NOTE 21: CONDUIT DEBT OBLIGATIONS, COMMITMENTS, AND CONTINGENCIES

A. Conduit Debt Obligations

The State, by action of the General Assembly, created the North Carolina Medical Care Commission which is authorized to issue tax-exempt bonds and notes to finance construction and equipment projects for nonprofit and public hospitals, nursing homes, continuing care facilities for the elderly and related facilities. The bonds are not an indebtedness of the State and, accordingly, are not reflected in the accompanying financial statements. Each issue is payable solely from the revenues of the facility financed by that issue and any other credit support provided. In addition, no commitments beyond the payments from the facilities and maintenance of the tax-exempt status of the conduit debt obligation were extended by the North Carolina Medical Care Commission. Therefore, each issue is separately secured and is separate and independent from all other issues as to source of payment and security. The indebtedness of each entity is serviced and administered by a trustee independent of the State. Maturing serially and term to calendar year 2053, the outstanding principal of such bonds and notes as of June 30, 2023, was $4.75 billion with interest rates varying from .75% to 6%.

The North Carolina Capital Facilities Finance Agency (Agency) is authorized by the State to issue tax-exempt bonds and notes to finance industrial and manufacturing facilities, pollution control facilities for industrial (in connection with manufacturing) or pollution control facilities and to finance facilities and structures at private nonprofit colleges and universities, and institutions providing kindergarten, elementary and secondary education, and various other nonprofit entities. The Agency's authority to issue bonds and notes also includes financing private sector capital improvements for activities that constitute a public purpose. The bonds issued by the Agency are not an indebtedness of the State and, accordingly, are not reflected in the accompanying financial statements. Each issue is payable solely from the revenues of the facility financed by that issue and any other credit support provided. In addition, no commitments beyond the payments from the nonprofit entities and maintenance of the tax-exempt status of the conduit debt obligation were extended by the North Carolina Capital Facilities Finance Agency. Therefore, each issue is separately secured and is separate and independent from all other issues as to source of payment and security. The outstanding principal of such bonds and notes as of June 30, 2023, was $1.35 billion carrying both fixed interest rates and variable interest rates which can be reset periodically.

The North Carolina Department of Transportation (NCDOT) is authorized by General Statute 136-18(39) and General Statute 136-18(39a) to enter into private partnership agreements to finance by tolls and other financing methods the cost of constructing transportation infrastructures. Such an agreement was entered into on June 26, 2014 with I-77 Mobility Partners LLC (Mobility Partners) to design, build, finance and operate the I-77 High Occupancy Toll (HOT) Lanes Project. The NCDOT issued $100 million of senior private activity bonds (PABs) on behalf of Mobility Partners and provided additional direct funds of $116.2 million. The PABs are not an obligation of the NCDOT or the State. The bonds are payable from payments received by the Mobility Partners, and NCDOT has committed to maintaining the tax-exempt status of the bonds. Additional funding was obtained by Mobility Partners in the form of a federal Transportation Infrastructure Finance and Innovation Act (TIFIA) loan in the amount of $189 million. The NCDOT is also providing limited credit enhancement support for the Project through the Developer Ratio Adjustment Mechanism (DRAM) as set forth in Section 13.3 of the Comprehensive Agreement, which is capped at $12 million in any operating year and $75 million in aggregate during the DRAM Period. The DRAM is triggered when the projected annual net revenue after payment of operating expenses is not sufficient to pay the scheduled debt service payments and is available until the earlier of the final maturity of the TIFIA loan or the date the Project debt is refinanced. As of June 30, 2023, the outstanding principal of the PABs was $100 million.

B. Litigation

***Hoke County Board of Education et al. v. State of North Carolina et al.* — Right to a Sound Basic Education (formerly *Leandro*) —** In 1994, students and boards of education in five counties in the State filed suit in Superior Court requesting a declaration that the public education system of North Carolina, including its system of funding, violates the State constitution by failing to provide adequate or substantially equal educational opportunities, by denying due process of law, and by violating various statutes relating to public education. Five other school boards and students therein intervened, alleging claims for relief on the basis of the high proportion of at-risk and high-cost students in their counties' systems.

