuck with the wells."

Following its purchase of the pipeline, B&W continued providing gas to Navitas at the rate of $.60 per Mcf,[2] according to a pre-existing contract. A representative for B&W testified that two to three years following the purchase of the pipeline, the Authority informed B&W that the pipeline had to be regulated. The Authority granted B&W a CCN on January 8, 2015. B&W filed a petition to increase rates with the Authority on April 2, 2015, following expiration of the aforementioned contract. B&W sought to increase its rates from $.60 per Mcf to $3.69 per Mcf, representing a significant rate increase. Both Navitas and the Consumer Protection and Advocate Division of the Office of the Tennessee Attorney General ("Consumer Advocate") were allowed to intervene and oppose the rate increase, and the Authority opened a contested case proceeding.

In its petition, B&W combined the purchase price of the pipeline and gas and oil wells, as well as certain acquisition costs, such as due diligence costs, into the proposed rate base. B&W argued that it should be allowed to charge a rate that covered its expenses, including depreciation, and that allowed B&W to earn a reasonable rate of return on its investment in physical assets. The parties engaged in discovery prior to the hearing, which was scheduled for September 2015. During discovery, B&W stated that it had no records from the prior owner disclosing the original cost of the pipeline.

On August 11, 2015, the Consumer Advocate and Navitas submitted pre-filed testimony in opposition to the proposed rate increase, including the proposed value of the pipeline for rate-making purposes. The Consumer Advocate's witness, Ralph Smith, asserted that the rate base should not include the acquisition costs of the pipeline in 2010 but that it should include only the original pipeline cost minus depreciation pursuant to the Uniform System of Accounts, which the Authority required B&W to utilize. B&W submitted pre-filed rebuttal testimony, wherein B&W's witness, William Novak, contended that the investment made in purchasing the pipeline and wells, totaling over $2.6 million, should be included in the rate base as a reasonable "estimate" of the original cost of the pipeline.[3] In response to a request from the Authority seeking additional information concerning the value of the pipeline, on September 8, 2015, Navitas submitted a 2008 federal income tax return filed by Gasco.

***2** The contested case hearing took place before the Authority on September 14, 2015. During the hearing, the Consumer Advocate submitted the 2008 Gasco tax return as evidence with no objection from B&W. Mr. Smith, on behalf of the Consumer Advocate, testified that the 2008 Gasco tax return was the most reliable information regarding the pipeline's depreciated original cost. This tax return listed depreciable assets of $854,826.00 and reported depreciation for that year in the amount of $22,564.00. Mr. Smith opined that the pipeline had thus been almost fully depreciated by the time of the hearing. Mr. Novak opined that tax return information relied upon by Mr. Smith was actually referring to the oil and gas wells rather than the pipeline. At the conclusion of the hearing, B&W's counsel acknowledged that "no clear evidence of what the rate base ought to be" existed and that the issue was one of "policy and fairness."

On November 16, 2015, the hearing officer issued an order indicating that the parties had informed him that they "d[id] not seek additional argument, evidence, or new cross-examination of any evidence." No new evidence was thereafter filed by either party. On December 14, 2015, the Authority deliberated and set rates. As part of its ruling, the Authority rejected B&W's position that the 2010 purchase price of $2.6 million for the pipeline and wells should be included in the rate base. Instead, the Authority utilized the 2008 Gasco tax return, determining it to be the "most sound support for the prior owner's original cost and the value of the pipeline at the time of acquisition." Based on the information contained in the tax return, the Authority concluded that the original cost of the pipeline had been almost fully depreciated by the time of the 2015 rate hearing.

Following issuance of the Authority's order setting rates, B&W filed a timely motion for reconsideration. In this motion, B&W claimed that assigning a value of $1.2 million to $1.6 million to the pipeline would equitably balance the interests of the parties. B&W attached new documents, including a non-notarized affidavit of a prior president of Gasco and additional Gasco tax documentation, for the Authority to consider as additional evidence with respect to the value of the pipeline. B&W also argued in the motion

that the Authority had erred by failing to include related acquisition costs of $225,585.31 in the rate base calculation.

In an order dated May 16, 2016, the Authority declined to grant reconsideration with respect to the value of the pipeline, determining that the issue had been fully litigated during the hearing on the merits and that no good cause was presented to justify B&W's failure to introduce the additional evidence during the original proceeding. The Authority did, however, grant reconsideration regarding the issue of acquisition costs, directing the hearing officer to schedule arguments addressing this issue. Subsequently, on August 4, 2016, the Authority denied the inclusion of such acquisition costs in the rate base, determining that such costs had been included in the $2.6 million dollar purchase price previously rejected by the Authority. B&W filed a timely petition for review with this Court.

II. Issues Presented

B&W presents the following issues for our review, which we have restated slightly:

1. Whether the Authority acted in an arbitrary and capricious fashion when it refused to include in the rate base the acquisition price paid for the **pipeline** by **B**&**W** in 2010.

2. Whether the Authority abused its discretion by denying B&W's petition for reconsideration with respect to the value of the pipeline.

3. Whether the Authority's final order fails to comply with the requirements of Tennessee Code Annotated § 4–5–314(c) because it contains no findings of fact or conclusions of law with regard to the acquisition costs.

III. Standard of Review

This Court's review of the Authority's decision is governed by Tennessee Code Annotated § 4–5–322(h) (Supp. 2017). *See* *Consumer Advocate Div. ex rel. Tenn. Consumers v. Tenn. Regulatory Auth.*, No. M1999–01170–COA–R12–CV, 2001 WL 575570, at *3 (Tenn. Ct. App. May 30, 2001). Tennessee Code Annotated § 4–5–322(h) provides:

***3** The court may affirm the decision of the agency or remand the case for further proceedings. The court may reverse or modify the decision if the rights of the petitioner have been prejudiced because the administrative findings, inferences, conclusions or decisions are:

(1) In violation of constitutional or statutory provisions;

(2) In excess of the statutory authority of the agency;

(3) Made upon unlawful procedure;

(4) Arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion; or

(5)(A) Unsupported by evidence that is both substantial and material in the light of the entire record.

(B) In determining the substantiality of evidence, the court shall take into account whatever in the record fairly detracts from its weight, but the court shall not substitute its judgment for that of the agency as to the weight of the evidence on questions of fact.

The review by this Court is for the "very limited purpose of determining whether the [Authority] has acted arbitrarily, or in excess of its jurisdiction, or otherwise unlawfully." *Consumer Advocate & Prot. Div. of Office of Atty. Gen. v. Tenn. Regulatory Auth.*, No. M2011–00028–COA–R12–CV, 2012 WL 1964593, at *13 (Tenn. Ct. App. May 30, 2012) (quoting *CF Indus. v. Tenn. Pub. Serv. Comm'n*, 599 S.W.2d 536, 540 (Tenn. 1980)) (in turn quoting *City of Whitwell v. Fowler*, 343 S.W.2d 897, 899 (Tenn. 1961)). Such issues are reviewed *de novo* based upon the Authority's record. *See Consumer Advocate & Prot. Div. of Office of Atty. Gen.*, 2012 WL 1964593, at *13. As this Court has further explained:

[I]n reviewing an administrative decision, a court "shall not substitute its judgment for that of the agency as to the weight of the evidence on questions of fact." T.C.A. § 4–5–322(h)(5); *Humana of Tennessee v. Tennessee Health Facilities Comm'n*, 551 S.W.2d 664 (Tenn. 1977). Factual issues are reviewed upon a standard of substantial and material evidence, and not upon a broad, *de novo* review. *Southern Ry. Co. v. State Bd. of Equalization*, 682 S.W.2d 196, 199 (Tenn. 1984) (citing *CF Indus. v.*

Tennessee Pub. Serv. Comm'n, 599 S.W.2d 536, 540 (Tenn. 1980)). Substantial and material evidence is " 'such relevant evidence as a reasonable mind might accept to support a rational conclusion and such as to furnish a reasonably sound basis for the action under consideration.' " *Sweet v. State Tech. Inst. at Memphis,* 617 S.W.2d 158, 161 (Tenn. App. 1981) (quoting *Pace v. Garbage Disposal Dist. of Washington County,* 54 Tenn. App. 263, 390 S.W.2d 461, 463 (1965)). It is "something less than a preponderance of the evidence, but more than a scintilla or glimmer." *Wayne County v. Tennessee Solid Waste Disposal Control Bd.,* 756 S.W.2d 274, 280 (Tenn. App. 1988). A court will not disturb a reasonable decision of an agency with expertise, experience, and knowledge in the appropriate field. *Southern Ry. Co.,* 682 S.W.2d at 199.

In re All Assessments, No. 01A01–9812–BC–00642, 1999 WL 632824, at *4 (Tenn. Ct. App. Aug. 20, 1999).

IV. Fixing Just and Reasonable Rates: Original Cost versus Acquisition Cost

The Authority "has the power ... to fix just and reasonable individual rates, joint rates, tolls, fares, charges or schedules thereof ...." Tenn. Code Ann. § 65–5–101(a) (2015). Additionally, Tennessee Code Annotated § 65–5–103 (2015) states in pertinent part:

> ***4** (a) When any public utility shall increase any existing individual rates, joint rates, tolls, fares, charges, or schedules thereof, or change or alter any existing classification, the authority shall have power either upon written complaint, or upon its own initiative, to hear and determine whether the increase, change or alteration is just and reasonable. The burden of proof to show that the increase, change, or alteration is just and reasonable shall be upon the public utility making the same. In determining whether such increase, change or alteration is just and reasonable, the authority shall take into account the safety, adequacy and efficiency or lack thereof of the service or services furnished by the public utility.

With regard to utility rates, this Court has previously explained:

> The utility is permitted to set base rates that allow it to recover its operating expenses and earn a profit from the consumer from the operation of its business; in overseeing these base rates, the TRA is required to balance the interests of the utility with the interests of Tennessee consumers. *See* *Tenn. Am. Water Co. v. Tenn. Reg. Auth.,* No. M2009–00553–COA–R12–CV, 2011 WL 334678, at *15 (Tenn. Ct. App. Jan. 28, 2011). On one hand, the rate approved by the TRA must provide the utility the opportunity to earn a just and reasonable return on its investment; on the other hand the rate must not be exorbitant, so as to avoid the exploitation of consumers. *See* *Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n of the State of West Va.,* 262 U.S. 679, 690, 43 S. Ct. 675, 67 L.Ed. 1176 (1923). "A rate need only fall within the 'zone of reasonableness' ... that takes into consideration the interests of both the consumer and the utility." *Tenn. Cable Television Ass'n. v. Tenn. Pub. Serv. Comm'n,* 844 S.W.2d 151, 159 (Tenn. Ct. App. 1992).

Consumer Advocate & Prot. Div. of Office of Atty. Gen., 2012 WL 1964593, at *1.

In the instant action, the Authority in its order similarly explained the criteria utilized to set "just and reasonable rates" as follows:

> In setting rates for public utilities, the Authority balances the interests of the utilities subject to its jurisdiction with the interests of Tennessee consumers, i.e., it is obligated to fix just and reasonable rates. The Authority must also approve rates that provide regulated utilities the opportunity to earn a just and reasonable return on their investments. The Authority considers petitions for a rate increase, filed pursuant to Tenn. Code Ann. § 65–5–[1]03, in light of the following criteria:
>
> 1. The investment or rate base upon which the utility should be permitted to earn a fair rate of return;
>
> 2. The proper level of revenues for the utility;
>
> 3. The proper level of expenses for the utility; and

4. The rate of return the utility should earn.

As the Authority also explained in its order, "[t]he primary contested issue concerning rate base centered on whether to allow the inclusion of B&W's acquisition cost of $2,633,085 in rate base calculations, as proposed by [B&W]." With regard to this issue, the Authority made the following extensive findings:

> **B**&**W** acquired the pipeline and ninety-six (96) oil and natural gas wells for $2,633,085 from Gasco's bankruptcy proceeding in 2010. [B&W] had no records for the net book value of the pipeline, but rather recorded the acquisition price as plant in service. According to [B&W], because the seller would not sever the pipeline from the wells, B&W had to take the wells in order to get the **pipeline**; therefore **B**&**W** assigned none of the acquisition cost to the wells. B&W estimated the value of the producing wells to be $60,943 and the net liability of capping the inactive wells to be $29,845.
>
> * * *
>
> B&W believes it made a good business decision in purchasing the pipeline for $2.6 million because it is less than the cost to build one. Mr. Ramon further testified that [B&W] became aware after the purchase that approximately 40 to 50 of the wells had already been plugged or handed over to the landowners. Further, only thirteen (13) of the wells are currently producing oil or gas.
>
> ***5** In addition, [B&W] supported its acquisition cost with an independent analysis performed by Bell Engineering. The Bell analysis estimates the 2013 replacement cost of the pipeline to be $12,885,858 and the undepreciated costs are $6,559,308, which far exceeds the acquisition cost included in rate base. Even if this amount is depreciated back to the pipeline's construction date, its replacement value still exceeds the amount included in rate base....
>
> Navitas noted that 100% of the purchase price is attributed in B&W's rate case to the pipeline although other assets, including wells, were included in the transaction. Mr. Hartline asserts that there is no sound economic basis for spending $2 million on a pipeline that earns $20,000 annually. Therefore, a substantial portion of the purchase price is and should be attributed to the other assets purchased in the transaction. Mr. Hartline testified that the Bell Engineering report was an inappropriate basis to support inclusion of the acquisition costs as replacing the pipeline today would be uneconomic in the rural area the pipeline services.
>
> In the pre-filed testimony of Mr. Smith, the Consumer Advocate proposed to exclude from Plant in Service the pipeline purchase costs and, instead, treat it as an Acquisition Adjustment because B&W failed to provide reliable information on the original cost of the pipeline. Mr. Smith explains that any amount paid for utility plant in excess of the utility's original costs are referred to as "Goodwill" or Acquisition Premium, and not allowed recovery in rates because it is not used or useful in the provision of utility service. Disallowance of Goodwill or Acquisition Premium discourages companies from marking up the cost of assets used to provide utility service through the transfer or selling to different owners. Mr. Smith states that B&W was unable to provide the original cost, and the pipeline cost was not available from the books of Gasco (the seller) or the property tax information on file for Gasco. He determined from the responses to data requests that B&W did acquire 96 oil and gas wells along with the **pipeline** and that **B**&**W** determined the net value of these wells to be a negative $29,845 due to the cost of capping inactive wells. Therefore, none of [the] purchase price was assigned by B&W to the wells.
>
> From B&W's 2012 trial balance, Mr. Smith ascertained that there was a gross profit of $182,582, which included $19,729 for gas transportation and $162,853 from oil and gas sales and royalties. Thus, according to Mr. Smith, of the revenues generated by the pipeline, 11% were from transportation service and 89% from oil and gas sales and royalties. The wells in question have since been transferred to a B&W affiliate, Rugby Energy, LLC, and are operated by another affiliate, Enrema, which is the same affiliate charging B&W an annual operator fee. Because of the gross profit in 2012 and the transfer taking place between two affiliates with the same ownership, Mr. Smith questions the lack of compensation for the wells. For these reasons, the Consumer Advocate removed the acquisition amount of $2,597,285 from Plant in Service and left only the $437,715 as the cost of the pipeline. This represents the amount spent by B&W for safety

improvements after B&W acquired the pipeline. Removing this amount from Plant in Service results in a reduction of the attrition year mid-point accumulated depreciation by $568,367 for a total rate base reduction of $2,028,918 related to the cost of the pipeline.

***6** In response to data requests from Authority Staff, Navitas provided records from the previous owner of the pipeline, including a 2008 tax return. During the hearing, Mr. Smith addressed the 2008 federal income tax return, stating that the reported pipeline assets at the end of 2008 were $854,926 as plant-depreciable assets. The tax return reported accumulated depreciation of $703,017 as of December 31st, 2008 and a land asset reported in the amount of $68,538. The reported tax year depreciation was $22,564, which is representative of a depreciable life of approximately 38 to 40 years; reasonable for a gas pipeline. Mr. Smith points out the return was prepared by a CPA and signed by an officer of the Company and as such, appeared to be the most reasonable and reliable information available on the value of the pipeline.

With respect to Gasco's 2008 tax return, Mr. Novak responded that the affiliate IRS PBA code listed is for mineral extraction. Therefore the return is not really applicable in this case because it does not represent a value for the pipeline. Rather it represents a value for the oil and gas wells. Mr. Smith was cross-examined regarding the IRS PBA codes noted by Mr. Novak. Mr. Smith noted that Schedule L of the return lists these as depletable assets, and a pipeline or building should be classified as depreciable assets. Therefore, the tax return is applicable and if one carries the amount out through the midpoint of the attrition year, it would be almost zero ($17,182) as the Consumer Advocate proposed. Mr. Smith agrees that either zero or $17,182 would be an acceptable cost of the pipeline at the midpoint of the 2016 attrition year.

Mr. Novak asserts that the Consumer Advocate has ignored the data provided by [B&W] and the State of Tennessee's tax assessment of the pipeline when he disallows the acquisition cost of the pipeline in his analysis. The tax assessment relied upon by the Company reported to the State of Tennessee as the cost of the pipeline in exact and equal amounts in each county the pipeline operates within, which Mr. Smith questions. Mr. Smith points out that the previous owner had a total assessment of $756,000, with $976 assessed in Fentress County, $227,660 in Pickett County and the remainder in Campbell County, including Jellico. Mr. Smith notes that the tax assessment is prepared by the Company and requires information regarding B&W's last rate case. In sum, the Consumer Advocate contends that the tax assessment relied upon by the Company is an unreasonable basis to support the inclusion of the acquisition price in rate base.

* * *

There is no persuasive evidence that suggests that including the entire purchase price is in the public interest. Under the circumstances of this case, the most reasonable determination is based upon information that is related to the actual cost of the plant when it was constructed. Based on the evidence in the proceeding, the panel finds that including the pipeline at the original cost, rather than the acquisition cost, is the solution that is most fair to both customers and B&W.

The panel further finds that the 2008 tax return of Gasco Distribution Systems, Inc. and Subsidiaries provides the most sound support for the prior owner's original cost and the value of the pipeline at the time of acquisition. Therefore, the panel concludes that B&W's Plant in Service include $923,364 as the original cost of the pipeline, which includes the prior owner's original cost of plant of $854,826 and land of $68,538. Further, including $923,364 as the original cost of the pipeline, along with $437,715 of uncontested additions since B&W's acquisition, as well as uncontested land, structures and intangible property of $119,842, results in total Plant in Service of $1,480,921. Finally, the panel further adopts Accumulated Depreciation of $919,975 which includes accumulated depreciation of $854,826 related to the original pipeline acquired by B&W and $65,149 of accumulated depreciation related to the new additions.

***7** (Footnotes omitted).

B&W argues that the rate base set by the Authority was unjust, due to the Authority's reliance upon "a document that was misinterpreted, which led the Authority to understate the value of the pipeline." B&W contends that the Authority

abused its discretion by accepting the depreciated "tax value" of the pipeline rather than its "book" value. B&W further contends that the Authority's decision was not supported by substantial and material evidence. We disagree.

This Court "shall not substitute its judgment for that of the agency as to the weight of the evidence on questions of fact." *See* *In re All Assessments*, 1999 WL 632824, at *4 (quoting Tenn. Code Ann. § 4–5–322(h)(5)). Factual issues are reviewed upon a standard of substantial and material evidence, which this Court has defined as " 'such relevant evidence as a reasonable mind might accept to support a rational conclusion and such as to furnish a reasonably sound basis for the action under consideration.' " *See* *In re All Assessments*, 1999 WL 632824, at *4 (quoting *Sweet v. State Tech. Inst. at Memphis,* 617 S.W.2d 158, 161 (Tenn. App. 1981)) (in turn quoting *Pace v. Garbage Disposal Dist. of Washington Cty.*, 54 Tenn. App. 263, 390 S.W.2d 461, 463 (1965)). This Court will not disturb a reasonable decision of an agency with "expertise, experience, and knowledge in the appropriate field." *See* *In re All Assessments*, 1999 WL 632824, at *4.

The Authority's decision to exclude the $2.6 million purchase price of the pipeline and wells from the rate base was supported by substantial and material evidence. Mr. Smith testified at length regarding his interpretation of the 2008 Gasco tax return, which was the only evidence presented regarding the prior owner's cost or valuation. Mr. Smith explained that the tax return showed $854,926.00 as plant/depreciable assets, which he opined could only refer to the pipeline because oil and gas wells constituted depletable rather than depreciable assets. Mr. Smith further explained that the amount of depreciation shown on the return, $22,564.00, was in accordance with a thirty-eight to forty-year depreciation schedule, which would be reasonable for a pipeline. Mr. Smith opined that the 2008 tax return was the most reliable information concerning the prior owner's assessment of value and that its reliability was further supported by its preparation by a certified public accountant and submission to the IRS. Based on this proof, we determine that the Authority's decision was based on evidence that is "both substantial and material in the light of the entire record." *See* Tenn. Code Ann. § 4–5–322(h).

Moreover, the Authority's determination to rely upon original cost information aligns with other rate base decisions. For example, in a factually similar case, the Authority held:

> [T]he commission finds that the book value of the Franklin system at the time of the United Cities acquisition should be based on the original cost figures developed by Mr. Crenshaw and approved by the comptroller in 1973 rather than on the much higher estimate arrived at by the company's witness more than ten years later. The customers of the Franklin system have paid once for the system's assets; to accept the company's argument that the cost of those assets has now doubled would force ratepayers to pay once again for these same assets.
>
> ***8** Company witness Fleming recognized the danger to ratepayers of permitting a gas utility to write up the value of its assets above their book value, and readily acknowledged that "as everyone is well aware, this commission generally allows the original costs of utility facilities in rate base." He noted that the reason why regulatory commissions insist on using original cost "is to keep people from double paying, in effect, artificially inflating the rate base" as the result of purchasing assets at a price higher than book value.

See Re: United Cities Gas Co., No. U–84–7333, 1985 WL 1213311 (Tenn. P.S.C. June 10, 1985) (footnote omitted). *See also In Re: Petition of Chattanooga Gas Co. to Place into Effect A Revised Natural Gas Tariff*, No. 97–00982, 1998 WL 35628746 (Tenn. P.S.C. Oct. 7, 1998) (rejecting the utility's request to include acquisition costs in rate base upon determining that additional benefit to customers came from subsequent investments in plant system that were already incorporated into rate base).

As the Authority also noted in this action, B&W's acquisition cost included oil and gas wells. Testimony demonstrated that a significant portion of the income generated by B&W in the past came from oil and gas sales rather than pipeline operations. Testimony further demonstrated that rather than purchasing the pipeline and wells to maintain the status quo with regard to operations, B&W administrators hoped to utilize the pipeline for other uses in the future that may or may not involve providing utility service. For the foregoing

reasons, we conclude that the Authority's determination regarding rate base should be affirmed.

IV. Denial of Petition to Reconsider **Pipeline** Value

B&**W** alleges that the Authority abused its discretion by denying B&W's petition to reconsider the valuation of the pipeline and thus refusing to consider the new evidence presented by B&W with its petition. With regard to a petition for reconsideration, the Uniform Administrative Procedures Act states:

> (a) Any party, within fifteen (15) days after entry of an initial or final order, may file a petition for reconsideration, stating the specific grounds upon which relief is requested. However, the filing of the petition shall not be a prerequisite for seeking administrative or judicial review.
>
> * * *
>
> (d) An order granting the petition and setting the matter for further proceedings shall state the extent and scope of the proceedings, which shall be limited to argument upon the existing record, and no new evidence shall be introduced unless the party proposing such evidence shows good cause for such party's failure to introduce the evidence in the original proceeding.

Tenn. Code Ann. § 4–5–317 (2015) (emphasis added).

In its petition, B&W argued that the 2008 Gasco tax return had been misinterpreted by the Authority. B&W stated that it had located the former president of Gasco, Fred Steele, who had in turn located and provided the depreciation schedules and other tax information for Titan Energy, a subsidiary of Gasco that owned the pipeline prior to B&W's purchase. Mr. Steele's unsworn affidavit and the additional tax information were attached to B&W's petition. B&W asserted that this additional tax information demonstrated that the pipeline had been depreciated at an accelerated rate for tax purposes over a period of seven years. According to B&W, this tax information also demonstrated that the sale of the pipeline was recorded in 2010 at a value of $1,212,892.80. Importantly, however, B&W's petition failed to contain any information concerning good cause for B&W's failure to present this evidence at the original hearing, as required by Tennessee Code Annotated § 4–5–317(d).

***9** As the Authority points out, B&W had ample opportunity during the contested case hearing and for approximately sixty days thereafter to present any necessary evidence to meet its burden of proof, but B&W chose not to present additional evidence until after the Authority ruled. Because B&W failed to demonstrate good cause why this evidence could not have been presented earlier, we conclude that the Authority did not abuse its discretion by declining to consider the additional evidence. *See* Tenn. Code Ann. § 4–5–317(d). *See*, *e.g.*, *Pavement Restorations Inc. v. Ralls*, No. W2016–01179–COA–R3–CV, 2017 WL 657775, at *8 (Tenn. Ct. App. Feb. 17, 2017) ("The refusal [by an administrative agency] ... to grant a rehearing will not be found to be arbitrary or capricious unless the appellant can 'show specifically why [the appellant] was unable to procure the "newly discovered" evidence and that [the appellant] exercised due diligence in attempting to obtain the evidence prior to' the hearing.") (quoting *Bridges v. Culpepper*, No. 02A01–9704–CH–00074, 1997 WL 589242, at *4 (Tenn. Ct. App. Sept. 24, 1997)) (in turn quoting *Brown v. Weik*, 725 S.W.2d 938, 947 (Tenn. App. Oct. 3, 1983)). *See also* Tenn. Code Ann. § 65–2–116 (providing that a petition for rehearing before the Authority can be maintained where new evidence is discovered "which could not have been previously discovered by due diligence.").

V. Requirements of Tennessee Code Annotated § 4–5–314(c)

Finally, B&W argues that the Authority failed to make sufficient findings of fact and conclusions of law regarding its exclusion of B&W's related acquisition costs in the amount of $225,585.31 from the rate base. As B&W points out, the Uniform Administrative Procedures Act requires the following, in relevant part, with regard to a decision of the Authority:

> (c) A final order, initial order or decision ... shall include conclusions of law, the policy reasons therefor, and findings of fact for all aspects of the order, including the remedy prescribed .... Findings of fact, if set forth in language that is no more than mere repetition or paraphrase of

> the relevant provision of law, shall be accompanied by a concise and explicit statement of the underlying facts of record to support the findings. The final order ... must also include a statement of the available procedures and time limits for seeking reconsideration or other administrative relief and the time limits for seeking judicial review of the final order.

Tenn. Code Ann. § 4–5–314 (2015). Additionally, Tennessee's statutory scheme specifically applicable to proceedings before the Authority provides:

> Every final decision or order rendered by the authority in a contested case shall be in writing, or stated in the record, and shall contain a statement of the findings of fact and conclusions of law upon which the decision of the authority is based. Copies of such decisions or orders shall be delivered or mailed to each party or to the party's attorney of record.

Tenn. Code Ann. § 65–2–112 (2015).

In the case at bar, B&W alleges that the Authority failed to make specific findings of fact regarding the related acquisition costs. We disagree. The Authority specifically held in its order upon reconsideration:

> B&W included the acquisition costs of $225,585.31 as part of the purchase price of $2.6 million as part of [B&W's] proposed rate base. The Authority previously set rates in a decision which rejected the purchase price of the system put forth by [B&W] and included the acquisition costs of $225,585.31 at issue upon reconsideration. By rejecting [B&W's] proposal to establish rates based on the purchase price, the Authority also tacitly rejected the acquisition costs related to the purchase. After reviewing and reconsidering the record, the panel found that the Authority made its decision based on the best evidence it had before it and voted unanimously to affirm its decision.

As this Court has previously explained:

> An agency, when issuing a final order, must provide a concise and explicit statement of the underlying facts supporting the agency's findings. Tenn. Code Ann. § 4–5–314(c). Findings of fact made by the agency should be based exclusively on the evidence of the record and on matters noted in the proceeding. Tenn. Code Ann. § 4–5–314(d). Exactness in form and procedure is not required; rather, the findings based on the evidence need only be specific and definite enough so that a reviewing court may determine the pertinent questions of law and whether the agency's general findings should stand, particularly when the findings are material facts at issue. *See* *Levy v. State of Tennessee Bd. Of Exam'rs for Speech Pathology and Audiology,* 553 S.W.2d 909, 911–12 (Tenn. 1977) (quoting *State Bd. of Med. Exam'rs v. Grandy,* 149 S.E.2d 644, 646 (S.C. 1966)). "The sufficiency of an agency's findings of fact must be measured against the nature of the controversy and the intensity of the factual dispute." *CF Industries v. Tennessee Pub. Serv. Comm'n,* 599 S.W.2d 536, 541 (Tenn. 1980).

***10** *Consumer Advocate Div. ex rel. Tenn. Consumers*, 2001 WL 575570, at *4 (emphasis added).

In this matter, the Authority clarified that its rejection of the related costs stemmed from its decision to exclude the overall acquisition costs of $2.6 million, and the reasons for such exclusion were explained in great detail in the Authority's earlier order setting rates, as set forth above. We conclude that the Authority made sufficient factual findings to facilitate this Court's review. We therefore determine this issue to be without merit.

VI. Conclusion

For the foregoing reasons, we affirm the Authority's decision in all respects. Costs on appeal are taxed to the appellant, **B&W Pipeline**, LLC. This case is remanded to the Authority for enforcement of the judgment below.

All Citations

Not Reported in S.W. Rptr., 2017 WL 5135977, Util. L. Rep. P 27,420

Footnotes

[1] Effective April 4, 2017, the Tennessee Regulatory Authority was renamed the Tennessee Public Service Commission. *See* 2017 Tenn. Pub. Acts Ch. 94 (S.B. 747). Because this name change occurred during the pendency of this appeal and after submission of the appellant's initial brief, we will continue to utilize the moniker, Tennessee Regulatory Authority, for purposes of this appeal.

[2] This is the abbreviation for one thousand cubic feet of natural gas.

[3] Both Mr. Smith and Mr. Novak are certified public accountants.

1985 WL 1205492 (Tenn.P.S.C.), 69 P.U.R.4th 534

Re United Cities Gas Company

Docket No. U–84–7333

Tennessee Public Service Commission

August 11, 1985

Before Eskind, chairman, and Cochran, commissioner.

By the COMMISSION:

Order Upon Reconsideration

The United Cities Gas Co. has filed a petition asking the commission to reconsider part of its order issued June 10, granting the company a rate increase of approximately $2.5 million in additional annual revenue. The company specifically suggests that it be allowed to recover from ratepayers, over a period of 8.75 years, the excess amount that the utility paid to buy the Franklin city gas system. The company's proposal would cost ratepayers approximately $80,000 a year for the next 8.75 years.

The staff opposes the company's position which would pass on to ratepayers the difference between the book value of the Franklin system and the price paid for the system by United Cities.

The commission considered the petition on July 16, 1985, at a regularly scheduled executive session, and voted to reaffirm its earlier decision. In support of its decision, the commission makes the following findings of fact and conclusions of law.

I. The company bought the system for $1.5 million, approximately twice its book value. They argued at the hearing that the system's book value was understated and that the system's ‘true’ value—according to a company sponsored study—was $1.5 million, the same price that unitEd citiEs had paid to buy it. The company argued that it should be allowed to earn a return on the entire purchase price, rather than on the system's book value, at an additional cost to ratepayers of more than $100,000 per year. The commission rejected that argument.

The company now offers a compromise, proposing that it be allowed to amortize the acquisition adjustment over the plant's remaining life of 8.75 years. The company would still recover the full purchase price but would earn no return on the unamortized portion of the adjustment. This alternative would increase rates approximately $80,000 per year for the next 8.75 years.

As the company acknowledged, the money involved is not significant; the principle is. The commission has already heard the arguments on the importance of this case and ruled that now is the time to stop the bidding war for municipal gas systems. The June 10 order stated, ‘As long as they can pass on those higher costs to their customer, there is little to stop the utilities from bidding whatever it takes to buy new territory. It is our responsibility to protect ratepayers from this result. . . .’ The company has presented no arguments to change that conclusion.

II. The petition repeats the company's argument that the commission's treatment of the Franklin issue is inconsistent with ‘the commission's own audit manual.’ There is actually no such thing as the commission's ‘audit manual.’ A number of years ago, members of the agency's accounting staff wrote an audit program for use in training and guiding new staff members. To our

knowledge, that program has never been approved by or even submitted to the commission. It is an internal training program for the accounting division which states:

'The program is not intended to provide answers to all decisions the analyst must make nor is it intended to be a substitute for judgment and experience of analysts but rather to channel that judgment and experience into the areas necessary to comprehensively review the utility's testimony, exhibits, and work papers so that equitable and supportable conclusions can be reached by the staff. The audit procedures set forth in the program cannot be suitable for all utilities and the staff is expected to use judgement in their application.'

Moreover, Mr. Burcham, chief of the division, testified that he saw no inconsistency between the audit program and the staff's position in this case and challenged the company's assertion that the purchase of the Franklin system had resulted in operating efficiencies for the United Cities system.[1]

III. During argument on the petition to reconsider, the company also stated that even at a price of $1.5 million, the cost of adding Franklin's 2,800 customers to the company's system is less than the cost of building new plant to reach the same number of customers. Therefore, according to United Cities, the company is actually saving money by buying the Franklin system.

This argument makes sense in a competitive environment. In a regulated context, however, the comparison between ***536** the cost of buying Franklin and the cost of building new plant is irrelevant. There are three reasons for this.

First, United Cities is not buying a new gas system; it is buying an old one with a remaining useful life of only 8.75 years. The average life of new plant is 25 years under present depreciation schedules. The flaw in the comparison is transparent. The price of an old car may be less than a new one but still twice what the old model is worth.

Second, Tennessee is an 'original cost' jurisdiction. Under our system of regulation, utility plant is 'worth' only its present net book value (original **cost** **less** accumulated **depreciation**). The comparison between net book value and the cost of building new plant has no significance for rate-making purposes because it ignores the ratepayers' contribution to the existing plant.

Since the Franklin system was built, ratepayers have contributed each year to the cost of building that plant by paying for its depreciation and maintenance. Its book value today represents the remaining, unrecovered portion of the owner's original investment on which the owner is entitled to earn a fair return. The ratepayers, in effect, have already paid for a significant part of their gas system. The remaining part—the net book value—stays in the rate base and earns for the owner a just and reasonable return. Under regulation, we would not permit the owner to inflate the value of his rate base just because it would now cost more to replace the system than it did to build it. Otherwise, the ratepayers would end up paying over and over again for the same system because, as construction costs rose, the customers' payments would never catch up to the cost of rebuilding the system.

United Cities has not 'saved' anything by buying Franklin at twice the system's book value. What the company will do (if we accept the utility's argument) is wipe out the accumulated contribution of the city's ratepayers and make them start paying for the system all over again. Nothing will change. The system is just passing from one owner to another—at a 100% profit—and the ratepayers are being asked to pay the bill.[2]

Third, United Cities' discussion of the cost per customer of buying the Franklin system is misguided from a public policy standpoint.

In exchange for its monopoly status and substantial protection from risk, a regulated utility has a public duty and responsibility to provide service, at a reasonable cost, to anyone within its certificated area. The ratepayers in Franklin already have service; there is no public need for United Cities to buy that system. There is, however, a continuing demand for new service from residences and business in the United Cities service area. Of course, there are common sense, financial limitations upon the utility's obligation to reach every inhabitant in the service area,[3][a] but the utility's primary responsibility is to provide service even ***537** though the cost of reaching each new customer will likely be higher than the average cost of serving existing customers.

For this reason, the comparison between the cost of reaching new customers and the cost of buying Franklin's 2,800 ratepayers is not valid. When it reaches new customers in an unserved area, the utility is meeting its statutory and common law obligations. It is serving the public convenience and necessity, and the additional cost will be spread over the company's customer base. There is no such duty to absorb smaller systems into the United Cities network, and no reason to burden ratepayers with the cost of that expansion. The managers of a regulated utility are not in a competitive environment, nor are they responsible solely to their shareholders. They manage property which is 'affected with a public interest' and devoted to the public use, Munn v. Illinois (1877) 94 US 113, 24 L Ed 77. Purchase of an existing system is in the public interest if the buyer can demonstrate that he can serve the customers of that system more efficiently than the present owner.[3][b] In the absence of such a showing, the acquisition of one utility by another serves little purpose other than enlarging the corporate empire of the managers of the surviving company.

IV. The commission did not deny the company's request to purchase the Franklin system. The company's expertise in obtaining new gas supplies and sources of capital will help meet the demands of a rapidly growing community. This does not justify, however, forcing customers to pay higher gas rates simply because their system has been sold from one utility to another. As the company's management was well aware at the time of this sale, this commission has traditionally permitted a utility to include in its rate base only the net book value of utility assets.[4] The company elected nevertheless to pay twice that value for the Franklin system and has now asked that the commission use the cost of adding new plant, rather than book value, as the measure of whether the sale price was a prudent expense. We reject that comparison for the reasons discussed above and reaffirm our earlier decision on the proper rate-making treatment of the Franklin purchase.

It is therefore ordered:

1. That the petition for reconsideration is denied.

2. That any party aggrieved with the commission's decision in this matter has a right of judicial review by filing a petition for review in the chancery court of Davidson county within 60 days from and after the date of this order.

Footnotes

1 The audit program also states that it 'is the auditor's guide to the responsibilities and duties in regard to the work to be performed. To this end, the auditor should take steps to safeguard and prevent the unauthorized use of this program.' The record does not indicate how the company obtained access to the audit program.

2 The company's logic, if applied to the purchase of a large utility rather than a small one, would lead to immense rate increases. For example, South Central Bell has an intrastate rate base of about $1.3 billion, which represents an investment of about $1,000 per existing customer. On the other hand, it costs Bell about $2,000 each time a new

customer is added. Under the reasoning of United Cities, another utility could buy Bell for twice its book value, double the rate base from $1.3 billion to $2.6 billion, and raise everyone's telephone rates to pay for it. The buyer's argument would be, just as United, Cities has argued, that the high purchase price was reasonable since the buyer paid no more to buy the Bell network than it would have cost to reach the same number of new customers at $2,000 each.

3[a See commission Rule 1220–4–5–.12.

4 Fifteen years ago, Professor A. J. G. Priest wrote in his now famous book on utility regulation that 'Tennessee clearly has raised its tent in the 'original cost' cantonment.' Priest, '*Public Utility Regulation*,' Vol 1, p. 150 (1969). The majority of the other states follow the same principle. Id., at p. 141.

[b] If United Cities has introduced evidence showing that it could operate the Franklin system more efficiently than the city and achieve identifiable cost savings sufficient to offset the impact of doubling the system's book value, United Cities might then be able to justify passing on to the ratepayers the full cost of buying the system. No such evidence is before us, however.

Report on the Performance of Wastewater Systems Utilizing Drip Dispersal in Tennessee

June 7, 2024

Land Based Systems Unit, Division of Water Resources
Tennessee Department of Environment and Conservation

Executive Summary

Beginning in the mid-1990s and continuing to present the State of Tennessee has been issuing permits for systems relying on drip dispersal technology to transmit wastewater to the soil environment in a manner that does not constitute direct discharge to surface water or groundwater. The soil environment provides treatment of the wastewater and facilitates its return to the environment. For most of these systems, drip dispersal is the sole means by which wastewater is managed. These systems have been largely used in support of residential subdivisions with other rural establishments such as churches, schools, and businesses also relying on this technology. Performance of these systems, relative to their permit conditions, has been and continues to be highly variable.

One of the most challenging aspects of operating these systems within permit conditions involves the ability of the soil to receive and transmit the applied wastewater away from the point of application without resulting in prolonged soil profile saturation or ponding of wastewater on the surface of the ground. In many cases these ponded conditions result in overland flow of wastewater away from the identified land application area. Noncompliance of this type is particularly critical as in many cases the wastewater flows onto adjacent properties, residential yards, or drainageways and surface waters, but is not treated to levels or sampled at frequencies that are required for discharging systems.

The Tennessee Department of Environment and Conservation's Division of Water Resources conducted a survey of 420 land application areas supporting 374 land application systems in the state in January and February of 2024. The purpose of this statewide survey was to observe the hydraulic performance of the soil profile component of these systems and report the results in a manner that may inform design engineers, operating entities, local governing bodies, and future standard development.

Fourteen of the 374 permitted land application systems were either not in use or had not been constructed. Site observations at the remaining 360 land applications systems indicate approximately one-fourth of the systems exhibited notable performance issues, including wastewater not being appropriately controlled and, in many cases, leaving the land application area and entering adjacent properties and/or drainageways or surface waters; approximately one-fourth of the systems exhibited less severe, but nonetheless noncompliant issues such as localized saturation and ponding or areas that were overgrown preventing evaluation; and approximately one-half of the active systems did not exhibit any indication of noncompliance.

A. BACKGROUND

1.0 Introduction

This report summarizes the scope, method, and observations from the recent statewide survey of land application systems and associated land application areas. Land application of wastewater into soil is relatively widespread in Tennessee. Over 370 systems rely in whole or in part on land application of wastewater through drip dispersal (not including subsurface sewage disposal systems subject to TCA 68-221, Part 4). The Tennessee Department of Environment and Conservation's (Department) Division of Water Resources (Division) is responsible for permitting these systems and permit compliance oversight.

The design objective of these systems involves utilizing an area(s) of soil (land application area) capable of receiving the total daily volume of applied wastewater and transmitting it away from the points of application while maintaining an environment within the soil conducive to further treatment. These types of wastewater systems are not authorized to directly discharge to groundwater or surface water; instead, the systems return treated wastewater to the environment by percolation through an unsaturated soil profile, and evaporation and transpiration (ET). ET is recognized as being seasonally limited. Treatment in the soil profile occurs primarily through physical filtration, biological consumption of nutrients by organisms residing in the soil, and pathogen die-off related to residence time.

There are multiple methods to introduce wastewater to an area of suitable soil; however, drip dispersal technology is the most prominent method in the state utilized in support of these types of systems. Drip dispersal technology relies on pressurizing a network of drip dispersal lines containing pressure-compensating emitters. When pressurized, each emitter in that portion of the system begins dripping at a rate of approximately one-half gallon per hour. Typically, there are multiple short dosing events spaced equally throughout each 24-hour period.

The Division has observed challenges associated with this method of wastewater management in its role of permit compliance oversight. A common challenge and most difficult to resolve is hydraulic overload of the soil profile. The purpose of this statewide project was to obtain insight on the hydraulic performance of the soil profile component of these systems and report the results in a manner that may inform design engineers, operating entities, local governing bodies, and future standard development. This report provides a description of the survey and a summary of the resulting observations.

2.0 Background

In December of 2023 there were 374 systems in the state permitted to utilize drip dispersal technology, in whole or in part, to manage wastewater. Figure 1 illustrates the geographical distribution of these systems across the state.