The suit is similar to a number of suits in other states, some of which resulted in holdings that the respective systems of public education funding were unconstitutional under the applicable state law. The State filed a motion to dismiss, which was denied. On appeal, the North Carolina Supreme Court upheld the present funding system against the claim that it unlawfully discriminated against low wealth counties but remanded the case for trial on the claim for relief based on the Court's conclusion that the constitution guarantees every child the opportunity to obtain a sound basic education. Trial on the claim of one plaintiff-county was held in the fall of 1999. On October 26, 2000 the trial court, in Section Two of a projected three-part ruling, concluded that at-risk children in North Carolina are constitutionally entitled to such pre-kindergarten educational programs as may be necessary to prepare them for higher levels of education and the "sound basic education" mandated by the Supreme Court. On March 26, 2001, the Court issued Section Three of the three-part ruling, in which the judge

ordered all parties to investigate certain school systems to determine why they are succeeding without additional funding. The State filed a Notice of Appeal to the Court of Appeals, which resulted in the Court's decision to re-open the trial and call additional witnesses. That proceeding took place in the fall of 2001. On April 4, 2002, the Court entered Section Four of the ruling, ordering the State to take such actions as may be necessary to remedy the constitutional deficiency for those children who are not being provided with access to a sound basic education and to report to the Court at 90-day intervals remedial actions being implemented. On July 30, 2004, the North Carolina Supreme Court affirmed the majority of the trial court's orders, thereby directing the executive and legislative branches to take corrective action necessary to ensure that every child has the opportunity to obtain a sound, basic education. Thereafter, the State took steps to respond to the trial court's orders.

On June 15, 2011, the General Assembly enacted legislation which placed certain restrictions on the North Carolina pre-kindergarten program which had been established by the General Assembly in 2001. Following a hearing requested by the plaintiffs, the trial court entered an order prohibiting the enforcement of legislation having the effect of restricting participation in the program. On appeal, the North Carolina Court of Appeals affirmed the trial court's order prohibiting the State from denying any eligible "at risk" children admission to the program. The State appealed this decision, and in November 2013, the North Carolina Supreme Court held that amendments to the 2011 legislation had rendered the appeal moot. The case was remanded to the Superior Court.

On March 13, 2018, the Superior Court issued an Order appointing WestEd to serve as the Court's independent, non-party consultant to make recommendations for specific actions necessary to achieve sustained compliance with the constitutional mandates of Leandro. On October 4, 2019, WestEd submitted its final report and recommendations to the Court. The WestEd report estimated that over the eight-year period beginning in the fiscal year 2019-2020, it could take as much as $6.86 billion in additional funding beyond 2018-2019 appropriations for the State to meet its Leandro obligations. On January 21, 2020, the Court entered a Consent Order Regarding the Need for Immediate, Systemic Action for the Achievement of Leandro Compliance. In that Order, the Court found that many children across North Carolina are still not receiving the constitutionally-required opportunity for a sound basic education and the State had to make systemic changes and investments to fulfill its obligations. Consistent with that decision, the Court ordered the State Defendants, in consultation with the plaintiff parties, to develop a comprehensive remedial plan to provide all children with the opportunity for a sound basic education. The Court did not order the State to appropriate any funds but ordered the State to remedy the deficiencies identified in its Order of January 21, 2020.

In June 2020, the parties submitted a Joint Report to the Court on Sound Basic Education (SBE) for All: Fiscal Year 2021 Action Plan For North Carolina. The Joint Report detailed the actions the State and NC SBE were committed to taking in the first year (Fiscal Year 2021) of an eight-year Plan. The parties agreed that the actions outlined in the Joint Report were the necessary and appropriate actions needed in Fiscal Year 2021 to begin to adequately address the constitutional violations in providing the opportunity for a sound basic education to all children in North Carolina. The State Defendants estimated that the costs of the action steps detailed in the Joint Report would require an additional State investment of $426.99 million in Fiscal Year 2021. The Court thereafter ordered the parties to formalize the commitments in the Joint Report in a Consent Order which the Court entered on September 11, 2020.

On March 15, 2021, the State Defendants submitted the Comprehensive Remedial Plan required under the January and September Consent Orders. The State Defendants, including the NC State Board of Education, agreed that the actions outlined in that Plan were the necessary and appropriate actions needed over the next eight years to address the constitutional violations and provide the opportunity for a sound basic education to all children in North Carolina. Attached to the Plan was an Appendix which detailed the implementation timeline for each action step, as well as the estimated additional State investment necessary for each of the actions described in the Plan. The State Defendants estimated that the actions steps in the Plan would cost an additional $5.5 billion in recurring funds at the end of the eight-year implementation period.

On June 7, 2021, the Court entered an Order directing the State Defendants to implement the Comprehensive Remedial Plan in full and in accordance with the timelines contained therein. The Court further ordered the State Defendants to seek and secure "such funding and resources as are needed and required to implement in a sustainable manner the programs and policies set forth in the Comprehensive Remedial Plan." The Court held open the possibility of entering judgment in the future "granting declaratory relief and such other relief as needed to correct the wrong" if the State fails to implement the actions described in the Plan. Finally, the Court ordered State Defendants to submit a report no later than August 6, 2021, regarding progress toward fulfilling the terms and conditions of the Order and stated that it would hold a hearing in September 2021 to address issues raised in that report.