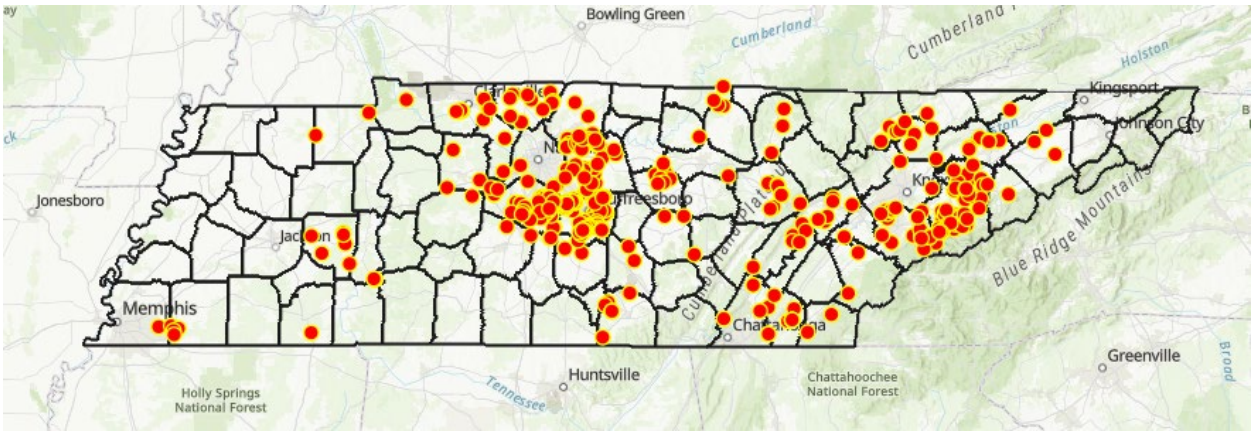

Figure 1. Distribution of Land Application Systems Utilizing Drip Dispersal in Tennessee

These systems are permitted through the Tennessee Water Quality Control Act (TNWQCA)[1]. Most systems are permitted through the State Operating Permit (SOP) process as non-discharging systems. As a result, the permit conditions do not support direct discharge to surface water or groundwater. Direct discharges to surface water or groundwater are governed by federal programs, National Pollutant Discharge Elimination Systems (NPDES) and Underground Injection Control (UIC), respectively. The Department has obtained primacy to implement both federal programs and accomplishes this through the TNWQCA. Some NPDES permits also include land application area components and are not identified as SOPs. NPDES permits with land application components would also not support direct discharge from the land application area.

While the state's SOP program does not support direct discharge to groundwater, UIC Authorization by Rule is required for these systems since they meet the definition of Subsurface Fluid Distribution Systems in both the federal and state UIC rules.

For this report a wastewater system utilizing drip dispersal to manage wastewater, in whole or in part, through the soil profile will be referred to as a "land application system" or "system" and the identified area(s) supporting drip dispersal will be referred to as the "land application area(s)". Figure 2 provides a timeline of the number of land application system permits issued in the state.

[1] TCA 69-3-101

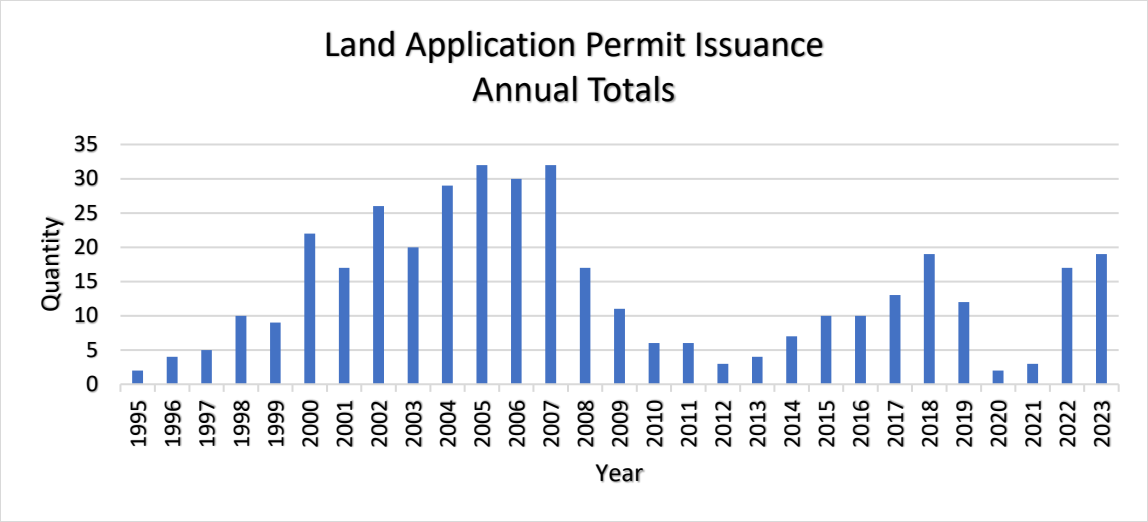

Figure 2. Land Application Permit Issuance – Annual Totals

Tennessee Code Annotated section 69-3-108(e) obligates any applicant seeking a new or expanded wastewater discharge into surface waters to first consider alternative methodologies such as land application or beneficial reuse. Land application involves the application of wastewater to an area with soil properties that allow for absorption of the wastewater, transmission of the wastewater away from the point(s) of application, and further treatment of the wastewater. Land application also provides for evaporation and transpiration of wastewater; however, these transport mechanisms are largely seasonal.

Figure 3 provides a conceptual model of a typical land application system supporting residential development. Wastewater from each home is directed through a collection system to a secondary treatment plant (sand filter, lagoon, manufactured unit, etc.). Secondary treatment plants are designed to reduce the strength of the wastewater as measured by five-day biochemical oxygen demand (BOD_5) to 45 milligrams per liter (mg/l). The resulting effluent is then pumped to and dispersed in an area of soil with suitable properties. Residence time in an appropriate soil profile is expected to result in continued pollutant reduction such that flow reaching groundwater does not compromise groundwater quality.

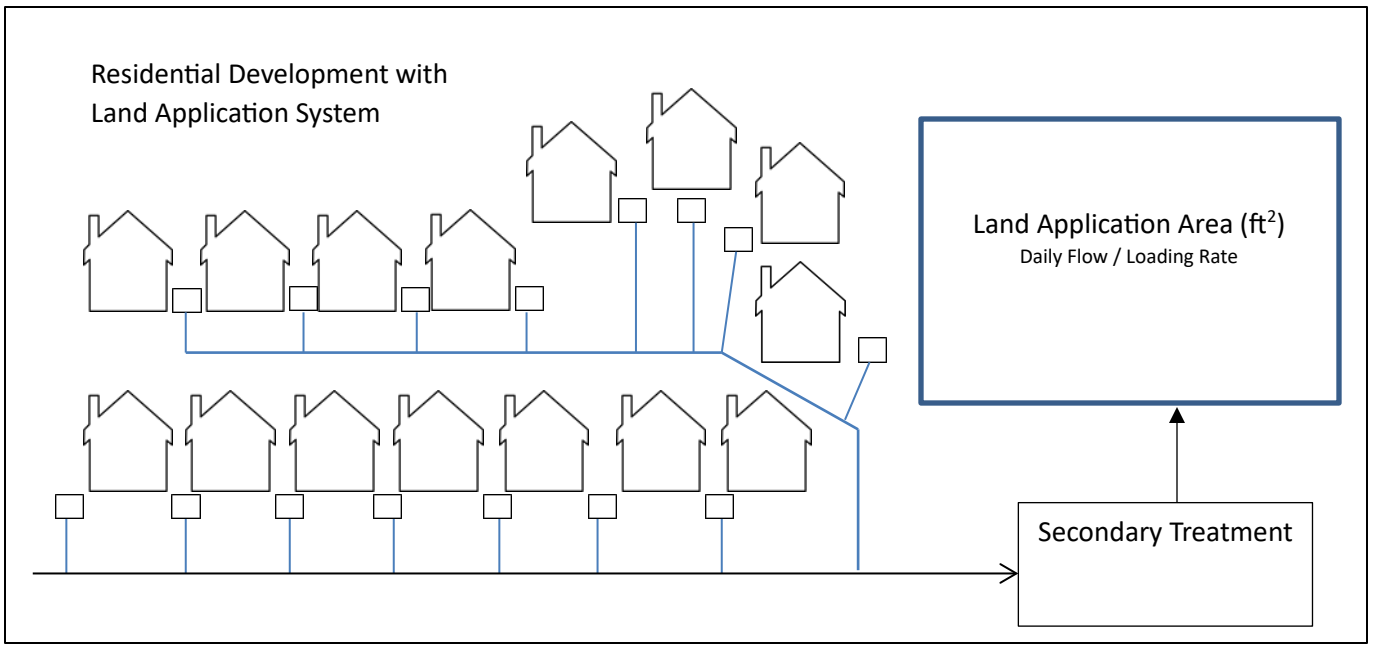

Figure 3. Conceptual Layout of Land Application System Supporting Residential Development

3.0 Permitting Process

The state's permitting process for land application systems has two components: 1) plans approval, and 2) operating permit issuance. Plans are prepared by a licensed engineer with the land application area component having been mapped by a licensed soil scientist. The applicant submits these plans and specifications to the Division. The plans typically include the design of the proposed wastewater collection system, a description of the unit that will treat the wastewater to secondary treatment levels, and identification of the proposed land application area(s) that will further treat the wastewater and facilitate its return to the environment.

Final plans and specifications are to be prepared by the licensed engineer in accordance with generally accepted engineering practices.[2] The Division reviews the plans submitted by the applicant pursuant to the procedural criteria set forth in Rule 0400-40-06-.03 and .04. It is the professional engineer's responsibility to ensure that the proposed land application area is appropriate, and that the system will meet permit requirements. Approval of the final engineering plans constitutes the applicant's permit to construct the system as designed.[3]

[2] 0400-40-02-.05(2)

[3] The standard plan approval letter states: "TDEC's approval of this land application waste treatment system shall not be construed as creating a presumption of correct operation nor as warranting by the commissioner that the approved facilities will reach the designated goals. T.C.A. § 69-3-108(i). Similarly, TDEC's issuance of a state operating permit in no way guarantees that this land application system will function properly. Notwithstanding these approvals, owners and operators are required to ensure that operation of this system does not result in pollution of waters of the state, including groundwater."

The second component of the permitting process involves the application for an operating permit for the proposed system.[4] Operating permit elements include treatment levels, sampling frequencies, inspection frequencies, operator certification standards, standard conditions that must be maintained and a description of occurrences that are not allowed by the permit. Issuance of operating permits are subject to public notice, public comments, and public hearings, when requested. The maximum term for these operating permits is five years.

Construction of the system may not begin until the public comment period associated with the operating permit for the proposed system has closed.

3.1 Design Considerations

There are two primary design considerations that inform the size of the land application area supporting these systems. These are: 1) anticipated daily flow, and 2) the loading rate of the soil profile. The anticipated daily flow for a given system may be estimated in multiple ways. For subdivisions, the typical design is based on 300 gallons per day per home. The estimated loading rate of the soil profile is based on the texture and structure of the soil along with consideration of the soil profile's depth. Values ranging from 0.075 to 0.25 gallons per day per square foot are common. For example, the daily flow for a 30-home subdivision would be 9,000 gallons per day (30 homes x 300 gallons per day per home). If the loading rate for the soil profile is estimated to be 0.2 gallons per day per square foot, the land application area required to support the systems equals 45,000 square feet (9,000 gallons per day/0.2 gallons per day per square foot).[5] Therefore, the submitted design for this example would be expected to identify and utilize that amount of suitable soil area. Typically, the distribution network for these systems is established in independent zones with the dose volume being commensurate with the size of the zone.

3.2 Anticipated Performance

The land application area component (soil profile) of these systems is expected to accept and transmit the applied wastewater away from the point of application in a manner that does not result in prolonged saturation of the soil profile, persistent ponding of wastewater on the surface of the ground or overland flow of wastewater away from the application area. Furthermore, the soil environment is expected to provide an additional level of treatment such that groundwater quality is not compromised.

The land application area should be accessible, well-defined, and not overgrown with vegetation in support of maintainability, operability, and inspections by both the permittee and the Division.

Land application area performance for these systems is highly variable across the state. The following photographs are provided to illustrate this variability. Photo 1 reflects a dysfunctional land application area. Note the presence of saturated soils and ponding of wastewater. Photo 2 reflects a functional land application area. Note the lack of soil saturation and ponding of wastewater. Furthermore, note the

[4] Rule 0400-40-06

[5] An area loaded at 0.2 gallons per day per square foot results in the application of 2.25 inches of wastewater per week. This volume along with typical rainfall amounts in the state amounts to approximately 14 feet of fluid on the area annually.

uniform striping in Photo 2 with uptake of nutrients through the grass as compared to Photo 1 with indistinct green areas along with areas where the vegetation is distressed or dead. These systems are in areas of the state with similar soil conditions, they both serve subdivisions, and they are a similar age (~18 years old). Yet, they demonstrate remarkably different performance. The system in Photo 2 reflects achievement of the design objective and does not indicate any evidence of permit noncompliance; whereas the system in Photo 1 does not comply with permit conditions and is not meeting the design objective. The Division, and others, are striving to understand the cause(s) of the disparity illustrated by this example.

Photo 1. Dysfunctional Land Application Area

Photo 2. Functional Land Application Area

There are several permit conditions which, if violated, demonstrate a system malfunction. For example, these permits prohibit discharge of wastewater to any surface waters or to any location where it is likely to enter surface waters. The permits also prohibit operation of a drip irrigation system in a manner that creates a health hazard or a nuisance, surface saturation, and ponding within the land application area.

B. STATEWIDE SURVEY

1.0 Project Description

The Project, a survey of the existing land application systems and areas statewide, was conducted to obtain insight on the hydraulic performance of the soil profile component of these systems. Specifically, the land application area(s) for each land application system was evaluated relative to its hydraulic performance. The primary observations reported for each land application area were qualitative and included the presence or absence of saturated soils, ponding of wastewater, and overland flow of wastewater.

The Division considered the first step toward achieving the project objective was to inspect all existing systems across the state. This was accomplished by a select group of staff making targeted observations, in a small window of time and during a period of the year when the hydrology of the soil profile is the common limiting condition (winter months with negligible evapotranspiration).

The Division began the survey of sites during the second week of January. A week of very cold weather followed by a week of wet weather prevented completion of the project until the second week of February 2024. Local precipitation conditions leading up to each site visit were also documented to provide consistency with observations recorded.

The operating entity for each inspected system received an email announcing the project on December 28, 2023. Additional site-specific follow up notice was attempted prior to the actual visit.

Division staff inspectors utilized ArcGIS Survey123 to record their observations. The observations related to the performance of the land application area and matters that impacted those observations. For example, typical observations included whether the land application area was well defined, well-maintained or overgrown, and whether it was accessible to support walk-through. These types of observations go toward establishing that the inspection was being made at the correct location and that the inspector's observations were not encumbered by vegetation.

As an initial matter, inspectors evaluated whether wastewater entered the land application area and engaged the soil such that observations about the performance of the land application area would be informative to the project. Inspectors observed the secondary treatment plant area (sand filter, lagoon, manufactured unit) to determine whether the wastewater was discharging to the drip field or bypassing the land application area and discharging, in whole or in part, at the secondary treatment plant. The performance of land application areas supporting systems where none or only a portion of the wastewater was reaching the land application area were not considered informative of the project objective.

Within the land application area, inspectors observed whether saturated soils or ponded conditions were present and whether those conditions indicated either infrastructure problems or an overloaded land application area, or both. Examples of infrastructure problems included broken pipes, failed emitters, and other damaged infrastructure components. In some cases, the infrastructure problems

were so significant that the drip dispersal network was not apparently being utilized. The performance of land application areas with infrastructure problems that resulted in wastewater not fully engaging the drip dispersal network were not informative of the project objective.

In contrast, the observations of land application areas that receive all the flow and for which there is no indication of infrastructure problems most accurately reflect the performance of the soil profile and are most informative of the project. Inspectors made observations throughout these land application areas pertaining to hydraulic overload, saturation, and ponding. They further qualified ponded conditions as to whether the ponding was producing overland flow, whether the overland flow was leaving the land application area and whether the observed flow was entering surface water or surface drainage features. Inspectors also made observations pertaining to system construction including whether the drip lines were on the surface of the ground or buried, and drip line spacing.

2.0 Survey Observations

Division staff visited 420 land application areas supporting 374 land application systems. Nineteen staff were involved in conducting the visits. Division staff made standardized observations for each site along with site-specific notes. They also collected photographs and videos for most sites. Reports were prepared for each land application area and are available for review at the following link: https://www.arcgis.com/apps/dashboards/c83fa34306ce4283b6cdec1f8e35259a.

Utility or system representatives accompanied Division staff on 74% of the inspections.

Most (84%) of the land application areas in the state were inspected during the second week of January. The remainder were inspected the last week of January extending through the second week of February.[6]

Common characteristics related to system performance and hydraulic performance became evident during the data assessment component of the project. As a result, the systems were categorized into primary and secondary subpopulations based on survey observations (Table 1). The primary division was based on whether the observations collected at the system properly supported the project design objective of evaluating hydraulic performance of the land application area(s). Secondary divisions reflect significant variations within each primary subpopulation.

[6] One land application system supported by three land application areas was inadvertently overlooked in the January and February efforts. This system was inspected on March 11, 2024.

Table 1. Common Characteristics of Populations/Subpopulations			
Primary Subpopulation		Secondary Subpopulation	
X	Systems in which wastewater either did not reach the land application area or did not engage the soil area. These areas were not informative for evaluating land application area performance	X1	Systems that were permitted but were not operational. This includes systems that were either not in use or had not been constructed.
		X2	Systems that discharged all or a portion of their wastewater flow at the secondary treatment plant. Most or all the flow from these systems did not reach the land application area.
		X3	Systems that exhibited significant infrastructure problems in the land application areas such that the drip dispersal network was not engaged, or not fully engaged.
A	Land application areas that receive wastewater from systems and engage the soil profile. This subpopulation does support the project design objective of evaluating hydraulic performance of the land application area(s).	A1	Land applications areas with no observations that indicate malfunction.
		A2a	Land application areas where localized areas of soil saturation and ponding were observed.
		A2b	Land application areas where extensive areas of ponding and/or overland flow (slope dependent) were observed. This includes areas where overland flow remained within the land application area, ran off the land application area, and, in some cases entered drainage features or surface waters.
		A3	Land application areas that were so overgrown that it was impractical to make valid observations of the land application area.

Appendix A provides example photographs that illustrate each of these subpopulations except for X1 since they were not operational. The photographs in Appendix A are only provided as typical examples and are not exhaustive.

The land application areas supporting the systems in the “X” primary subpopulation were not informative for evaluating land application area performance.

Land application areas supporting systems in the “A” primary subpopulation were informative for evaluating land application area performance, with some of these systems being supported by multiple land application areas. Systems with multiple land application areas often had areas reflecting different “A” secondary subpopulations. For example, one land application system was supported by four land application areas: two A1, one A2a, and one A3 subpopulations.

Table 2 summarizes the number of systems and areas in each primary and secondary subpopulation. Reports were generated for 420 land application areas supporting 374 land application systems. The 14 systems that had not been installed or were not active (X1) are not informative of the project objective

and were not evaluated further. Removal of the X1 population resulted in 360 land application systems currently managing wastewater. Of the 360 land application systems evaluated, observations of noncompliance were documented at 183 (Figure 4). Instances of noncompliance ranged in severity from complete bypass of wastewater from the system to lack of maintenance resulting in overgrown conditions preventing access to the area. It is important to note that instances of noncompliance identified during this project are specific to the characteristics being observed. Other characteristics pertaining to compliance such as fencing, signage, reporting, and secondary treatment plant effectiveness were not considered during this project.

Table 2. Subpopulation Distributions

Primary Subpopulation	Secondary Subpopulation	Land Application Systems (#)	Land Application Areas (#)	Description
X		55	57	Observations were not informative of project objective
	X1	14	14[1]	System Not Installed or Operational
	X2	25	26	Wastewater Discharging at Secondary Treatment (not reaching land application area)
	X3	16	17	Wastewater Discharging Through Infrastructure (not engaging drip dispersal network)
A		319	363	Observations were informative of project objective
	A1	177[2]	205	Areas with No Observed Malfunction
	A2a	77[2]	87	Areas with Localized Malfunction
	A2b	53[2]	57	Areas with Extensive Ponding and/or Overland Flow
	A3	12[2]	14	Areas Overgrown/Not Accessible
	Total	374	420	

1. A report was completed for each of these systems. However, the reports for these systems do not reflect an assessment of a land application area.
2. Many land application systems are supported by more than one land application area. Observations were made at some of the land application areas that fit into more than one subpopulation. For the purposes of this table, each land application system was only counted in the subpopulation of the most severe compliance issue, if any, observed at any of the land application areas supported by that system. The observations ranked in severity from most severe to least severe as follows: A2b (most severe noncompliance), A2a (less severe noncompliance), A3 (least severe noncompliance), and A1 (compliant). For example, there were 53 systems with at least one land application area in the A2b secondary subpopulation. These 53 systems may have also had areas in other performance subpopulations. Likewise, the 12 systems with land application areas in the A3 performance subpopulation may have had other areas in the A1 performance subpopulation but would not have areas in the A2a or A2b performance subpopulations.

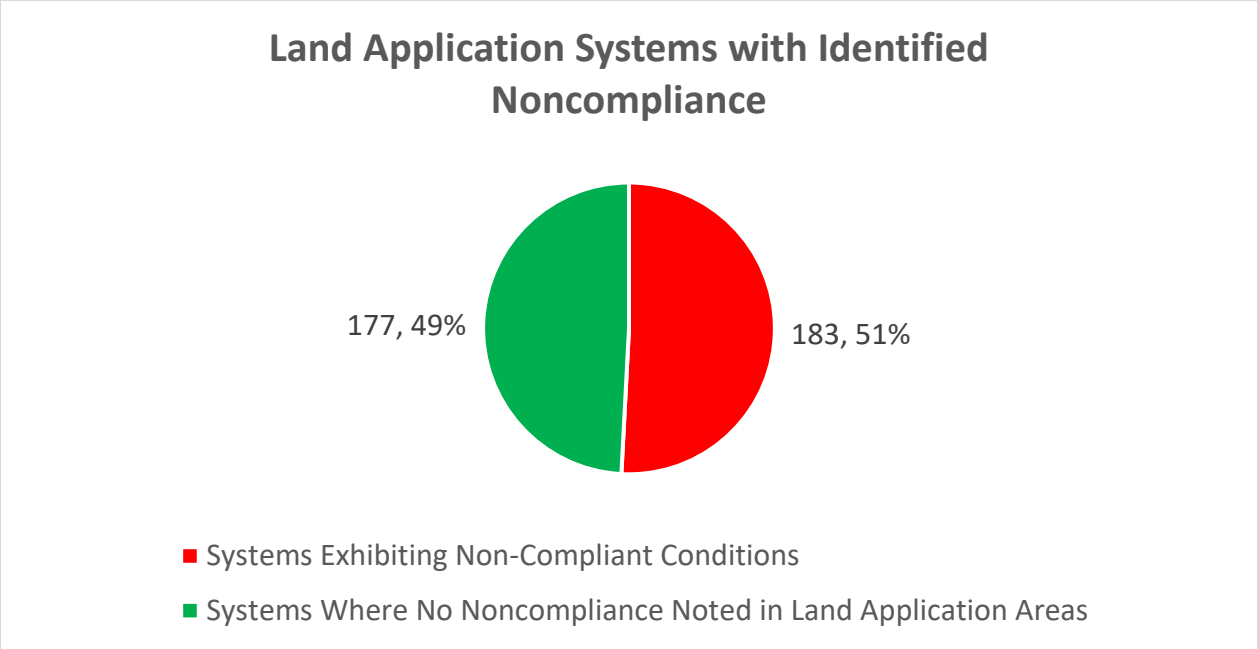

Figure 4. Systems with observed noncompliant conditions vs. Systems with no observed noncompliant conditions.

Of the previously listed subpopulations, three are indicative of major noncompliance: X2, X3, and A2b. Of the 360 systems actively managing wastewater, 94 (26%) exhibited conditions indicative of those subpopulations; 89 (25%) exhibited relatively minor indications of noncompliance (A2a, A3); 177 (49%) exhibited no observations of noncompliance (A1) (Figure 5).

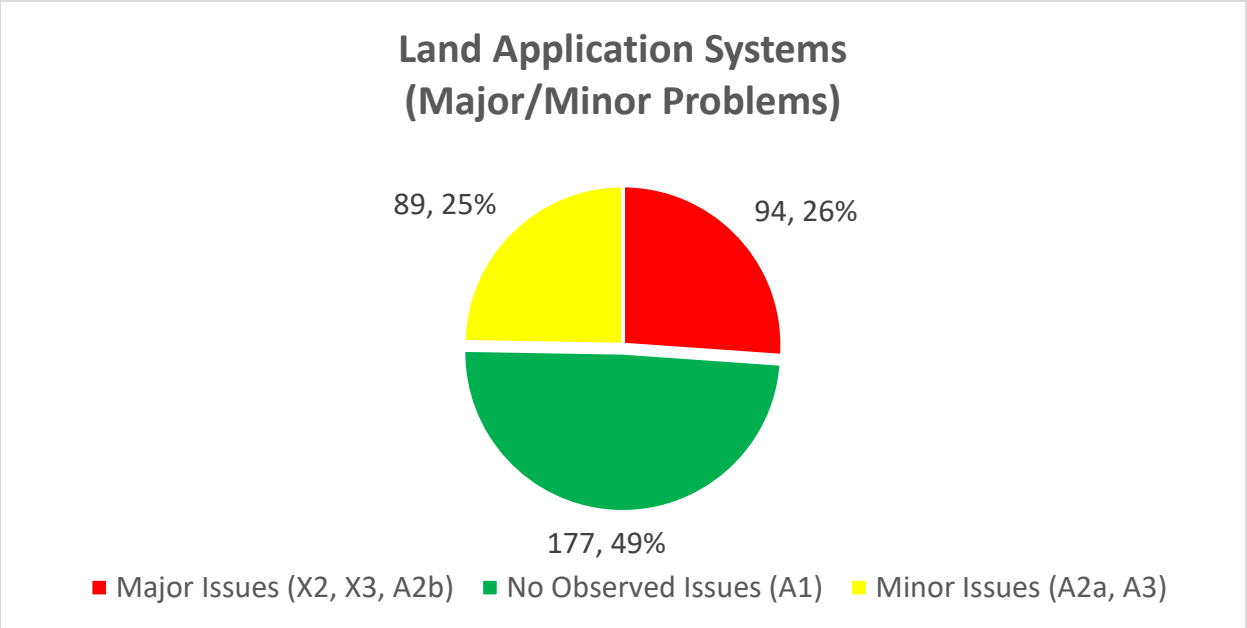

Figure 5. Major Issues Observed/Minor Issues Observed/No Observed Issues

Observations made at 363 land application areas supporting the 319 systems in the "A" primary subpopulation determined into which secondary subpopulation the areas were categorized. Of the total "A" subpopulation, 56% of the land application areas did not exhibit indications of noncompliance; 24% of the areas exhibited localized saturation and ponding (A2a); 16% of the areas exhibited extensive saturation and ponding including some with overland flow (slope dependent) and offsite wastewater migration (A2b); and 4% of the areas were too overgrown to evaluate (A3). Figure 6 depicts the occurrence of these secondary "A" subpopulations.

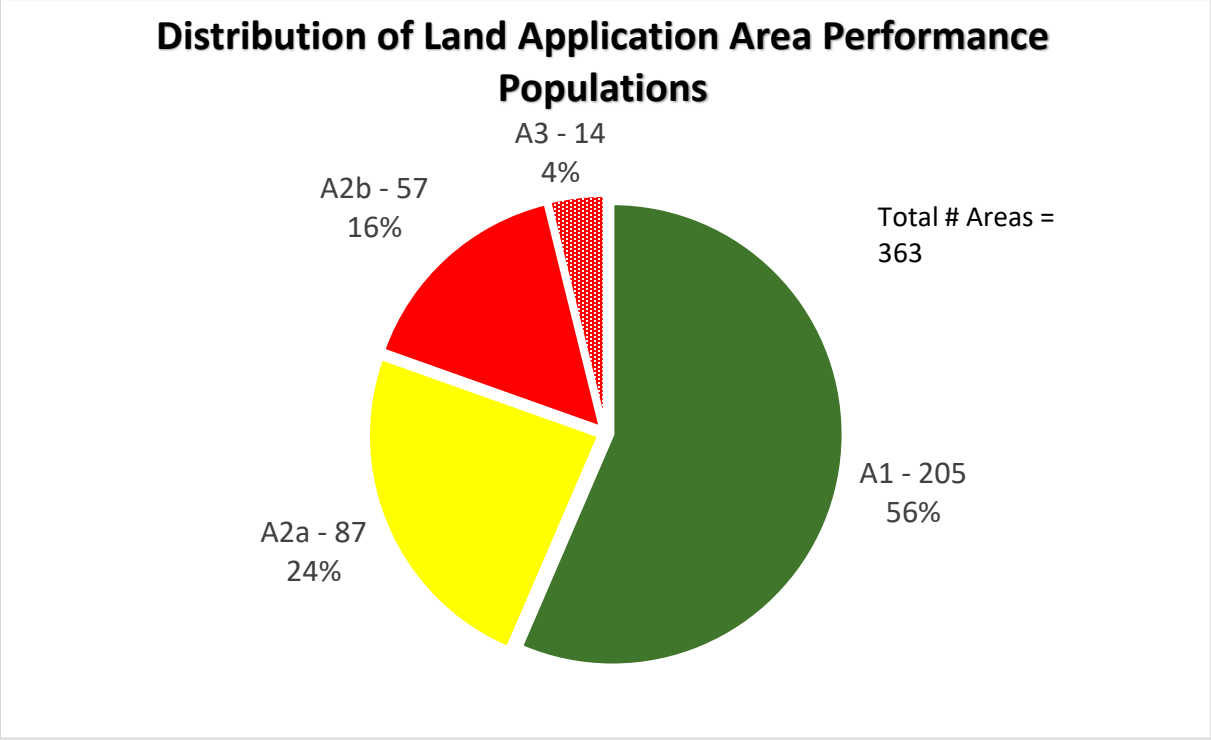

Figure 6. Occurrence of Land Application Area Performance Populations

3.0 Discussion

The project as described in this report is the first such effort to evaluate the performance of all land application areas utilizing drip dispersal in the state in a small window of time while utilizing a uniform set of observations. As such, there is no previous comprehensive data set to which a comparison can be made.

The observations made during these site visits were generally qualitative. No measurements of size of land application area, size of drip field footprint, degree of saturation, areal extent of ponding, or volume of observed flow were conducted.

The project was conducted with no foreknowledge of performance subpopulations. These subpopulations became evident during the data evaluation component of the project. Categorization of systems and areas into subpopulations was largely based on the standard observations collected at each

site. When observations alone left any question to subpopulation determination, survey notes and pictures were utilized. In some cases, follow-up site visits were made as well as follow-up discussions with Division staff that conducted the site visits. While qualitative, the observations and associated subpopulation designations are considered by the Division to be of high confidence and consistency.

Rainfall events were interspersed throughout the site visit period. These events were documented in the intake form as to both date of event and amount. In some cases, follow-up visits were conducted to ensure earlier observations were not influenced by precipitation. Observations of ponding due to precipitation were not considered to be indications of malfunction. Ponding associated with surfacing wastewater exhibits characteristics significantly different than ponding associated with precipitation including smell, appearance, sheen, lush green vegetation, and dead or distressed vegetation.

The term “malfunction” is utilized in the report to describe a range of observations; all of which represent permit noncompliance. This report does not identify cause of noncompliance, nor does it proclaim site-specific or program-specific follow-up actions.

This report presents a survey of land application systems utilizing drip dispersal and a qualitative assessment of their performance. A general discussion of project conclusions is provided below:

1. The number of systems at which wastewater was being discharged to the environment without utilizing the land application area was notable and unexpected. These occurrences are not part of any approved design nor are they allowed by permit condition.
2. Over one-half of the land application areas supporting systems where wastewater was being dispersed through drip dispersal did not exhibit indications of malfunction or noncompliance.
3. Many instances of malfunction in the land application areas were relatively isolated and appeared to be associated with drip field infrastructure (i.e., emitters, valves, connections). Understanding the cause of these instances requires excavation and was beyond the scope of this project. Identifying and resolving these problems should be accomplished by the permittee through routine inspections and maintenance. Left unresolved the problems will persist and may become worse.
4. Instances of extensive land application area overload were common with many being extreme. However, assessing whether the overloaded area(s) was the entirety of the drip field or associated with independent zones that are being dosed too heavily or being dosed solely was not possible within the scope of the project. Likewise, there were examples of systems with multiple land application areas where one area was clearly overloaded but other areas did not indicate overload and, in some cases, did not appear to be in use. Therefore, even systems with extensive land application area overload may find remedy by balancing dose volumes and ensuring all available drip field is being utilized.
5. There are systems where all apparent land application area exhibits hydraulic overload such that repairs, or improved maintenance would not likely provide adequate remedy. Resolution of these situations may involve establishing additional land application area capacity or NPDES discharge capacity.

The results of this project support continued evaluation of problem cause and potential site-specific and program-specific remedies. Continued evaluation includes but is not limited to the following:

1. Comparison of system design flow to actual flow.
2. Determination of drip field installed. For example, if the design indicated two acres of land application area, was this amount installed? In some cases, the land application component of the system may have been planned for construction in stages with later stages not having been installed. In other cases, non-emitting infrastructure may have been installed in the land application area resulting in less-than-optimal land application area utilization.
3. Review of soil suitability and appropriateness of loading rates.
4. Determination of long-term acceptance rates for soils being dosed daily for extended periods of time. Does the utilization of soil in this manner decrease its expected performance longevity?
5. Regular execution of projects similar in scope to the one described in this report and projects that target certain subpopulations for more intensive evaluation.

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Appendix A

Photographic Examples of Performance Subpopulations

X2. Wastewater effluent being directed to adjacent ditch rather than the drip field.

X2. Wastewater effluent being discharged from the control building rather than to the drip field.

X2. Wastewater effluent being discharged from the pump vaults rather than to the drip field.

X2. Wastewater effluent being discharged from the sand filter rather than to the drip field.

X3. Infrastructure piping unearthed and disconnected by uprooted tree.

X3. Infrastructure piping failure allowing extensive effluent release.

A1. No apparent drip field overload or other malfunction.

A1. No apparent drip field overload or other malfunction.

A1. No apparent drip field overload or other malfunction.

A2a. Localized saturation/ponding. Likely associated with a damaged valve.

A2a. Localized saturation/ponding. Likely associated with a failed emitter.

A2a. Localized saturation/ponding. Likely associated with a failed emitter or damaged line.

A2b. Extensive saturation/ponding.

A2b. Extensive saturation/ponding.

A2b. Extensive saturation/ponding.

A2b. Extensive saturation/ponding.

A2b. Extensive saturation/ponding including overland flow leaving the land application area.

A2b. Extensive saturation/ponding including overland flow leaving the land application area.

A2b. Extensive saturation/ponding including overland flow leaving the land application area and entering drainageways or surface water.

A2b. Extensive saturation/ponding including overland flow leaving the land application area and entering drainageways or surface water.

A3. Drip field covered in dense vegetation.

A3. Drip field covered in dense vegetation.

A3. Entrance to drip field. Entire area grown up in small trees and briars.

NORTH CAROLINA UTILITIES COMMISSION
RALEIGH

Docket No. W-933, Sub 12 Exceptions Due on or Before February 22, 2024
Docket No. W-1328, Sub 0

NOTICE TO PARTIES

Parties to the above proceeding may file exceptions to the report and Recommended Order hereto attached on or before the day shown above as provided in N.C. Gen. Stat. § 62-78. Exceptions, if any, must be filed with the North Carolina Utilities Commission, Raleigh, North Carolina, and a copy thereof mailed or delivered to each party of record, or to the attorney for such party, as shown by appearances noted. Each exception must be numbered and clearly and specifically stated in one paragraph without argument. The grounds for each exception must be stated in one or more paragraphs, immediately following the statement of the exception, and may include any argument, explanation, or citations the party filing same desires to make. In the event exceptions are filed, as herein provided, a time will be fixed for oral argument before the Commission upon the exceptions so filed, and due notice given to all parties of the time so fixed; provided, oral argument will be deemed waived unless written request is made therefore at the time exceptions are filed. If exceptions are not filed, as herein provided, the attached report and recommended decision will become final and effective on February 23, 2024, unless the Commission, upon its own initiative, with notice to parties of record modifies or changes said Order or decision or postpones the effective date thereof.

The report and Recommended Order attached shall be construed as tentative only until the same becomes final in the manner hereinabove set out.

STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

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

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of		
Joint Application by Red Bird Utility Operating Company, LLC d/b/a Red Bird Water and Etowah Sewer Company, Inc. for Transfer of Public Utility Franchise and for Approval of Rates	))))))	RECOMMENDED ORDER APPROVING TRANSFER AND RATES, GRANTING FRANCHISE, DETERMINING AMOUNT OF BOND, AND REQUIRING CUSTOMER NOTICE

HEARD: Wednesday, November 1, 2023, at 7:00 p.m. in the Henderson County Courthouse, 200 North Grove Street, Courtroom 2, Hendersonville, North Carolina 28792

Monday, November 20, 2023, at 1:00 p.m. in the Commission Hearing Room, Dobbs Building, 430 North Salisbury Street, Raleigh, North Carolina, 27603

BEFORE: Commissioner Floyd B. McKissick, Jr., Presiding, and Commissioners Kimberley W. Duffley and Jeffrey A. Hughes

APPEARANCES:

For Red Bird Utility Operating Company, LLC:

Kiran H. Mehta, Molly M. Jagannathan, and Mindy L. McGrath, Troutman Pepper Hamilton Sanders LLP, 301 South College Street, Suite 3400, Charlotte, North Carolina 28202

For the Using and Consuming Public:

Davia Newell and James Bernier, Jr., Staff Attorneys, the Public Staff – North Carolina Utilities Commission, 4326 Mail Service Center, Raleigh, North Carolina 27699-4300

BY THE COMMISSION: On October 8, 2020, Red Bird Utility Operating Company, LLC d/b/a Red Bird Water (Red Bird), and Etowah Sewer Company, Inc. (Etowah), filed with the Commission an Application for Transfer of Public Utility Franchise and for Approval of Rates (Application) seeking authority to transfer the wastewater utility system

and public utility franchise serving the unincorporated community of Etowah in Henderson County, North Carolina, from Etowah to Red Bird. Red Bird filed with the Commission supplemental and additional materials in support of its Application on October 22, 2020.

The intervention and participation of the Public Staff – North Carolina Utilities Commission (Public Staff) is recognized pursuant to N.C. Gen. Stat. § 62-15(d) and Commission Rule R1-19 (e).

On October 19, 2020, Red Bird's counsel filed a letter informing the Commission that CSWR – North Carolina Utility Operating Company, LLC, changed its name to Red Bird Utility Operating Company, LLC.

On December 22, 2020, the Public Staff filed a deficiency letter outlining additional information that was needed to complete the Application.

Red Bird filed additional information to address the issues identified in the Public Staff's December 22, 2020, letter on May 14, 2021, October 7, 2021, February 15, 2022, August 17, 2022, and August 23, 2022.

On June 14, 2023, Red Bird filed a letter with the Commission indicating that it considered the Application complete.

On July 25, 2023, the Public Staff filed a second deficiency letter outlining additional, updated information that was needed to complete the Application and recommended that the Commission determine that the Application is incomplete. On July 28, 2023, the Commission issued an Order Finding Application Incomplete.

Pursuant to the Commission's Order, on August 15, 2023, Red Bird filed additional information to address the issues identified in the Public Staff's July 25, 2023.

On August 22, 2023, the Public Staff filed a letter in which it recommended that the Commission find the Application to be complete.

On September 14, 2023, the Commission issued its Order Finding Application Complete and Requiring the Public Staff to Provide Specific Application Data (September 14 Order).

On September 21, 2023, the Public Staff filed a letter that addressed the Commission's questions pursuant to its September 14 Order.

On September 26, 2023, the Commission issued an Order Scheduling Hearings, Establishing Discovery Guidelines, and Requiring Customer Notice (Scheduling Order), which established the procedural schedule in this proceeding, including filing requirements of the parties.

On October 2, 2023, the Commission issued an order changing the time for commencement of the expert witness hearing. On the same date, Red Bird filed a Proposed Notice to Customers (Notice). The Notice was approved by Commission Order issued on October 4, 2023.

On October 10, 2023, Red Bird filed a Certificate of Service, which indicated that service of customer notice had been conducted as required by Commission order. The same day, Red Bird also filed the direct testimony and exhibits of Josiah Cox, President of Red Bird Utility Operating Company, LLC.

On October 18, 2023, a Notice of Appearance of Counsel for Red Bird was filed by Kiran H. Mehta, Molly M. Jagannathan, and Holly R. Ingram of the law firm of Troutman Pepper Hamilton Sanders, LLP, as counsel for Red Bird.

On October 19, 2023, the Public Staff filed a motion requesting that the Commission revise the Scheduling Order to change the dates pertaining to formal discovery guidelines and filing requirements put forth in the Scheduling Order. By order dated October 20, 2023, the Commission granted the Public Staff's motion.

The Public Staff filed its direct testimony on October 27, 2023, consisting of testimony and exhibits of Public Staff witnesses Lynn Feasel, Public Utilities Regulatory Manager of the Water, Sewer, and Telecommunications Sections with the Accounting Division of the Public Staff; D. Michael Franklin, Public Utilities Engineer, Water, Sewer, and Telephone Division of the Public Staff; and John R. Hinton, Director of the Economic Research Division of the Public Staff.

On October 27, 2023, the Public Staff filed a letter that recommended that the customer hearing be held as scheduled.

On October 31, 2023, attorney Daniel C. Higgins filed a motion requesting that he and the law firm of Burns Day & Presnell, P.A., be allowed to withdraw as counsel for Red Bird in the instant docket, which was granted by Commission order on November 1, 2023.

The public witness hearing was held as scheduled on November 1, 2023. The Public Staff had received six consumer statements of position from Etowah customers by October 27, 2023. Four Etowah customers testified at the public witness hearing. The testifying witnesses expressed concerns regarding the approval of a 200-unit subdivision on the site of the Etowah Valley Country Club, and whether the additional wastewater load could be served by the existing Etowah system or would require an additional wastewater treatment plant (WWTP), a matter not before the Commission in this proceeding. The Public Staff received an additional seven consumer statements as of the date of the expert witness hearing on November 20, 2023, expressing concern about the possible additional costs after the transfer to Red Bird, which were not included in the proposed rates contained in the customer notice. No customers complained of service issues.

On November 1, 2023, Mindy McGrath filed a Notice of Appearance as counsel of record for Red Bird in these dockets.

On November 13, 2023, Red Bird filed the rebuttal testimony and exhibits of Josiah Cox; the rebuttal testimony and exhibit of Brent G. Thies, Vice President and Corporate Controller for CSWR, LLC, an affiliate of Red Bird; and the rebuttal testimony of James A. Beckemeier, Managing Member of BL-STL, LLC, d/b/a Beckemeier LeMoine Law, a vendor of Red Bird which oversees and facilitates all of Red Bird's utility system acquisitions throughout the United States.

On November 15, 2023, Red Bird filed the corrected rebuttal testimony of Brent Thies, a witness list and estimated cross examination times for the scheduled expert witness hearing, and a Verified Report Regarding Issues Raised at Public Hearing (Report on Customer Comments).

On November 20, 2023, an expert hearing was held as scheduled in Raleigh, North Carolina.

On November 29, 2023, the Public Staff filed a verified response to the Company's Report on Customer Comments.

On December 4, 2023, Red Bird filed summaries of the testimony of its witnesses, Josiah Cox, Brent Thies, and James Beckemeier.

On December 14, 2023, Red Bird filed Late-filed Exhibit 1 and accompanying attachments to respond to the Commission's request at the expert witness hearing that Red Bird provide additional information concerning Red Bird affiliates and the process by which those affiliates recover certain acquisition costs including due diligence expenses.

On December 22, 2023, the Commission issued a Notice of Due Date for Proposed Orders and/or Briefs setting the due date of filing proposed orders and/or briefs as January 16, 2024, which was subsequently revised to January 12, 2024.

On January 12, 2024, the Public Staff and Red Bird filed their respective Proposed Orders, and Red Bird filed its Post-Hearing Brief.