On August 6, 2021, the State Board of Education and the State of North Carolina filed separate Reports on Progress on the Comprehensive Remedial Plan. On August 27, 2021, the Plaintiffs and the Plaintiff Intervenors filed Reponses to those Reports. The Court scheduled a hearing on September 8, 2021, to "address issues raised in the reports and responses."

On October 16, 2021, the trial court held a hearing during which it indicated that it would enter an order directing certain executive branch officials to transfer funds sufficient to fund Years two and three of the Comprehensive Remedial Plan. On November 10, 2021, the trial court entered such an order.

On November 18, 2021, the State Budget Act was enacted. On that day, the State filed a notice of appeal of the trial court order transferring funds, followed shortly by an appeal of the Legislative Leaders who noticed intervention into the case by virtue of N.C. General Statute §1-72.2. The State filed a petition to bypass the Court of Appeals and have the claim directly heard by the North Carolina Supreme Court. That petition was granted by the Court, who first remanded the case for clarification on how the enactment of the State Budget Act impacted the trial court order of November 10, 2021.

At the same time the appeal was entered of the trial court order transferring funds, the Office of the State Controller filed a petition for temporary stay, writ of supersedas and writ of prohibition with the Court of Appeals enjoining the trial court from ordering the transfer of funds without an appropriation. The writ of prohibition was granted and subsequently appealed to the Supreme Court.

During that time, the Honorable Michael Robinson was selected to preside over the matter. Judge Robinson amended the trial court order of November 2021 by incorporating the financial changes associated with the State Budget Act. Judge Robinson also incorporated his understanding that because the Court of Appeals had recently entered a writ of prohibition in a collateral appeal barring the transfer of funds, the trial court was no longer permitted to include the transfer within the bounds of the amended order.

The case was heard by the North Carolina Supreme Court on August 31, 2022. On November 4, 2022, the Supreme Court filed an opinion. With that opinion, the Supreme Court stayed the writ of prohibition issued by the Court of Appeals, in part, concluding that the court erred when it concluded that it lacked the authority to order the transfer of funds. Mandate on the opinion issued directly to the trial court on November 29, 2022, commanding that the trial court conform the subject order to the Supreme Court opinion. Subsequently in January 2023, the North Carolina Supreme Court lifted the stay of the writ of prohibition and reinstated the prohibiting the trial court from ordering the transfer of funds.

Since that time, the trial court convened a hearing to determine what funds remained due to satisfy the obligations of Years 2 and 3 of the Comprehensive Remedial Plan. Following the entry of an order on 14 April 2023, the Legislative Intervenors appealed the matter to the North Carolina Court of Appeals, and thereafter, were granted a bypass petition to the North Carolina Supreme Court. The case is currently pending before the Supreme Court as the parties complete briefing.

Michael Hughes, on behalf of himself and others similarly situated v. Board of Trustees Teachers' and State Employees' Retirement System, et al.- This suit involves a declaratory judgment action, a claim for "violation of N.C. General Statute § 135-5"; and (3) Breach of Contract, all of which arise from an allegation that, as a retiree from North Carolina's Teachers' and State Employees' Retirement System ("TSERS"), Plaintiff is entitled to receive a comparable cost of living increase in his retirement allowance each year in which the North Carolina General Assembly increases the salaries of active State employees, and that such increases must be comparable. This matter is a putative class action, which Plaintiff purports to bring on behalf of retirees in TSERS, the Consolidated Judicial Retirement System ("CJRS"), and the Legislative Retirement System ("LRS") against the TSERS Board of Trustees, TSERS, CJRS, LRS, State Treasurer Dale R. Folwell (in his official capacity as ex officio Chair of the TSERS Board of Trustees, and the State of North Carolina ("Defendants").

Defendants moved to dismiss Plaintiff's Complaint pursuant to Rule 12(b)(6) of the North Carolina Rules of Civil Procedure for failure to state a claim, arguing there is no statutory basis for Plaintiff's claim that he is entitled to such an increase because: (1) the portion of the statute on which Plaintiff's argument relies, N.C. General Statute § 135-5(o), which states that retired TSERS members "may receive cost-of-living increases in retirement allowances if active members of the system receive across-the-board cost-of-living salary increases[,]" is permissive, not mandatory; (2) the condition that must be met before retirement allowances may be increased – that "active members of the system receive across-the-board cost-of-living salary increases" has not been met since Plaintiff retired; and (3) Plaintiff's Complaint concedes that the TSERS Board of Trustees does not have the authority to award retirement allowances pursuant to N.C. General Statute § 135-5(o). Defendants' Motion to Dismiss came on for hearing on August 24, 2022 in Wake County Superior Court. The court entered an order on August 26, 2022 that denied Defendants' motion.