WHEREUPON, based upon the entirety of the evidence and the record herein, the Commission now makes the following

FINDINGS OF FACT

1. Red Bird is a North Carolina limited liability company, in good standing. Red Bird is a wholly owned subsidiary of its sole member, Red Bird Utility Holding Company, LLC (RBUH), which is also a North Carolina limited liability company in good standing. RBUH is a wholly owned subsidiary of its sole member, North Carolina Central States Water Resources, LLC (NCCSWR), which is also a North Carolina limited liability

company in good standing and a wholly owned subsidiary of CSWR, LLC (CSWR). U.S. Water Systems, LLC (U.S. Water), is a Delaware limited liability company and the sole owner/member of CSWR. U.S. Water was formed by the independent investment firm Sciens Capital Management, LLC (Sciens Capital), to oversee water sector investments using investor dollars held by Sciens Water Opportunities Fund. Sciens Capital, is also the limited partner of U.S. Water. The membership of U.S. Water is comprised of Gullfoss Investments, LLC; Todd Thomas, Senior Vice President of CSWR; and Josiah Cox.

2. Central States Water Resources, Inc. (Central States) is the sole managing member of Red Bird, RBUH, and NCCSWR. Central States has no assets or paid employees and performs all its managerial responsibilities through CSWR. The Board of Directors of Central States provides input on the utilization of the personnel of CSWR.

3. U.S. Water, Sciens Capital, and Gullfoss Investments, LLC, are affiliates of Red Bird and CSWR.

4. Red Bird presently holds five utility franchises in North Carolina. On December 8, 2021, in Docket No. W-1328, Sub 7, the Commission issued an Order Accepting and Approving Bond, Granting Franchise, Approving Rates, and Requiring Customer Notice (Utility Franchise Order I) granting Red Bird a wastewater utility franchise for the Ocean Terrace and Pine Knoll Townes I, II, and III townhome communities in Carteret County, North Carolina. On February 7, 2023, in Docket Nos. W-1328, Sub 4, and W-1040, Sub 10, the Commission issued its Order Approving Stipulation, Approving Bond, Approving Transfer and Rates, and Requiring Customer Notice (Utility Franchise Order II) approving the transfer of the Bear Den Acres Development water system and public utility franchise in McDowell County, North Carolina, to Red Bird. On August 29, 2023, in Docket Nos. W-1328, Sub 9 and W-992, Sub 8, the Commission issued an Order Approving Stipulation, Approving Bond, Approving Transfer and Rates, and Requiring Customer Notice (Utility Franchise Order III) approving the transfer of the water and wastewater systems serving the Baywood Forest Subdivision, the wastewater system serving the Cottonwood Subdivision, and the public utility franchise serving all of Crosby Utilities, Inc.'s service areas in Wake County, North Carolina. On December 14, 2023, in Docket Nos. W-1146, Sub 13 and W-1328, Sub 10, the Commission issued a Recommended Order Approving Stipulation, Approving Transfer and Rates, Granting Franchise, Approving Bond, and Requiring Customer Notice (Utility Franchise Order IV), approving the transfer of the water and wastewater systems serving the Lake Royale subdivision in Franklin and Nash Counties, North Carolina, from Total Environmental Solutions, Inc., to Red Bird.[1] On January 31,2024, in Docket Nos. W-1296, Sub 3 and W-1328, Sub 3, the Commission issued an Order Approving Stipulation, Approving Transfer and Rates, Approving Bond, and Requiring Customer Notice (Utility Franchise Order V, collectively, with Utility Franchise Orders I, II, III, and IV, the Utility Franchise Orders), approving the transfer of

[1] The Utility Franchise IV Order became final and effective on January 2, 2024.

the water and wastewater utility systems serving the Jefferson Landing subdivision in Ashe County, North Carolina, from JL Golf to Red Bird.

5. In addition to the five systems for which Red Bird has been granted franchises in North Carolina, Red Bird's indirect corporate parent, CSWR, through separate state affiliates, has acquired and currently operates more than 800 water or wastewater utility systems in Missouri, Arkansas, Kentucky, Louisiana, Texas, Tennessee, Mississippi, Arizona, Florida, and South Carolina, and provides utility service to more than 221,000 wastewater customers and over 146,000 water customers.

6. The Etowah utility system currently serves 485 wastewater customers in Henderson County, North Carolina, 440 of whom are residential wastewater customers.

7. Red Bird seeks Commission approval to acquire Etowah's sewer utility system. Etowah was issued a Certificate of Public Convenience and Necessity (CPCN) to provide sewer utility service to the unincorporated community of Etowah in Henderson County, North Carolina in Docket No. W-933, Sub 0.

8. Etowah's wastewater system is regulated and permitted by the North Carolina Department of Environmental Quality (DEQ) and operates under two DEQ permits: Permit NC0071323, which is a National Pollutant Discharge Elimination System (NPDES) permit and is applicable to the WWTP; and Permit WQCSD0135, which is for the wastewater collection system. The WWTP has two treatment trains, including one that has been in operation since 1988 and a second that was added between 1998 and 2002. The Etowah wastewater system consists of 125,000 gallons per day of wastewater collection, treatment, and extended aeration discharge facilities.

9. A Red Bird affiliate, Central States, entered into a Purchase and Sale Agreement for the sale of the Etowah utility system (Purchase Agreement) on August 23, 2019. The Purchase Agreement was amended on October 15, 2020. According to the amended Purchase Agreement, the Purchase Agreement was assigned to Central States' affiliate, Red Bird, and closing of the sale will occur after regulatory approval is obtained in a form satisfactory to Red Bird as set forth in more detail in Section 2.05(a) of the Purchase Agreement or on another date agreed to in writing by Etowah and Red Bird.

10. After acquisition of the Etowah system, Red Bird plans to make capital improvements to the wastewater utility system. Based on its consulting engineer's 2020 projections, Red Bird estimates that the cost of necessary improvements to the Etowah sewer system will be approximately $470,200, consisting of $141,400 for work on the collection system and $328,800 for work on the WWTP.

11. Upon acquisition, Red Bird intends to adopt and charge Etowah customers the present rates, fees, and additional charges approved in Docket Nos. W-933 Sub 10 and M-100, Sub 138, which have been in effect since January 1, 2016. The present and proposed rates are as follows:

Monthly Wastewater Utility Service:	Present and Proposed
Residential Flat Rate	$26.33
Commercial Customers (metered rates)	
Base Charge, zero usage	$26.33
Usage Charge, per 1,000 gallons	$ 4.05
Connection Charge:	
Residential	$2,300 per connection
Commercial	$2,300, minimum per connection, plus $6.97 per gallon of design flow over 330 gallons per day
Reconnection Charge:	
If wastewater service cut off by utility for good cause	$14.99

12. Red Bird proposed that the determination of whether or to what extent it should be afforded an acquisition adjustment in connection with the proposed transfer of the Etowah wastewater utility system should be deferred to Red Bird's first general rate case for the Etowah system after the transfer to Red Bird is completed.

13. Red Bird proposed that the determination of whether or to what extent it should be permitted to recover due diligence costs incurred in connection with the proposed transfer of the Etowah wastewater utility system to Red Bird should be deferred to the first general rate case proceeding for the Etowah system after the transfer to Red Bird is completed.

14. Red Bird asserts that the determination of the appropriate rate base to be included in rates for the Etowah wastewater utility system should be deferred to the first general rate case proceeding for the Etowah system after the transfer to Red Bird is completed.

15. In this transfer proceeding, it is appropriate to determine the present amount of rate base for the Etowah wastewater system, including the amount of net plant cost, the acquisition adjustment, and the due diligence expenses to be recorded on Red Bird's books in compliance with generally accepted accounting principles (GAAP) for corporate accounting and reporting purposes. In prior transfer dockets, the Commission has followed this practice which is in the public interest. *See* Order Approving Transfer and Denying Acquisition Adjustment, *Petition of Utilities, Inc., for Transfer of Certificate of Public Convenience and Necessity for Providing Sewer Utility Service on North Topsail Island and Adjacent Mainland Areas in Onslow County from North Topsail Water and Sewer, Inc. and for Temporary Operating Authority,* No. W-1000, Sub 5 (N.C.U.C. Jan. 6, 2000).

16. Rate base treatment of an acquisition adjustment is not appropriate under the circumstances and evidence presented in the current docket and should not be approved for ratemaking purposes.

17. Etowah is providing safe and reliable service to its customers of the Etowah wastewater system. The provision of continuous, safe, adequate, and reliable wastewater utility service is essential to Etowah's customers.

18. The Etowah system is not a troubled system.

19. Red Bird indicated that its costs of due diligence and transactional and regulatory work related to the acquisition of the Etowah system were approximately $317,269.22 as of the time of the filing of Red Bird witness Cox's direct testimony.

20. It is appropriate for ratepayers to bear costs for due diligence and other transactional costs in the amount of $10,000, which is to be included in the rate base established in this proceeding. The determination of whether an amount greater than the $10,000 amount approved herein will be recovered from customers should be determined in Red Bird's first general rate case. It is appropriate for Red Bird to amortize its due diligence and transactional costs over a period of 27.74 years, with amortization beginning in the month in which the transfer of the Etowah wastewater system to Red Bird closes.

21. The rate base for the Etowah system should be set at ($282,207).

22. It is reasonable and appropriate for Red Bird to post a bond in a form acceptable to the Commission in the amount of $100,000 prior to closing on the transfer of the Etowah wastewater system.

23. Red Bird has the technical, managerial, and financial capacity to own and operate the Etowah wastewater system, and the transfer should be granted, subject to the rate base, acquisition adjustment, due diligence costs, other transactional expenses, and bond amount established by the Commission herein.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 1-3

The evidence supporting these findings of fact is contained in Red Bird's verified Application, the supplemental filings made by Red Bird in this docket, the testimony and exhibits of Red Bird witness Cox, and the Commission's records in Docket Nos. W-1328, Subs 3, 4, 7, 9, and 10; W-1040, Sub 10; W-992, Sub 8; W-1146, Sub 13, and W-1296, Sub 3, including the Commission's Utility Franchise Orders issued in each of these dockets.

Red Bird witness Cox provided testimony at the expert witness hearing regarding Red Bird, its parent holding companies, its relationship to CSWR, and the role of CSWR,

U.S. Water, Sciens Capital, and Gullfoss Investments, LLC, in financing Red Bird's operation of the Etowah system. Tr. vol. 2, 110-16.

In his direct testimony, witness Cox explained that Red Bird was formed to acquire water and wastewater assets in North Carolina and to operate those assets as regulated public utilities. Witness Cox also testified that Red Bird is an affiliate of CSWR. He is the president of Red Bird, Central States, and CSWR. *Id.* at 20, 23, 28, 113-14. He further testified at the expert witness hearing that U.S. Water acquired CSWR from him. U.S. Water is now the sole member of CSWR. *Id.* at 122-23.

The membership of U.S. Water is composed of Gullfoss Investments, LLC; Todd Thomas; and Josiah Cox. *Id*. at 131-32. Witness Cox also testified that Sciens Capital is the limited partner of U.S. Water and created U.S. Water to oversee the water sector investments of Sciens Capital, including its investments in CSWR. *Id.* at 128, 138.

The board of directors of U.S. Water consists of Dan Standen, John Rigas, and Tom Rooney. *Id.* at 107. Witness Cox, Dan Standen, John Rigas, and Tom Rooney are the same individuals that serve as directors of Central States, which is the managing entity of Red Bird and its various holding companies. *Id.* at 107, 127, 128, 145. Additionally, John Rigas and Dan Standen are also management personnel in Sciens Capital. *Id.* at 133, 138.

Based upon competent, substantial, and material evidence in the record, the Commission concludes that these findings are informational, procedural, or jurisdictional in nature and are not contested by any party.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 4-5

The evidence supporting these findings of fact is based on the Commission's records in the Utility Franchise Orders.

These findings of fact are also based on the direct testimony of Red Bird witness Cox that CSWR's subsidiaries have acquired and operate over 800 water and/or wastewater utility systems in Missouri, Arkansas, Kentucky, Louisiana, Texas, Tennessee, Mississippi, North Carolina, Arizona, Florida, and South Carolina. *Id.* at 26, 28-30, 32.

Based upon competent, substantial, and material evidence in the record, the Commission concludes that these findings of fact are informational, procedural, or jurisdictional in nature and are not contested by any party.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 6

The evidence supporting this finding of fact is contained in Red Bird's verified Application, the supplemental filings made by Red Bird in this docket, the testimony and

exhibits of Red Bird witness Cox, and the testimony and exhibits of Public Staff witness Franklin. Tr. vol. 2, 41, 203.

Based upon competent, substantial, and material evidence in the record, the Commission concludes that this finding is informational and procedural in nature and is not contested by any party.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 7

The evidence supporting this finding of fact is based on the verified Application in these dockets and the Commission's records in Docket No. W-933, Sub 0. Based upon competent, substantial, and material evidence in the record, the Commission concludes that this finding of fact is uncontested.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 8

The evidence supporting this finding of fact is based on Confidential Attachment L to the Application, the testimony of Public Staff witness Franklin, and the Commission's records in these and other dockets relating to Etowah. Tr. vol. 2, 205.

Based upon competent, substantial, and material evidence in the record, the Commission concludes that this finding of fact is informational and procedural in nature and is not contested by any party.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 9

The evidence supporting this finding of fact is based on filings in this docket, including the Purchase Agreement for Sale of Utility System with Etowah dated August 23, 2019, and the First Amendment to Purchase and Sale Agreement dated October 15, 2020, whereby Central States assigned its rights under the Agreement for Sale of Utility System to Red Bird as the buyer.

Based upon competent, substantial, and material evidence in the record, the Commission concludes that this finding is informational in nature and is not contested by any party.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 10

The evidence supporting this finding of fact is found in Confidential Attachment L to the Application; Attachment L.1 and Confidential Attachment L.2 of the supplemental filings made by Red Bird in these dockets on May 13, 2021, and October 7, 2021, respectively; the testimony and exhibits of Red Bird witness Cox; and the testimony of Public Staff witness Franklin. *Id.* at 45, 47, 197.

Red Bird witness Cox testified that in order to address operational and/or compliance issues associated with Etowah's wastewater utility system, Red Bird's engineering consultant, McGill Associates (McGill), recommended the following work be performed:

1. Purchase portable davit crane or hoist to lift pumps for maintenance.

2. Brandymills Lift Station
   a. Install transfer switches for connection to portable backup power supply
   b. Replace pump guide rail and chains.
   c. Install baseplate for portable mounted pump hoist.
   d. Replace Myers 2 HP pumps

3. Jonathan Creek Lift Station
   a. Replace pump guide rail and chains.
   b. Install baseplate for portable mounted pump hoist.
   c. Replace Hydromatic 5 HP pumps.

4. Sunset Ridge Lift Station
   a. Install baseplate for portable mounted pump hoist.
   b. Replace pump guide rail and chains.
   c. Replace 2 HP pumps.

5. Meadows Lift Station
   a. Dewater and clean wet well.
   b. Install transfer switches for connection to portable backup power supply
   c. Replace pump guide rail and chains.
   d. Replace control panel enclosures.
   e. Install baseplate for portable mounted pump hoist.
   f. Replace Myers 3 HP pumps.

6. Homeplace Lift Station
   a. Install transfer switches for connection to portable backup power supply
   b. Replace pump guide rail and chains.
   c. Install baseplate for portable mounted pump hoist.
   d. Replace Myers 3 HP pumps.

7. Etowah Reach Lift Station
   a. Install transfer switches for connection to portable backup power supply
   b. Replace pump guide rail and chains.
   c. Install baseplate for portable mounted pump hoist.
   d. Replace Hydromatic 3 HP pumps.

Public Staff witness Franklin testified that the McGill survey and capital estimates are preliminary, and the existence of problems cannot be truly known until Red Bird has acquired and begun to operate the system. *Id.* at 215-16. Witness Franklin opined that

this uncertainty raises the question of whether Red Bird's willingness to make capital investments can actually be considered a tangible benefit. *Id.* at 216. Witness Franklin stated that it will be incumbent upon Red Bird to ensure that the capital improvements are reasonable and prudent for the capital investment associated with the improvements to be added to rate base and included in rates in a future rate case proceeding. *Id.* at 218.

The Commission notes Red Bird's assertion that the Etowah wastewater utility system requires maintenance and upgrades to ensure it is able to continue providing safe and reliable service to the customers it serves, along with some customers' testimony and statements that improvements to the systems are necessary. However, the Commission concludes, based upon competent, substantial, and material evidence in the record, that the scope and extent of capital improvements and repairs that are reasonable and prudent is, at this time, not adequately known or knowable by any party to this proceeding. Thus, the Commission concludes that the appropriate time and venue to determine the reasonableness and prudence of proposed and/or actual capital investments is the next general rate case involving this wastewater utility system.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 11

The evidence for this finding of fact is found in the verified Application, the pleadings, the testimony of Red Bird witness Cox, and the exhibits in this docket, as well as the Commission's Order Approving Tariff Revision and Requiring Customer Notice, *Etowah Sewer Company Tariff Filing to Reflect House Bill 998,* No. W-933, Sub 10 and *Implementation of House Bill 998 – An Act to Simplify the North Carolina Tax Structure and to Reduce Individual and Business Tax Rates,* No. M-100, Sub 138 (N.C.U.C. May 13, 2016).

Based upon competent, substantial, and material evidence in the record, the Commission concludes that this finding is informational in nature and is not contested by any party.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 12-15

The evidence supporting these findings of fact is found in the direct and rebuttal testimony of Red Bird witness Cox, the rebuttal testimony of Red Bird witness Thies, and the direct testimony of Public Staff witnesses Franklin and Feasel.

Red Bird witness Cox testified that issues pertaining to rate base, due diligence costs, and acquisition adjustment and their effect on the acquired utility's rate base and revenue requirement are more properly examined in the context of a general rate case hearing. Witness Cox also testified that Red Bird is not requesting that the Commission determine in this proceeding the rate base, the appropriateness of an acquisition adjustment, or the appropriate amount of due diligence costs, if any, and that it is premature for the Public Staff to speculate what those costs may be. *Id.* at 50.

Witness Cox provided confidential calculations of the rate base, stated the purchase price, and further stated that based on Red Bird's calculation of rate base and the difference between the purchase price of the Etowah wastewater system and the net book value of the system, Red Bird requests approval of "a reasonable portion" of the acquisition adjustment resulting in connection with the proposed acquisition of the Etowah wastewater utility system. *Id.* at 46, 47.

Red Bird witness Cox stated that he was "surprised to learn that the practice here, when the purchasing utility will adopt the purchased utility's rates, terms and conditions for service, as Red Bird proposes to do with the Etowah system, is that the Commission typically goes beyond the threshold issue of competence and establishes rate base in the acquired assets, as well as the purchaser's due diligence costs associated with the acquisition." *Id*. at 50. Witness Cox further stated that, based on Red Bird's experience in other jurisdictions, he would have expected this Commission to defer deciding these issues until Red Bird's initial general rate case after the acquisition. Witness Cox also contended that recent changes to the applicable law pertaining to water and wastewater utility acquisitions enacted by the North Carolina legislature in Session Law 2023-67 limit the focus of the Commission's inquiry in acquisition cases. Witness Cox opined that "[b]y limiting the focus of the Commission's inquiry in acquisition cases I believe the General Assembly has signaled that extraneous issues - such as whether an acquisition adjustment should be approved - should be deferred to a rate case or other post-acquisition proceedings." *Id.*

Witness Cox testified as to the costs Red Bird has incurred in conducting its due diligence inquiry and investigation relating to the Etowah wastewater system. Cox Direct Exhibit 4 indicates that although total due diligence costs would not be known until the close of the Etowah purchase, Red Bird had incurred costs totaling $317,269.22 for due diligence, transactional, and regulatory work related to the purchase of the Etowah wastewater system. *Id.* at 51. Witness Cox further stated that Red Bird believes that the due diligence costs shown in Cox Exhibit 4 should be included in rate base and recoverable in Red Bird's first general rate case. *Id*. at 52-53. Witness Cox also testified that purchases of smaller systems often require more due diligence work than larger better managed systems, and therefore Red Bird will not know the total due diligence and transactional costs associated with the acquisition until the purchase actually closes. *Id.* at 51.

In his rebuttal testimony, witness Cox reiterated that Red Bird proposes to adopt the rates currently in effect for Etowah customers should the Commission approve the acquisition of the Etowah wastewater system. Therefore, witness Cox contended that the proposed transfer would have no impact on the customers' rates after closing. *Id.* at 283. Witness Cox noted that Public Staff witnesses Feasel and Franklin estimate future rates using projections for various components of the Red Bird's operating costs of the Etowah wastewater system and have calculated rate increases related to an acquisition adjustment, capital improvements, and due diligence costs. *Id.* at 283-84. Witness Cox again asserted Red Bird's position that rate impact estimates are irrelevant to the issues before the Commission. *Id.* at 284. In addition, witness Cox testified that the Commission

should disregard the rate impact testimony of the Public Staff, because the underlying estimates are based on assumptions regarding "all elements of ratemaking - revenue, expenses, rate base, capital structure, rate of return, rate design, etc. - that may or may not be valid." *Id.* In introducing Red Bird's intent to pursue establishing consolidated rates for its approved systems, witness Cox stated that, based on the experience of Red Bird's affiliate group outside of North Carolina, "consolidated rates are an effective mechanism to mitigate 'rate shock' that otherwise would result when small, undercapitalized, and mismanaged systems are acquired by experienced and technically competent owners that invest the capital required to address needed capital improvements in those systems." *Id.* at 284-85. Witness Cox further testified that calculating the acquisition's effect on future rates would be inappropriate because the impact on future rates is not known and measurable. *Id.* at 285.

In his rebuttal testimony, Red Bird witness Thies also testified regarding how Red Bird views the underlying assumptions and calculations. Witness Thies testified that rates for the Etowah wastewater system could be significantly different if rates are set on a standalone basis versus those set on a consolidated basis. *Id*. at 301.

A Red Bird affiliate, Central States, entered into a Purchase and Sale Agreement for the sale of the Etowah wastewater utility system with Etowah Sewer Company, Inc. (Purchase Agreement) on August 23, 2019, which was filed as Confidential Attachment G to the Application. The Purchase Agreement was amended on October 15, 2020. According to the amended Purchase Agreement, the Purchase Agreement was assigned to Central States' affiliate, Red Bird, and closing of the sale will occur after regulatory approval is obtained in a form satisfactory to the Buyer (Red Bird) as set forth in Section 2.05(a) of the Purchase Agreement or on another date agreed to in writing by Etowah and Red Bird. Section 2.05 (a) provides in pertinent part:

> Section 2.05 Other Termination Rights. In addition to any other rights and remedies set out herein (including but not limited to the termination rights in Sections 2.03, 2.04, 3.02(b) and 5.02), the Buyer shall have the right to terminate this Agreement as set out below:
>
> (a) At any time up to and including the Closing Date if the regulatory bodies required to approve the sale of the System and the Property to the Buyer have not fully and unconditionally approved the sale upon the terms set out herein. In Buyer's sole and absolute discretion, Buyer may terminate this Agreement if the necessary regulatory approvals are not fully and unconditionally granted to Buyer in a form satisfactory to Buyer (as determined in Buyer's sole and absolute discretion) prior to the Closing by giving written notification of such termination to Seller, and upon such termination the Buyer shall receive a prompt return of the Earnest Money.

On cross-examination, witness Cox provided confirmation regarding a provision in the Purchase Agreement whereby Red Bird could terminate the Purchase Agreement

with Etowah for any reason if it does not receive regulatory approval unconditionally granted in a form satisfactory to Red Bird, as determined in Red Bird's sole and absolute discretion. Tr. vol. 2, 73-74.

Public Staff witness Franklin testified that the Public Staff does not agree with Red Bird's assertion that consideration of an acquisition adjustment and due diligence expenses should be deferred until Red Bird's first general rate case versus this transfer proceeding. *Id.* at 22 He also stated that Session Law 2023-67 provides that the Commission shall issue an order approving the application upon finding that the proposed grant or transfer, among other things, is in the public interest. Witness Franklin opined that, "[t]he Commission cannot determine if the transfer is in the public interest if it does not know the impact to rate base and customer rates of the acquiring utility's proposed acquisition adjustment and due diligence expenses." *Id.* Witness Franklin also emphasized that Red Bird has indicated that in its first general rate case proceeding it would seek uniform rates. He testified that having to decide issues pertaining to acquisition adjustments and due diligence expenses for multiple utility systems in a future rate case would, "unduly complicate and encumber the rate case proceeding." *Id.* Witness Franklin also noted that the information required for an acquisition adjustment decision and most of the due diligence expenses of Red Bird are already known. Furthermore, witness Franklin testified that deferring to Red Bird's future rate case the decisions on an acquisition adjustment and appropriate due diligence expenses would not be in the public interest. He noted that there is a long-established procedure by the Commission to address these costs as part of a transfer proceeding. *Id.* at 222. Witness Franklin cited as support the following utility transfer proceedings, which predate the Commission's precedent decision in Docket No. W-1000, Sub 5[2]: Docket Nos. W-274, Sub 122; W-354, Subs 39, 40, 41, 74, 79, and 81; and W-1012, Subs 2 and 3. *Id.* at 222.

Public Staff witness Feasel testified that the value of the acquisition adjustment and the rates should be determined in the current transfer proceeding as soon as the transaction is closed because Red Bird needs to record the acquisition adjustment on its books and start amortizing the acquisition adjustment immediately for corporate accounting and reporting purposes. She stated that the value of the acquisition adjustment and the depreciation rates should be determined in the current transfer proceeding so that Red Bird can meet GAAP reporting requirements. *Id.* at 253-54.

For comparison purposes, witness Feasel, calculated the estimated revenue requirement associated with the acquisition adjustment, due diligence expenses, and planned future improvements to the Etowah wastewater system that Red Bird intends to recover in its first general rate case proceeding after acquiring the Etowah wastewater system. Witness Feasel provided in her testimony a confidential table that compared Red

[2] Order Approving Transfer and Denying Acquisition Adjustment, *Petition of Utilities, Inc. for Transfer of the Certificate of Public Convenience and Necessity for Providing Sewer Utility Service on North Topsail Island and Adjacent Mainland Areas in Onslow County from North Topsail Water and Sewer, Inc. and for Temporary Operating Authority*, Docket No. W-1000, Sub 5 (N.C.U.C. Jan. 6, 2000).

Bird's calculations to the Public Staff's and showed significant differences between the calculations. *Id.* at 196-97.

Witness Franklin testified as to the impact on the future rates of the Etowah customers. Witness Franklin stated that inclusion in rate base of the entire acquisition adjustment calculated by the Public Staff would equate to a $22.23 increase in the residential monthly wastewater flat rate and commercial metered monthly base charge, which is equivalent to an 84% increase in residential wastewater monthly flat rates and commercial metered monthly base charge. *Id.* at 217-18. Witness Franklin further testified that revenue requirements to support Red Bird's due diligence costs would result in a $6.42 per month increase in the residential monthly wastewater flat rate and commercial metered monthly wastewater base charge, zero usage rate. He stated that this is equivalent to a 24% increase in residential monthly wastewater flat rate and commercial metered monthly wastewater base charge (zero usage) of $26.33 recommended by the Public Staff. *Id.* at 210, 220.

The Commission has a long-standing practice of establishing the rate base of a utility that is to be acquired by a purchaser. Section 62-111 of the North Carolina General Statutes governs transfers of utility franchises. On June 30, 2023, the law applicable to water and wastewater acquisitions changed with the enactment of S.L. 2023-67, which amended N.C.G.S. § 62-111 by creating, among other things, timelines for the Commission's consideration of applications for grants or transfers of CPCN's for certain water and wastewater systems. Section 62-111, Section 1.(b) applies to this Application and provides that the Commission shall issue an order approving an application, if the Commission finds that

> the proposed grant or transfer, including adoption of existing or proposed rates for the transferring utility, is in the public interest, will not adversely affect service to the public under any existing franchise, and the person acquiring said franchise or certificate of public convenience and necessity has the technical, managerial, and financial capabilities necessary to provide public utility service to the public.

Red Bird argues that the statutory language added to N.C.G.S. § 62-111 should be interpreted to require a lower level of scrutiny in determining whether a transfer is in the public interest, that determining the acquisition adjustment and due diligence expenses in this transfer docket would be premature, and that the Commission should wait to determine these issues in a general rate case. Red Bird asserts that the costs and circumstances could change between approval of the transfer and the filing of a rate case and contends that the new statute does not require consideration of these issues to determine whether a transfer is in the public interest. Additionally, Red Bird asserts that since it does not propose to change the currently approved rates, once the Commission determines that Red Bird has the technical, managerial, and financial capacity to acquire the utility, then the Commission should stop its analysis with a finding that fitness for acquisition is the equivalent of determining that the transfer is in the best interest of the ratepayers. Notwithstanding Red Bird's position that the Commission should delay

consideration of these issues until Red Bird's first general rate case, Red Bird witness Cox provided Red Bird's calculation of rate base, its due diligence expenses incurred to date, and transaction costs incurred to date, and unequivocally stated its intention to request rate base treatment for a reasonable portion of the acquisition adjustment and recovery of the due diligence and transaction expenses which are beneficial to customers when it files its first general rate case. However, none of Red Bird's witnesses were able to provide support for Red Bird's argument that the Commission should not determine such foundational issues in the transfer proceeding. During cross-examination by Commissioner McKissick and the Public Staff, witness Cox was unable to provide a basis for Red Bird's contention that a determination of technical, managerial, and financial capacity when rates will not be changed, alone proves that the transfer is in the best interest of the ratepayers.

Well-established principles of statutory interpretation in North Carolina dictate:

> The intent of the General Assembly may be found first from the plain language of the statute, then from the legislative history, the spirit of the act and what the act seeks to accomplish. If the language of a statute is clear, the court must implement the statute according to the plain meaning of its terms so long as it is reasonable to do so. Courts should give effect to the words actually used in a statute and should neither delete words used nor insert words not used in the relevant statutory language during the statutory construction process. Undefined words are accorded their plain meaning so long as it is reasonable to do so. In determining the plain meaning of undefined terms, this Court has used standard, nonlegal dictionaries as a guide. Finally, statutes should be construed so that the resulting construction harmonizes with the underlying reason and purpose of the statute.

Midrex Techs. v. N.C. Dep't of Revenue, 369 N.C. 250, 258, 794 S.E.2d 785, 792 (2016) (internal citations omitted).

Under the plain language of the statute, the Commission must establish that the transfer is in the public interest. In fact, the very first requirement in the amended statute is a finding that the proposed acquisition is in the public interest. This was also a prerequisite before the statute was modified. The new statute does not, on its face, restrict the Commission from considering other factors in determining whether the transfer is in the public interest. If the Legislature had intended that the Commission only determine whether the applicant possessed the financial, technical, and managerial capabilities, and analyze whether existing rates and the purchaser's stated proposed rates are reasonable, it would have expressly stated so. The purpose and title of the statute, to expedite the transfer of water or wastewater public utilities, clearly does not expressly limit the Commission's review to a company's adoption of existing rates or proposed rates in determining whether the transfer is in the public interest. The statute merely says that the Commission should include certain issues in its consideration, but it does not limit its consideration of any particular issues. When there is uncontroverted evidence of the

Company's incurrence of costs, its intention to recover those costs, and the impact of that recovery on ratepayers, the Commission should take into consideration the magnitude of the impact on customer rates to determine whether ratepayers will be better or worse off after the transfer. Red Bird submits that customers will be better off with the approval of the transfer and approval of an acquisition adjustment because Red Bird is able to invest the capital necessary to address the needs of the Etowah system, and that customers will further benefit from ownership and operation of the system by an adequately capitalized and professionally run utility. Tr. vol. 2, 48.

Because there is no specific language in the amended statute that limits the Commission's consideration of factors that might affect the public interest, the Commission shall proceed with its usual, customary, and required inquiry into all aspects of anticipated service and rates occasioned by the proposed transfer. The Court of Appeals found, in *State of North Carolina ex rel. Utilities Commission v. Village of Pinehurst,* 99 NC App. 224, 393 S.E.2d 111 (1990)*, aff'd* 331 NC 278, 415 S.E. 2d 199 (1992), that "the Commission is required to make inquiry into all aspects of anticipated service and rates occasioned by the proposed transfer."

The Commission is not persuaded by Red Bird's argument that the amendments to N.C.G.S. § 62-111 limit the Commission's consideration of financial issues such that an acquisition adjustment and/or due diligence expense should be ignored at the time of transfer or that such considerations play no part in determining whether the transfer is in the public interest. There is no evidence that the new statutory provisions constrain the purview of the Commission's review of transfer applications. An integral provision in the statute is that the Commission shall allow the transfer of a utility system if it is found that the transfer is in the public interest.

The Commission finds the Public Staff's arguments convincing as they are supported by the evidence in this case and longstanding practices in transfer proceedings, some of which were referenced by witness Franklin. The Commission finds persuasive and sensical the Public Staff's position that the public interest cannot be determined without consideration of the known and anticipated costs that the utility proposes to be passed on to the ratepayers.

During the public hearings held in this proceeding on November 1, 2023, and in the numerous statements of position filed in these dockets, Etowah customers stressed that they were concerned about the impact of the transfer on future rates, notwithstanding the fact that Red Bird intends to initially charge current rates. The first public witness who testified at the hearing, Ms. Julie Brandt, stated that, "Instead of the base fee we pay now, we understand it will significantly go up. Possibly triple. There was nothing included to show the proposed rates 33 months after acquisition." Tr. vol. 1, 16. The other customers who testified expressed the same concern regarding the uncertainty of a potential rate increase and the possibility that the future rates would include all of the costs sought by Red Bird and increase as large as projected by witness Franklin. The customers indicated, based on the Public Staff's projections, that they were not in favor of the transfer. *Id.* at 16-17, 22.

Red Bird witness Cox acknowledged that future increases in customer rates would be important to ratepayers. Commissioner Hughes asked witness Cox, "Would you agree, that—that the public is quite interested in what their longtime payment for water and sewer services are going to be? That that is something that they're at least interested in?" Tr. vol. 2, 175. Witness Cox responded, "Absolutely, sir." *Id.*

When questioned by Commissioner McKissick as to why the Commission should not establish rate base in this proceeding, witness Cox responded, "We don't believe all the details are in on—on this." *Id.* at 162-63. In response to cross-examination from the Public Staff as to why Red Bird would close on the Etowah transfer without first receiving the Commission's decision on the amount of acquisition adjustment, witness Cox stated that Red Bird would like to have the opportunity at a future date to present evidence to the Commission that under Red Bird ownership "the public good was necessitated" and customers have benefitted before any rate increases were implemented. *Id.* at 75-76. Witness Cox further stated that at this time "all the facts are not in, in terms of how – how bad the system really is, how much improvements have to be made, how much benefit [Red Bird] will bring to customers".

The Commission is not persuaded by Red Bird's argument that determination of rate base and review of expenses would be premature because all pertinent information to establish rate base and final costs will not be available until closing or later. Commissioner Duffley questioned whether it is typical that access to invoices and other supporting information is provided during the due diligence period. Tr. vol. 3, 32. Witness Theis responded affirmatively. *Id.* Additionally, Commissioner Duffley noted that Red Bird had updated its rate base twice as of the date of the hearing to the amount of $423,561 and asked whether that number was accurate. *Id.* at 32-33. Witness Thies stated that while he thought that Red Bird's rate base number was accurate, there might be accumulated depreciation missing. *Id.* at 33. Witness Thies again contended that definitive information about the utility assets is not available until after Red Bird takes ownership and begins to operate the new system, particularly with small systems. *Id.* Commissioner Duffley then asked what the percentage change in calculations would be once Red Bird owned the system versus the prepurchase calculations. *Id.* at 34. Witness Thies estimated the typical range to be only a 5 to 10 percent difference. *Id.* Contrary to Red Bird's assertion, the evidence shows that the Company has all pertinent information needed to set rate base and the possible difference in expenses is minimal.

The Commission also is not persuaded by any claim that Red Bird would be harmed or prejudiced if the Commission determines the rate base and due diligence costs in this transfer proceeding. Red Bird witness Cox testified that if the Commission denied all the due diligence costs and the acquisition adjustment then Red Bird's investors would bear the loss. He further stated, "nothing happens in terms of benefits to customers, nothing happens to quality of service, any of those items." Tr. vol. 2, 170-71. Witness Cox acknowledges that Red Bird was aware that the practice in North Carolina is to establish rate base in transfers. The Commission notes that the regulatory practices in other jurisdictions in which Red Bird operates have no bearing on the decision rendered in this proceeding.

The Public Staff also states in support of its position that deferring determination of rate base until Red Bird's first general rate case would unnecessarily add complexity to the rate case, especially if the Company proposes to consolidate the rates of its other acquired systems. It has been the Public Staff's historical practice to use the Commission-approved rate base, rates, and revenues from the most recent prior rate or transfer proceeding as a starting point for the utility's next rate or transfer case, and the Commission has accepted use of this methodology. *Id.* at 222, 298. Public Staff witness Feasel testified that this procedure was also used in this docket. *Id.* at 194, 243. The Commission also agrees with the Public Staff's concern regarding the increased complexity that would be created if it defers until the general rate case adjudication of issues that have occurred since the last rate case when the utility was in the hands of the previous owner who may be unavailable to provide and substantiate information that affects the rate base established in its last rate case.

In light of the facts and circumstances of this case and tenets of statutory construction, the Commission concludes that the recent amendments to N.C.G.S § 62-111 do not limit the Commission's duty to consider other issues that affect the interests of the ratepayers such as the potential impact on future rates, in addition to ensuring that the purchaser of the utility has the technical, managerial and financial capability to acquire the utility. The Commission further concludes that in order to make a determination regarding whether the transfer of the Etowah wastewater system is in the best interest of the Etowah ratepayers, the Commission must determine the rate base and, therefore, should also consider the issues of an acquisition adjustment, due diligence expenses, and transactional expenses, which, as part of this transfer proceeding, will impact the future rates of ratepayers.

Based upon the competent, substantial, and material evidence in the record, the Commission concludes that it is reasonable, appropriate, and necessary for the Commission to evaluate and establish the rate base of the utility when it is transferred to a purchaser, and to determine whether an acquisition adjustment is justified and whether some portion of the due diligence costs and other expenses should be allocated to customers.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 16

The evidence and legal bases supporting this finding of fact are found in the verified Application, the testimony of Red Bird witness Cox and Public Staff witnesses Franklin and Feasel, and the records of the Commission.

As a general proposition, when a public utility buys assets that have previously been dedicated to public service as utility property, the acquiring utility is entitled to include in rate base the lesser of the purchase price or the net original cost of the acquired facilities owned by the seller at the time of the transfer. *See* Order Approving Transfer and Denying Acquisition Adjustment, *Petition of Utilities, Inc. for Transfer of the Certificate of Public Convenience and Necessity for Providing Sewer Utility Service on North Topsail Island and Adjacent Mainland Areas in Onslow County from North Topsail Water and*

Sewer, Inc. and for Temporary Operating Authority, Docket No. W-1000, Sub 5, 24 (N.C.U.C. Jan. 6, 2000) (W-1000, Sub 5 Order).

The Commission has indicated "a strong general policy against the inclusion of acquisition adjustments in rate base subject to exceptions in appropriate instances." *Id*. In the W-1000, Sub 5 Order, the Commission discussed the circumstances when the rate base treatment of acquisition adjustments is proper. The Commission stated:

> As should be apparent from an analysis of the Commission's previous Orders concerning this subject, a wide range of factors have been considered relevant in attempting to resolve this question, including the prudence of the purchase price paid by the acquiring utility; the extent to which the size of the acquisition adjustment resulted from an arm's length transaction; the extent to which the selling utility is financially or operationally "troubled;" the extent to which the purchase will facilitate system improvements; the size of the acquisition adjustment; the impact of including the acquisition adjustment in rate base on the rates paid by customers of the acquired and acquiring utilities; the desirability of transferring small systems to professional operators; and a wide range of other factors, none of which have been deemed universally dispositive. Although the number of relevant considerations seems virtually unlimited, all of them apparently relate to the question of whether the acquiring utility paid too much for the acquired utility and whether the customers of both the acquired and acquiring utilities are better off after the transfer than they were before that time. This method of analysis is consistent with sound regulatory policy since it focuses on the two truly relevant questions which ought to be considered in any analysis of acquisition adjustment issues. It is also consistent with the construction of G.S. 62-111 (a) adopted in State ex rel. Utilities Commission v. Village of Pinehurst, 99 N.C App. 224, 393 S.E.2d 111 (1990), aff'd 331 N.C. 278, 415 S.E.2d 199 (1992), which seems to indicate that all relevant factors must be considered in analyzing the appropriateness of utility transfer applications. As a result, . . . the Commission should refrain from allowing rate base treatment of an acquisition adjustment unless the purchasing utility establishes, by the greater weight of the evidence, that the price the purchaser agreed to pay for the acquired utility was prudent and that both the existing customers of the acquiring utility and the customers of the acquired utility would be better off [or at least no worse off] with the proposed transfer, including rate base treatment of any acquisition adjustment, than would otherwise be the case.

Id. at 27.

In the present case, Red Bird Witness Cox testified that Red Bird determined that the purchase price was prudent because it was the only price that the acquired utility would accept. Tr. vol. 2, 61. Witness Cox's justification of the purchase price relies on the incorrect assertion that the Etowah wastewater utility system is troubled or distressed. However, that reliance is misplaced due to the absence of supporting evidence that the system is troubled and is contrary to the report of Red Bird's own expert, i.e., the McGill Report.

During cross examination, Witness Cox admitted that Red Bird did not provide the Public Staff with information, requested in discovery, relating to the initial offer and any subsequent counter offers. *Id.* at 69. Rather, Red Bird responded that it did not have any information responsive to the Public Staff's discovery request. Further, since the initial purchase agreement in 2019, witness Cox indicated that Red Bird has made no attempt to renegotiate the purchase price to account for depreciation in plant assets. *Id.* at 71.

Public Staff witness Feasel testified that the estimated revenue requirements would be $129,356 if the acquisition adjustment calculated by the Public Staff is included in rate base. *Id.* at 196. Public Staff witness Franklin testified that the resultant impact to rates would be a $22.23 increase in residential monthly wastewater flat rates and commercial metered monthly base charge, which is equivalent to an 84% increase. *Id.* at 217-18.

Based on the evidence in this proceeding and well-established precedent, the Commission concludes that approval of an acquisition adjustment is not in the public interest. The Commission notes that Red Bird's initial position in this case was to request rate base treatment of an unspecified "reasonable portion" of the acquisition premium. *Id.* at 47. The Commission further concludes that Red Bird has not established that the price it has contracted to pay was reasonable and that the benefits to Etowah's customers resulting from the allowance of rate base treatment of an acquisition adjustment in this case would offset or exceed the resulting burden or harm to customers associated therewith, including but not limited to the future rate impact of the acquisition adjustment. Further, as discussed and concluded herein, the Commission does not find the Etowah wastewater system to be a troubled system; consequently, the inclusion of an acquisition adjustment in rate base is not justified.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 17

The evidence supporting this finding is the testimony of Public Staff witness Franklin, Confidential Attachment L of the verified Application, and the Commission's records in these and other dockets relating to Etowah.

Public Staff witness Franklin testified that the Public Staff's Consumer Services Division did not receive any customer complaints regarding the Etowah wastewater system between October 1, 2020, and October 9, 2023. *Id.* at 208. Witness Franklin also testified that as of October 27, 2023, six customers filed consumer statements of position about the proposed transfer, but none complained of issues with Etowah's service.

Additionally, since October 27, 2023, the Public Staff received seven additional consumer statements after the filing of the Public Staff's testimony, but all seven expressed concerns over future rate increases as a result of the transfer and not about the quality of their utility service. *Id.* at 200.

Public Staff Witness Franklin testified that on October 12, 2023, he visually inspected the wastewater system while accompanied by a representative of Etowah's maintenance contractor, A & D Maintenance, Inc. Based on his observations and expertise, the wastewater system appeared to be in fair condition. These finding were in agreement and consistent with the condition of the wastewater system as stated in Confidential Attachment L of the Joint Application, McGill Associates Engineering Memorandum, Appendices A-1 and A-2, which were based on inspections performed on December 4, 2019. Witness Franklin acknowledged that while there are areas of the wastewater collection and treatment system that need improvement, most areas were determined by the Public Staff and Red Bird's engineer, McGill, to be in either good or average condition. *Id.* at 204. Witness Franklin concluded that based on his investigation and the recent performance of the wastewater system, including the lack of customer complaints, the routine maintenance performed, and recent improvements made by Etowah as discussed below, Etowah is providing safe and reliable service to its customers of the Etowah wastewater system. *Id.* at 211.

Based upon competent, substantial, and material evidence in the record, the Commission concludes that Etowah is providing safe and reliable service to its customers.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 18

The evidence for this finding of fact is found in the direct testimony and rebuttal testimony of Red Bird witness Cox and the testimony of Public Staff witness Franklin.

In his direct testimony, Red Bird witness Cox testified that the Etowah wastewater system is operationally distressed, troubled, and in need of capital investment. *Id.* at 27-28. During the evidentiary hearing, witness Cox explained that the Etowah system's poor operations history clearly indicates that the Etowah system is troubled or distressed. *Id*. at 56-58. For example, witness Cox explained that the Etowah system has been out of compliance with its wastewater discharge permit for "almost the entirety of the last five years." *Id*. at 56. Additionally, witness Cox testified that since 2020, when Red Bird entered into the contract to acquire the Etowah System, there have been eleven notices of violation (NOV) and many more instances of non-compliance. *Id*. Witness Cox testified that "any NOV is a failure . . . [and] when you have repeated failures of the same constituents, it shows the plant is not able to meet [its permit requirements]." Tr. vol. 3, 37. Witness Cox further noted that these repeated violations tell "everyone in the wastewater business, hey, this activated sludge plant is not really equipped to treat the waste down to the level it's required and on a consistent basis." *Id*. at 38.

Public Staff witness Franklin testified that there were no recent customer complaints regarding the performance of the wastewater system, and Etowah had performed routine maintenance and made recent improvements. Tr. vol. 2, 211. He

explained that the recent improvements include replacement of pumps at Sunset Ridge and the Main lift stations, installation of shut off valves at Homeplace and Jonathan Creek lift stations, and installation of additional diffuser leads to drop pipes at the WWTP. *Id.*

While there is evidence that the system has recently been issued NOVs, witness Franklin pointed out that during the three-year period between September 1, 2020, and October 1, 2023, the WWTP had a rate of 90.85%, and the wastewater collection system had a rate of 96.8%, for the number of days in regulatory compliance. *Id.* at 209. Furthermore, he noted that these NOVs associated with the WWTP had been closed, and Etowah has addressed the collection system violations identified in the January 2023 Compliance Inspection Report. *Id.* at 211-12. Witness Franklin testified that Etowah's response to DEQ's Compliance Inspection identifies actions taken to address the violations identified by DEQ, thus demonstrating that Etowah has the willingness, ability, and means to address them. Accordingly, he does not conclude the Etowah is troubled or distressed. *Id.* at 216

In his rebuttal testimony, Red Bird witness Cox disagreed with witness Franklin's operational assessment of the Etowah System. Witness Cox reiterated that the poor condition of the Etowah System facilities, combined with Etowah's substandard operations history, qualify the Etowah System as operationally distressed. *Id.* at 268.

In Docket No. W-1000, Sub 5, the Commission discussed the characteristics of a troubled system.

> The evidence supports the conclusion that NTWS management routinely makes prudent use of its available capital resources to provide an adequate quality of service to its customers. Furthermore, the NTWS system does not suffer from various system deficiencies, ongoing environmental regulatory violations and frequent customer complaints that typify operationally troubled systems. The Commission finds and concludes that the facilities owned and operated by NTWS are in satisfactory condition and are currently sufficient to provide sewer utility service to the customers. Without some evidence of inadequate service currently or in the recent past, the Commission cannot conclude that NTWS is operationally troubled. The record in this case is devoid of such evidence. Accordingly, the Commission concludes that NTWS is not an operationally troubled system.

Id. at 21.

Similarly, this case is devoid of evidence of various system deficiencies, ongoing environmental regulatory violations, and frequent customer complaints that typify operationally troubled systems either currently or in the recent past. As such, the Commission does not conclude that Etowah is operationally troubled.

In his rebuttal testimony, Red Bird witness Cox testified that Etowah is a financially distressed utility that does not have the capital, or access to capital, to maintain and

improve its system. Tr. vol. 2, 275-76. Additionally, during the expert witness hearing, witness Cox provided detailed testimony supporting the notion that Etowah is "unbankable" – that is, Etowah does not have access to commercial financing or institutional loan money to raise the funds necessary to invest in its system. *Id.* at 158. During his live testimony, witness Cox also testified that over the last five years, there have been basically no additions to plant in service. *Id.* at 56.

The Commission acknowledges that Etowah has been seeking to sell its wastewater utility system since at least 2016,[3] which most likely accounts for the lack of significant capital improvements to the wastewater system in recent years. Moreover, the Commission finds the testimony of Public Staff witness Franklin persuasive in that while there have been recent operational incidents at both the WWTP and the wastewater collection system, Etowah has demonstrated the willingness, ability, and means to address them. Consequently, the Commission concludes based on the evidence in the record that Etowah is not financially troubled, and in particular, not troubled to an extent that would justify inclusion of an acquisition adjustment in rate base.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 19-20

The evidence supporting these findings of fact is found in the direct testimony and exhibits of Red Bird witness Cox and Public Staff witnesses Franklin and Feasel and the rebuttal testimony of Red Bird witnesses Cox and Beckemeier.

In his direct testimony, Company witness Cox explained that after entering into an asset purchase agreement, Red Bird hired McGill to perform a preliminary survey and analysis of the water and/or wastewater system. *Id.* at 42. Witness Cox indicated that he was surprised to learn that it has been Commission practice to establish rate base and the purchaser's due diligence costs associated with a transfer. *Id. at* 50. He noted that the total due diligence and transactional costs associated with the transfer would not be known until the purchase actually closes. *Id. at* 51. Witness Cox indicated that the due diligence activities for Etowah included surveying work, legal title work, preliminary civil engineering work, environmental compliance site surveys, and accounting, totaling $317,269.22 as of the date of the filing of his direct testimony. *Id.* Witness Cox explained that due diligence gives preliminary insight to a potential purchaser regarding the system's condition and problems to be addressed, though all issues would not be known until Red Bird begins operating the acquired utility. He testified that due diligence also includes ensuring that clear title can be acquired and determining the required future capital investments. Witness Cox also pointed out that after due diligence, Red Bird has declined to proceed with some transactions that would not be in the best interests of CSWR or ratepayers.

[3] See Application for Transfer of Public Utility System (to owner exempt from regulation) filed on July 21, 2016, in Docket No. W-933, Sub 11. See also Order Rescinding Commission's Order Approving Transfer to Owner Exempt and Requiring Customer Notice issued on March 26, 2018, in that same docket.

During cross examination, Witness Cox was shown certain redacted invoices from 21 Design provided by Red Bird to the Public Staff in discovery. Tr. vol. 2, 80; Public Staff Cox Direct Cross Exhibit 1. Witness Cox noted that Red Bird receives unredacted invoices from vendors. *Id*. Witness Cox also conceded on cross examination that certain invoices provided to the Public Staff to support Red Bird's due diligence costs did not appear to be related to Etowah, which seemed to be a mistake. *Id.,* Public Staff Cox Direct Cross Exhibit 2. He also was unable to determine whether certain other invoices provided to the Public Staff were actually related to Etowah. Tr. vol. 2, 81-82; Public Staff Cox Direct Cross Exhibit 3. In reviewing an invoice from McGill, who conducted engineering due diligence, witness Cox admitted that McGill's billing codes did not necessarily line up with its activities. Tr. vol. 2, 84; Public Staff Cox Direct Cross Exhibit 3. When witness Cox reviewed certain heavily redacted legal invoices provided to the Public Staff by Red Bird in discovery, he was unable to identify the legal work being invoiced. Tr. vol. 2, 89-90; Public Staff Cox Direct Cross Exhibit 4. Witness Cox stated that if Red Bird were seeking to recover the due diligence costs in this proceeding, it would have provided more detailed documentation. Tr. vol. 2, 91.

While witness Cox's direct testimony indicated that due diligence costs would be shared between ratepayers and shareholders, he testified on cross-examination that the due diligence costs were beneficial to ratepayers and thus the costs that directly relate to providing service to ratepayers, such as costs related to engineering (GIS mapping, asset inventories, and plans), should be recovered from ratepayers. *Id.* at 99-101. Witness Cox admitted that if the Commission denies recovery of Red Bird's due diligence costs, Red Bird's shareholders would bear those costs. *Id.* at 171.

Public Staff witness Franklin stated that the invoices provided by Red Bird to support its due diligence costs were heavily redacted with missing, vague, or uninformative descriptions of the work performed. *Id.* at 219. He recommended that $10,000 of due diligence and transactional costs be included in rate base and that the remainder be absorbed by Red Bird's shareholders as a cost of doing business. *Id*. at 220. Witness Franklin testified that due diligence expenses are typically limited to transaction closing costs and are generally less than $10,000. His recommendation of $10,000 for due diligence expense is consistent with previous transfer applications, including those in Docket No. W-354, Sub 396, where the Public Staff recommended due diligence expenses of $8,229 be included in rate base, and Docket No. W-218, Sub 527, where the Public Staff recommended, and the Commission approved, the inclusion of $4,000 in attorney fees in rate base. Tr. vol. 2, 222.

Witness Franklin testified that the Commission cannot determine whether the transfer is in the public interest if it does not know the impact to rate base and customer rates of the acquiring utility's due diligence expenses. *Id.* at 249. Additionally, witness Franklin noted that Red Bird has indicated that in its first general rate case it would seek uniform rates. He stated that deferring the decision on the inclusion of due diligence expenses for multiple utility systems to a future rate case would unduly complicate the rate case proceeding. Witness Franklin indicated that the majority of the due diligence expenses are known and deferring a decision would not be in the public interest and

would be inconsistent with Commission precedent. *Id.* at 221-22. Witness Franklin testified that he was unaware of any other transfer case where the due diligence costs were not set by the Commission in that proceeding. *Id.* at 248. Witness Franklin testified that inclusion in rate base of Red Bird's due diligence costs would result in a $6.42 per month increase in residential monthly wastewater flat rates and commercial metered monthly wastewater base charge, zero usage rates, which would be equivalent to a 24% increase in residential monthly wastewater flat rates and commercial metered monthly wastewater base charge, zero usage rates. *Id.* at 220.

In his rebuttal testimony, Red Bird witness Cox stated that all the due diligence costs that Red Bird incurred are a necessary part of the transaction. Red Bird's estimated due diligence costs include costs associated with engineering, valuation, and legal assessments conducted in pursuit of the underlying acquisition. *Id.* at 280. He pointed out that due diligence costs were incurred to provide information required by the Commission's application regarding major replacements required in the next five and ten years, as well as to establish that the buyer can obtain control of all real property and clear title. *Id.* at 281. Witness Cox noted that the Public Staff proposed to amortize due diligence expenses over 27.74 years, while the Company proposed a 50-year period, consistent with the Company's proposed depreciation period. *Id.* at 303-04. Company witnesses Cox and Beckemeier described the extensive due diligence and transactional work required to acquire the Etowah system. *Id.* at 308-17.

The Commission understands that an acquiring utility must incur certain due diligence and transactional costs in order to consummate a transfer. As discussed previously, the Commission agrees with Public Staff witness Franklin that these costs must be considered in the Commission's determination as to whether a transfer is in the public interest. Deferring consideration of due diligence and legal costs to be included in rate base until a future rate case, especially when Red Bird will likely be seeking to establish uniform rates for multiple newly acquired small utilities, is not appropriate.

As of the filing of witness Cox's direct testimony, Red Bird asserts that it had incurred due diligence and legal costs in excess of $300,000, and that additional costs continue to be incurred. If the transfer is approved, Red Bird has indicated it will seek to recover those costs from ratepayers because the ratepayers should pay all the costs that are beneficial to them as customers of the utility. *Id*. at 100. The Commission finds that these costs provide a benefit to Red Bird allowing it to estimate the amount of capital that will be required to operate and maintain the system, discover legal defects to the title, and understand the operational issues specific to Etowah. Additionally, Red Bird gains valuable information regarding whether it would be beneficial for the Company to proceed with the transaction. If the transaction is consummated, the Commission acknowledges that ratepayers may also benefit from incurrence of these costs to the extent they are reasonably and prudently incurred and depending on the portion ratepayers must bear. Witness Franklin testified that the preliminary estimate of these costs provided in Cox Direct Exhibit 4 would significantly increase customer rates if the system were operated as a standalone utility. Accordingly, it would not be in the public interest to allocate all of these costs to ratepayers, as the benefits are shared by both the Company and

ratepayers. Thus, the Commission must determine the proper allocation of these costs to be included in rate base.

In determining the appropriate allocation of these costs, the Commission considers the quality of the responses provided to the Public Staff in its investigation. The evidence shows that Red Bird provided the Public Staff with heavily redacted invoices without adequate information to support them and some invoices that appeared to contain charges not related to this case. *See* Cox Direct Cross Exhibits 2-4. The Commission finds that these insufficient responses serve as obstacles preventing the Public Staff from conducting its investigation. The Commission understands redaction and assertion of privilege may be necessary, but Red Bird should strive to provide responses that are responsive to the Public Staff's requests and provide adequate information or properly assert privilege or reasons to withhold information. The Commission is also troubled by witness Cox's statement that Red Bird would have provided more detailed responses if it were seeking to recover the due diligence costs in this proceeding. Tr. vol. 2, 91. Red Bird should respond to discovery fully in accordance with statutes, Commission rules, and Commission orders. Red Bird cannot unilaterally choose its level of responsiveness based on what it seeks in a proceeding.

Based upon the competent, substantial, and material evidence in the record, the Commission finds it appropriate in this case to include in rate base $10,000 of Red Bird's due diligence costs and other transactional costs included on Cox Direct Exhibit 4 as recommended by Public Staff witness Franklin. The Commission acknowledges that, in the instant dockets, the Public Staff was unable to audit the due diligence expenses because Red Bird provided redacted invoices. The Commission directs Red Bird to provide unredacted invoices pertaining to the due diligence costs and other transactional costs listed in Cox Direct Exhibit 4, related to the Etowah transfer that benefit Etowah's customers, to the Public Staff in its first general rate case. The Commission directs the Public Staff to conduct a comprehensive audit of these expenses and determine whether any amount above the $10,000 approved herein should be recovered from customers in Red Bird's first general rate case. In making its recommendation to the Commission concerning engineering due diligence work listed in Cox Direct Exhibit 4, the Public Staff should consider whether the work performed results in reasonable and prudent capital investments to improve the wastewater system.

Further, the Commission finds that Red Bird's due diligence costs and other transactional costs should be amortized over a period of 27.74 years and the amortization of these costs should begin in the month that the transfer of the Etowah wastewater system to Red Bird is closed.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 21

The evidence in support of this finding of fact can be found in the verified Application, the testimony and exhibits of Red Bird witnesses Cox and Thies, the testimony and exhibits of Public Staff witnesses Feasel and Franklin, and the entire record in this proceeding.

Red Bird witness Cox provided testimony regarding Red Bird's rate base components, including the value of the utility assets, acquisition adjustment, and due diligence expenses. Tr. vol. 2, 21, 47, 53. Witness Cox testified that, based on Red Bird's audit of supporting documentation and its understanding of the Public Staff's valuation, it believes the rate base value of assets to be acquired is $277,423. *Id.* at 43.

Public Staff witness Feasel testified that the original cost rate base of the Etowah system is ($282,207). Tr. vol. 2, 194. Witness Feasel explained that she made her calculation of rate base by taking the net book value approved in the prior rate case proceedings for Etowah in Docket Nos. W-933, Sub 7 (Sub 7) and W-933, Sub 9 (Sub 9), and updating the accumulated depreciation through December 31, 2023, for the plant balance approved in the prior rate cases. Next, she added plant additions since the last rate case for which supporting documentation was provided, and removed items that should have been expensed instead of capitalized based on Public Staff witness Franklin's recommendation. She then added contributions in aid of construction (CIAC) that Etowah had received since the Sub 9 proceeding and updated accumulated depreciation through December 31, 2023, utilizing the depreciation rates recommended by witness Franklin and the amortization rates approved by the Commission in Sub 7 and Sub 9. *Id*.

Red Bird witness Thies stated in his rebuttal testimony that the final rate base determination can and should be deferred to the first rate case proceeding involving the Etowah System where necessary evidence will be available to determine the revenue requirement and to establish the appropriate rate design. *Id.* at 302. Witness Thies also testified to the differences in the Public Staff and Red Bird's rate base calculations, including differences in depreciation rates and lives, and further testified that depreciation changes should also be addressed in a rate case proceeding to allow for further evaluation and the completion of depreciation studies. *Id.* at 300.

The Commission finds the methodology employed to calculate the Public Staff's recommended original cost rate base of ($282,207) to be reasonable, appropriate, and supported by the evidence, and is approved for use in this proceeding. The Commission declines to adopt Red Bird's proposed change to its usual practice of determining rate base at the time of a transfer proceeding. Red Bird's current proposal is unlikely to yield significant new documentation related to plant investment since the prior general rate case and would unnecessarily complicate the future general rate case in which Red Bird proposes to establish rate base.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 22

The evidence supporting this finding of fact is contained in the verified Application, the testimony of Public Staff witness Franklin, and the rebuttal testimony of Red Bird witness Cox.

Public Staff witness Franklin recommended that Red Bird post a $200,000 bond based on Red Bird's lack of history of operations and management in North Carolina, the

large customer base, the system improvements planned by Red Bird, and the size of the WWTP and wastewater collection system. Tr. vol. 2, 224.

Session Law 2023-137, Section 24 revised N.C.G.S. § 62-110.3(a) to require a bond "in an amount not less than twenty-five thousand dollars ($25,000)," representing an increase in the minimum bond amount required from ten thousand dollars ($10,000). In addition, N.C.G.S. § 62-110.3 has historically required that the bond, "shall be conditioned upon providing adequate and sufficient service within all the applicant's service areas." Further, N.C.G.S. § 62-110.3(a) provides:

> In setting the amount of a bond, the Commission shall consider and make appropriate findings as to the following:
>
> (1) Whether the applicant holds other water or sewer franchises in this State, and if so its record of operation;
>
> (2) The number of customers the applicant now serves and proposes to serve;
>
> (3) The likelihood of future expansion needs of the service;
>
> (4) If the applicant is acquiring an existing company, the age, condition, and type of the equipment; and
>
> (5) Any other relevant factors, including the design of the system.

Witness Franklin testified that Commission Rules R7-37 and R10-24 restate and reaffirm these provisions and requirements although the Commission Rules have not yet been updated to reflect the revised bond amount required by N.C.G.S. § 62-110.3. He stated that a sufficient bond amount is required to ensure the continued provision of adequate and sufficient wastewater services in the event a wastewater utility is unable to provide such service due to financial constraints, mismanagement, or other factors. Witness Franklin explained that the factors the Commission must take into consideration as set forth in N.C.G.S. § 62-110.3(a)(1) – (5) make clear that the bond amount depends heavily on the applicant's financial, managerial, and technical expertise; the applicant's prior performance, if any; the number of current and projected future wastewater customers; system expansion plans and needs; the complexity of the applicant's system and facilities; and any other factors that bear upon the risk of the applicant providing inadequate, inconsistent, or insufficient wastewater services. He indicated that N.C.G.S. § 62-110.3 and Commission Rule R10-24 make it clear that a higher risk of deficient wastewater services necessitates a higher bond amount.

In his rebuttal testimony, Company witness Cox stated that Red Bird finds the Public Staff's bond recommendation to be excessive. Tr. vol. 2, 286. He noted that witness Franklin's response to a Red Bird data request stated that bond recommendations were not based on a mathematical formula and witness Franklin was

therefore unable to provide workpapers that quantified the Public Staff's factors in reaching its bond recommendation. *Id.* Witness Cox acknowledged that Red Bird does not have a history of operating utilities in North Carolina but emphasized that it nonetheless has significant operating and managerial experience owning and operating water and wastewater systems across its affiliate groups[4]. *Id*. at 287. He reiterated his direct testimony that Red Bird's affiliate groups own and operate facilities in ten other states and provide wastewater service to more than 200,000 customers and water service to more than 130,000 customers. Witness Cox added that the affiliate systems are successfully serviced and maintained by third-party operations and maintenance contractors hired to perform these services, and its North Carolina operations mirror those in the other states mentioned. *Id.* at 286-87. He further stated that, "there is no reason for the Commission - or the Public Staff - to believe Red Bird's performance here will be of lesser quality than its affiliates' performance elsewhere." *Id.* at 288. Additionally, witness Cox testified that according to Etowah's 2022 Annual Report, the bond currently required for the Etowah system is $20,000 and the Public Staff's recommendation is ten times the current bond amount. *Id*.

Based upon the competent, substantial, and material evidence in the record, the Commission finds that Red Bird has the technical, managerial, and financial capability to operate the Etowah wastewater system; however, Red Bird is new to the state and, by its own admission, does not have a history of operations and management in North Carolina. As noted by the Public Staff, the Etowah sewer system has a large customer base, there are significant improvements planned by Red Bird, and the size of the WWTP and wastewater collection system are substantial. Based on these factors, a greater bond amount than the statutory minimum is necessary to ensure the continued provision of adequate service if Red Bird is unable to continue providing service due to financial constraints, mismanagement, or other factors. The Commission therefore finds it reasonable and appropriate based on the specific circumstances of this proceeding that a bond of $100,000 should be posted by Red Bird.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 23

The evidence supporting this finding of fact is found in Red Bird's verified Application and supplemental filings; the testimony and exhibits of Red Bird witnesses Cox, Thies, and Beckemeier; the testimony and exhibits of Public Staff witnesses Franklin, Feasel, and Hinton; and the entire record in this proceeding.

In his direct testimony, Red Bird witness Cox testified that Red Bird has the financial, technical, and managerial ability to: acquire, own, and operate the Etowah system in a manner that fully complies with applicable health, safety, environmental protection, and regulatory laws and regulations; and to provide reliable, safe, and adequate service to customers. Tr. vol. 2, 30-31. Additionally, he testified that Red Bird

[4] Witness Cox was not accurate in his testimony regarding Red Bird's experience. The record reflects that Red Bird does not operate any water or wastewater utilities in states other than North Carolina, but instead, CSWR, its affiliate, has significant operating and managerial experience with regard to ownership and successful operation of water and wastewater systems across its affiliate groups.

is part of an affiliate group that has acquired and currently operates over 800 water or wastewater utility systems in other states and currently provides service to approximately 221,000 wastewater customers and over 146,000 water customers. *Id.* at 31-32.

In his direct testimony, Public Staff witness Franklin testified that Red Bird "has the financial, technical and managerial capabilities necessary to provide wastewater utility service to customers in Etowah's service area." *Id.* at 211. Public Staff witness Hinton also testified that based on his review of testimony and discovery responses provided by Red Bird, he believed Red Bird will have sufficient equity capital to acquire and improve Etowah's wastewater system, fund system upgrades, and support other capital improvements. *Id.* at 232. Witness Hinton noted, however, that the Public Staff had concerns regarding the ongoing viability of CSWR because it has reported losses on its consolidated income statements, and financial viability largely depends on external infusions of common equity largely provided by private equity. *Id.* Witness Hinton nonetheless stated that in view of the fact that witness Franklin and other Public Staff engineers are unaware of any plant and operational problems that stem from a lack of investment capital and based on Red Bird's business plan and record of acquiring water and sewer utility systems, he believed CSWR has sufficient capital resources to be considered financially viable. Witness Hinton noted, however, that Red Bird has not owned systems in North Carolina for very long and recommended that Red Bird meet with the Public Staff on an annual basis to discuss Red Bird's North Carolina water and wastewater operations and address any concerns with its financial condition. *Id.* at 233.

Based upon competent, substantial, and material evidence in the record, the Commission concludes that Red Bird has the technical, managerial, and financial capacity to provide adequate, safe, efficient, and reasonable sewer utility service on an ongoing basis to customers in the Etowah service area.

CONCLUSION

The Commission concludes that: (1) Red Bird's adoption of Etowah's existing rates should be approved effective upon the date of closing on the transfer; (2) Red Bird shall post a $100,000 bond for the Etowah service area prior to closing and provide the original bond documents to the Commission's Bond Administrator for acceptance and filing prior to closing; (3) Red Bird shall provide written notice to the Commission within three business days of closing that closing of the sale of the Etowah system has been completed; (4) upon closing of the transfer, Red Bird shall be granted a CPCN to provide wastewater utility service to the Etowah service area; (5) Red Bird shall adopt Etowah's accounting records upon closing, provide the detailed accounting records so received to the Public Staff, and make no adjustment or changes to those records without Commission approval; and (6) Red Bird shall provide notice to customers that the franchise has been granted and that the existing rates have been approved.

Consistent with the recommendations of the Public Staff, the Commission also concludes that the rate base of the Etowah assets Red Bird will acquire is ($282,207) and that no acquisition adjustment related to this transfer should be recovered in this

proceeding, Red Bird's first general rate case, or any future proceedings. Further, the Commission concludes that an amount of $10,000 in due diligence and transactional costs as recommended by the Public Staff should be included in the rate base established in this proceeding. However, the Commission directs Red Bird to provide the Public Staff unredacted supporting invoices supporting the expenses included on Cox Direct Exhibit 4 such that the Public Staff may conduct a comprehensive audit of all expenses in Red Bird's first general rate case and determine whether any amount above the $10,000 approved herein should be recovered from customers. In making its recommendation to the Commission concerning engineering due diligence work listed in Cox Direct Exhibit 4, the Public Staff should consider whether the work performed results in reasonable and prudent capital investments to improve the wastewater system.

Finally, the Commission concludes that that Red Bird's due diligence costs and other transactional costs should be amortized over a period of 27.74 years, and the amortization of these costs should begin in the month that the transfer of the Etowah wastewater system to Red Bird is closed.

IT IS, THEREFORE, ORDERED as follows:

1. That the Application for Transfer of Public Utility Franchise and for Approval of Rates, jointly filed on October 8, 2020, by Red Bird and Etowah is hereby approved;

2. That Etowah is hereby authorized to transfer its wastewater utility system and public utility franchise serving the Etowah Community in Henderson County, North Carolina, to Red Bird;

3. That Red Bird is granted a Certificate of Public Convenience and Necessity to provide wastewater utility service in the Etowah service area, effective upon the closing of the transfer of the sewer utility system assets to Red Bird;

4. That Red Bird is hereby authorized to adopt and charge Etowah customers the present rates, fees, and additional charges approved in Docket Nos. W-933, Sub 10, and M-100, Sub 138, which have been in effect since January 1, 2016;

5. That the original cost rate base for the Etowah wastewater utility system assets shall be ($282,207) as of December 31, 2023;

6. That Red Bird shall not recover any purchase acquisition adjustment related to this transfer in this proceeding, the first general rate case proceeding, or any future proceeding;

7. That due diligence, legal, and transactional costs of $10,000 shall be included in rate base in Red Bird's first general rate case;

8. That whether any amount of due diligence and transactional costs above the $10,000 amount approved herein may be recovered from customers shall be determined in Red Bird's first general rate case;

9. That Red Bird's due diligence costs and other transactional costs shall be amortized over a period of 27.74 years, and the amortization of these costs shall begin in the month that the transfer of the Etowah wastewater system to Red Bird is closed;

10. That prior to closing, Red Bird shall post a bond in the amount of $100,000 for the Etowah sewer utility service area in a form acceptable to the Commission and in compliance with N.C.G.S. § 62-110.3, and shall provide the original bond documents to the Commission's Bond Administrator for filing;

11. That the Certificate of Public Convenience and Necessity granted to Etowah in Docket No. W-933, Sub 0 is cancelled effective on the date when Red Bird files with the Commission written notification that the closing of the transfer of the wastewater system has been completed;

12. That Etowah's surety bond held by the Commission shall be released to Etowah upon receipt of written notification to the Commission that closing of the transfer of the Etowah utility systems has been completed;

13. That Red Bird shall provide notification to the Commission within three business days of the date of closing that the sale of the wastewater utility systems serving the Etowah Service Area has been completed;

14. That within 30 days of the closing of the sale of the Etowah wastewater utility systems, Red Bird shall file in these dockets the warranty deed showing Red Bird's ownership of the required easements and all interests in land it has obtained in connection with the operation and maintenance of the Etowah wastewater utility system;

15. That Appendix A constitutes the Certificate of Public Convenience and Necessity;

16. That the Schedule of Rates, attached as Appendix B, is approved and deemed to be filed with the Commission pursuant to N.C.G.S. § 62-138 and is authorized to become effective for service rendered on and after the date of closing on the transfer; and

17. That the Notice to Customers, attached as Appendix C, shall be mailed with sufficient postage or hand delivered by the Applicant to all customers affected by the transfer no later than 15 days after the date of this Order, and that the Applicant shall submit to the Commission the attached Certificate of Service properly signed and notarized not later than 30 days from the date of this Order.

ISSUED BY ORDER OF THE COMMISSION.

This the 7th day of February, 2024.

NORTH CAROLINA UTILITIES COMMISSION

Taylor C. Berry, Deputy Clerk

Commissioner Kimberly W. Duffley did not participate in this decision.

STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. W-1328, SUB 0

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

RED BIRD UTILITY OPERATING COMPANY, LLC d/b/a RED BIRD WATER

is granted this

CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY

to provide wastewater utility service

to

ETOWAH COMMUNITY

in

Henderson County, North Carolina

subject to any orders, rules, regulations
and conditions now or hereafter lawfully made
by the North Carolina Utilities Commission.

ISSUED BY ORDER OF THE COMMISSION.

This the 7th day of February, 2024.

NORTH CAROLINA UTILITIES COMMISSION

Taylor C. Berry

Taylor C. Berry, Deputy Clerk

SCHEDULE OF RATES

for

RED BIRD UTILITY OPERATING COMPANY, LLC

for providing wastewater utility service to

ETOWAH COMMUNITY

Henderson County, North Carolina

Monthly Wastewater Utility Service:

Residential Flat Rate	$26.33
Commercial Customers (metered rates)	
Base Charge, zero usage	$26.33
Usage Charge, per 1,000 gallons	$ 4.05

Connection Charge

Residential	$2,300 per connection
Commercial	$2,300, minimum per connection, plus $6.97 per gallon of design flow over 330 gallons per day

Reconnection Charge:

If wastewater service cut off by utility for good cause	$14.99

Bills Due:	On billing date
Bills Past Due:	15 days after billing date
Billing Frequency:	Shall be monthly for service in arrears
Finance Charge for Late Payment:	1% per month will be applied to the unpaid balance of all bills still past due 25 days after billing date

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Issued in Accordance with Authority Granted by the North Carolina Utilities Commission in Docket No. W-1328, Sub 0 on this the 7th day of February, 2024.

STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

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

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of Joint Application by Red Bird Utility Operating Company, LLC d/b/a Red Bird Water and Etowah Sewer Company, Inc. for Transfer of Public Utility Franchise and for Approval of Rates	)))))	**NOTICE TO CUSTOMERS**

NOTICE IS HEREBY GIVEN that the Commission has approved the application by Etowah Sewer Company, Inc. (Etowah), P.O Box 1659, Etowah, North Carolina 28729-1659, and Red Bird Utility Operating Company, LLC d/b/a Red Bird Water (Red Bird), 1650 Des Peres Road, Suite 303, St. Louis, Missouri 63131, to transfer the Etowah wastewater utility system and public utility franchise, in Henderson County, North Carolina, from Etowah to Red Bird. The rates approved for Red Bird are the present rates charged by Etowah and approved by the Commission for Etowah in Docket Nos. W-933, Sub 10 and M-100, Sub 138, effective January 1, 2016.

Information regarding this proceeding and the Commission's Order approving the transfer can be accessed from the Commission's website at www.ncuc.gov under Docket Number "W-1328 Sub 0."

ISSUED BY ORDER OF THE COMMISSION.

This the 7th day of February, 2024

NORTH CAROLINA UTILITIES COMMISSION

Taylor C. Berry

Taylor C. Berry, Deputy Clerk

CERTIFICATE OF SERVICE

I,_____, mailed with sufficient postage or hand delivered to all affected customers copies of the attached Notice to Customers and Appendix B as issued by the North Carolina Utilities Commission in Docket Nos. W-933, Sub 12 and W-1328, Sub 0, and the said Notice to Customers and Appendix B were mailed or hand delivered by the date specified in the Order.

This the ____ day of _____, 2024.

By: _____
Signature

_____
Name of Utility Company

The above named Applicant, _____, personally appeared before me this day and, being first duly sworn, says that the required Notice to Customers and Appendix B was mailed or hand delivered to all affected customers, as required by the Commission Order dated _____ in Docket Nos. W-933, Sub 12, and W-1328, Sub 0.

Witness my hand and notarial seal, this the ____ day of _____, 2024.

_____
Notary Public

_____
Address

(SEAL) My Commission Expires: _____
Date

STATE OF TENNESSEE
DEPARTMENT OF ENVIRONMENT AND CONSERVATION
Division of Water Resources
Nashville Environmental Field Office
711 R.S. Gass Blvd.
Nashville, Tennessee 37216
Phone 615-687-7000 Statewide 1-888-891-8332 Fax 615-687-7078

August 2, 2024

Mr. Jeff Risden, Chief Executive Officer
Tennessee Wastewater Systems, Inc.
e-copy: jeff.risden@adenus.com
849 Aviation Pkwy
Smyrna, TN 37167

RE: Compliance Evaluation Inspection and Notice of Violation
Tennessee Wastewater Systems, Inc.
Permit #SOP-01028
Robertson County

Dear Mr. Risden,

On Wednesday July 3, 2024, Mrs. Christina Wingett and Mr. Michael Murphy, performed a Compliance Evaluation Inspection (CEI) on the Maple Green Reclamation Facility for compliance with State Permit SOP-01028, which became effective on July 1, 2023, and expires on June 30, 2028. This inspection covers July 2021 to July 2024. On site, they met with Mr. Tracy Nichols and Mrs. Jenny Nichols during the inspection. The Division of Water Resources (Division) would like to thank you and your staff for your time and courtesy shown while on site.

Permit and Records Review

Records are maintained at a central office. Copies of quarterly reports, contract lab data, and maintenance logs were provided via e-mail on July 3, 2024. No transcription errors were noted between sample data results and reports. There is concern over site visit frequency with the majority of months showing a visit, but it is out of a 30-day range. For example, the site may be visited on the first of one month and then not until the 22nd of the following month leaving a 52-day gap between site visits. In the permit, the default operations schedule states sites must be visited every 14 days at minimum and the modified operations and maintenance schedule shows monthly visits are expected. The Division defines monthly to be at least every 30 calendar days.

Review of maintenance records show a lack of necessary detail. When reviewing the inspection log, the following issues were noted: for June 1st through 26th, 2024 and July 1st through 11th, 2024,

no columns are filled in for the condition of the site. The column for "drip field fenced" is marked yes for the past three years when the fields are not fenced. The column for "drip field good" is marked yes for the previous three years when ponding was observed in January 2024 and again during this inspection. Detailed notes and subsequent repair work should be included in the maintenance log and on the quarterly report. Per your permit section A. General Requirements:

> *"Instances of surface saturation, ponding or pooling shall be promptly investigated and noted on the Monthly Operations Report. The report shall include details regarding location(s), determined cause(s), the actions taken to eliminate the issue, and the date the corrective actions were made."*

Quarterly operating reports do not contain the required details for ponding that has been observed by both Division personnel and Tennessee Wastewater representatives.

Site Review

The site consists of two recirculating sand filters (RSF) and two unfenced, drip fields that serve a subdivision, Lowes distribution center, a hotel, two gas stations, a church, Coopertown Middle School, and an Emergency Medical Services station. The RSF utilizes a 50/50 recirculating rate. The pumps and wet wells were observed, and an oil sheen was seen in the effluent tank. Effluent passes through Arkal filters and no disinfection is in use, but fields are unfenced. The facility is visited once per calendar month but not within every 30 days as discussed above.

The drip field had numerous instances of ponding water, saturated soils, visible purple pipe, evidence of overland flow, and bare vegetation spots. The field is partially wooded. The wooded area was difficult to inspect due to woody briars and thorny vegetation. Numerous fallen trees are on drip lines, leaving large soil divots where the root balls had been pulled from the ground exposing purple pipe. Tree roots also have pushed the purple pipe up from the soil and pinched the lines. Numerous recently repaired areas were obvious and purple pipe was still visible in one of the repair areas which was pointed out to Mr. Nichols at the time of inspection.

Conclusions

Compliance with your permit requirements helps ensure the protection of human health and the environment. Lack of detailed recordkeeping, lack of proper vegetation maintenance, surface saturation and ponding, unreported surface saturation and ponding, and inadequate fencing are violations of your permit. This letter hereby serves as a **Notice of Violation**.

Action Items and Recommendations

Please provide a written response to the following action items within **30 days** of receipt of this letter or by September 2, 2024, whichever occurs first. The response should be sent to Mrs. Wingett at her email address below.

1. Submit a corrected 1st Q 2024 operation report with indication of ponding and repairs that occurred.
2. Submit a corrected 2nd Q 2024 operation report with indication of ponding and repairs that occurred.
3. Create and maintain detailed inspection records that meet the minimum requirements outlined in your permit.
4. Investigate oil sheen seen in the effluent tank. Evaluate water handling practices at the potential source gas stations.
5. Secure, repair, or replace fencing to sufficiently prevent or impede unauthorized entry. Provide photo documentation.
6. Maintain the drip field such that all lines are buried 6”- 10” below the ground surface as outlined in the permit.
7. Maintain vegetation to allow for reasonable access for inspection and repair work.

The Division would like to thank Mr. and Mrs. Nichols again for their courtesy and cooperation shown during the inspection. If you have any questions or concerns, please contact your inspector Christina Wingett at 615-961-3875 or christina.wingett@tn.gov.

Sincerely,

Michael Murphy
Program Coordinator
Division of Water Resources

e-copy: Jenny Nichols, Quality Control Technologist, jenny.nichols@adenus.com
Matt Nicks, TWS, matthew.nicks@adenus.com
Brad Harris, TDEC, brad.harris@tn.gov
Britton Dotson, TDEC, britton.dotson@tn.gov
John Newberry, TDEC, john.newberry@tn.gov
Timmy Jennette, TDEC, tim.jennette@tn.gov

Enclosure

STATE OF TENNESSEE
DEPARTMENT OF ENVIRONMENT AND CONSERVATION
DIVISION OF WATER RESOURCES
Davy Crockett Tower
500 James Robertson Parkway, 9th Floor
Nashville, Tennessee 37243-1102

Tennessee Wastewater Systems, Inc.
849 Aviation Parkway
Smyrna, TN 87167

jeff.risden@adenus.com

October 24, 2024

Re: **Notice of Violation**
SOP-00019, Starr Crest Resort
Tennessee Wastewater Systems, Inc.

Jeff Risden,

On August 5, 2024, personnel from the Tennessee Department of Environment and Conservation Division of Water Resources (Division) conducted an inspection of the above-referenced site to follow-up on observations made on January 10, 2024, during the Statewide Survey of land application systems (Statewide Survey) to evaluate compliance with the state operating permit (SOP) issued for this site. The Division notified you of notable noncompliance observations made during the Statewide Survey at this site by email on April 24, 2024. Inspection reports and associated photographs generated for all inspections can be reviewed at Drip Survey Dashboard (arcgis.com). Neither this recent inspection nor the Statewide Survey involved a full evaluation of permit compliance.

The August 5, 2024, inspection revealed the following violations: wastewater surfacing in the vicinity of the secondary treatment unit. The January 10 site visit documented multiple locations with damaged drip dispersal lines and wastewater effluent leaving the land application area and entering drainage features. This area was inaccessible due to vegetation during the August 5 inspection.

These conditions are a violation of your state operating permit. Section A, General Requirements, of SOP-00019 states:

This permit allows the operation of a wastewater collection, treatment, and storage system with disposal of treated wastewater through approved land application areas. There shall be no discharge of wastewater to any surface waters or to any location where it is likely to enter surface waters. There shall be no discharge of wastewater to any open throat sinkhole. In addition, the drip irrigation system shall be operated in a manner preventing the creation of a health hazard or a nuisance.

The land application component shall be operated and maintained to ensure complete hydraulic infiltration within the soil profile, transmission of the effluent away from the point of application, and full utilization of the soil profile as a portion of the treatment system.

Instances of surface saturation, ponding or pooling within the land application area as a result of system operation are prohibited.

Discharging wastewater to waters of the state or to a location from which it is likely to enter waters of the state without a permit violates the Tennessee Water Quality Control Act, Tennessee Code Annotated sections 69-3-101 to -148 (TWQCA). The TWQCA also makes it unlawful to discharge sewage or other wastes into waters of the State, into a location from which it is likely the discharged substance will move into waters of the State, into a well or location where it is likely that the discharged substance will move into a well, or into the ground such that it may affect waters of the State, except in accordance with the conditions of a valid permit. Tenn. Code Ann. §§ 69-3-103(29), -108(b), and -114.

Required Actions:

1. **Immediately** ensure appropriate measures are in place to prevent overland flow of wastewater effluent from leaving any portion of the land application system.
2. Within 10 days of your receipt of this notice, submit a written response (email or letter) describing actions taken to ensure no overland flow of wastewater is leaving the site.
3. Within 60 days of your receipt of this notice, submit a written response describing all system repairs or operational changes made to address noncompliance such as: infrastructure piping repair, pump replacement, drip line repair, replacing/repairing system controls, dosing adjustments, changes in the inspection frequency or processes, etc.
4. If additional construction is needed to return the system to compliance, submit a proposed corrective action plan/engineering report (CAP/ER) within 90 days of your receipt of this notice. Items in the CAP/ER may include, but are not limited to, reconstruction or replacement of the secondary treatment unit, and the development of additional drip dispersal area(s).
5. Within 10 days of your receipt of this notice, provide a detailed map(s) identifying, to scale, the location of the secondary treatment unit (and type of treatment) and all constructed drip field areas supporting this system, including the active drip field area acreage calculations. Separate maps are appropriate if the secondary treatment plant and drip fields are not located in close proximity. If not currently available, prepare a map(s) and submit to the Division within 90 days of your receipt of this notice. Maps shall be of sufficient detail to identify the location of the secondary treatment unit, allow accurate determination of acreage utilized for drip dispersal and allow for field determination of these areas (tied to existing landscape features, buildings, property lines, property corners, etc.).

6. Within 30 days of your receipt of this notice provide an account of the following:
    a. All current connections served by this system:
        i. Identify the nature of each connection (residential, commercial, school, church, etc.
    b. All planned, but not yet active, connections to be served by this system.
        i. Indicate the nature of each planned connection (residential, commercial, school, church, etc.).
        ii. Provide an anticipated timeline for when planned connections may be served by the system.

All correspondence and deliverables associated with the required actions are to be addressed to:

Bryan Pope
Davy Crockett Tower, 9th Floor
500 James Robertson Pkwy
Nashville, TN 37243
931 224-3098 / bryan.pope@tn.gov

Failure to timely accomplish the above-listed actions may result in formal enforcement action.

If you have questions about this Notice of Violation, please contact Britton Dotson at 615-308-0734 or by e-mail at britton.dotson@tn.gov.

Regards,

Britton Dotson
Environmental Fellow, Division of Water Resources

cc: Division of Water Resources, Knoxville Field Office