The matter is currently pending before the superior court and discovery has begun. Defendants are in the process of drafting a motion for judgment on the pleadings and motion to dismiss Plaintiff's Complaint on all three causes of action because: (1) they are are nonjusticiable under the political question doctrine; (2) they are barred by sovereign immunity as a matter of law; (3) there is no private right of action for "Violation of N.C. General Statute § 135-5"; and (4) Plaintiff does not have standing to bring this action against CJRS and LRS. At this stage, we believe that there is only a remote likelihood that Plaintiff's claims can continue against CJRS and LRS. Plaintiff's only allegation that he has a relationship to any of the Defendants in this case is that he is a retiree of TSERS, a pension plan administered by the North Carolina Retirement Systems Division within the Department of State Treasurer. TSERS is not the same pension plan as the CJRS or LRS pension plans named in this suit and Plaintiff has not alleged that he is a vested member of CJRS or LRS, or otherwise alleged a relationship with either entity. With regard to the claims by Plaintiff and the putative class of TSERS retiree he purports to bring this claim under, Defendants are optimistic about their motion to dismiss and for judgment on the pleadings, and therefore, at this stage, the likelihood of an unfavorable outcome is only reasonably possible. Defendants will strongly consider an interlocutory appeal if the sovereign immunity arguments raised in the motion to dismiss are denied and the claims are not otherwise resolved by the motions. If Defendants are unsuccessful, they will need to revisit their evaluation of the likelihood of an unfavorable outcome and the fiscal exposure of the State may be substantial in the event of the favorable outcome of this litigation for Plaintiffs.

Queen Anne's Revenge (QAR)/ North Carolina Department of Natural and Cultural Resources (NCDNCR). Intersal v. Wilson (NCDNCR), 15 CVS 9995, is a breach of contract action involving a 2013 Settlement Agreement between Intersal and NCDNCR concerning, inter alia, the negotiated media rights of the parties regarding the Queen Anne's Revenge (QAR). Intersal primarily seeks damages for photos related to the QAR posted on various websites by DNCR allegedly in violation of the terms of the settlement agreement, lost profits on a proposed exhibition tour of the QAR, and lost licensing fees for video of the recovery and conservation efforts. Plaintiff's proffered experts have estimated damages in excess of $385 million. This matter is set for trial in the NC Business Court before the honorable Judge Julianna Earp on February 19, 2024.

In November 1996, operating under a search permit issued by NCDNCR, Intersal discovered the QAR wreckage. Pursuant to the QAR permit, Intersal was entitled to claim treasure recovered from the ship. However, Intersal elected to forgo its claim to treasure in order to obtain exclusive media and replica rights related to the QAR shipwreck and its artifacts as well as the right to search for a second ship, the El Salvador. On September 1, 1998, Intersal and NCDNCR negotiated an Agreement (1998 Agreement) outlining the parties' rights and responsibilities.

On July 26, 2013, Intersal filed a Petition for a Contested Case in OAH alleging NCDNCR violated the 1998 Agreement. On October 15, 2013, Intersal, NCDNCR and Nautilus (Intersal's video designee) executed a Settlement Agreement (2013 Agreement). The 2013 Agreement superseded the 1998 Agreement and outlined the parties' renegotiated media rights and the terms for the search for the El Salvador. In July 2015, Intersal filed this breach of contract claim alleging NCDNCR breached the 2013 Agreement by, inter alia:

1. Displaying over 2000 QAR images and over 200 minutes of video without the required watermark or timestamp.
2. Failing to implement mandates of the 2013 Agreement such as changes to the QAR project media policy.
3. Failing to inform Intersal of commercial opportunities under the collaborative commercial narrative language of the 2013 Agreement.
4. Interfering with Intersal's QAR media rights by allowing filming and photographing of QAR recovery operations by other parties.
5. Interfering/failing to participate in an exhibition tour. Diminishing Intersal's tour by participating in a limited exhibit tour of museums and "profiting" from the museum tour.
6. Failing to make artifacts available for duplication.
7. Failure to renew a permit for the search of the El Salvador.

DNCR initially prevailed on a motion to dismiss which was subsequently overruled, in part, by the NC Supreme Court (Intersal v. Hamilton, 373 N.C. 89, 834 S.E. 2d 404 (2019)). The Court held that (1) any claims for breach of the 1998 Agreement were properly dismissed; (2) Intersal's breach of contract claims concerning its QAR media rights under the 2013 Agreement were still available; and, (3) the trial court erred in dismissing Intersal's breach of contract claim arising from NCDNCR's failure to renew Intersal's El Salvador permit.

The parties then engaged in discovery, including seven expert and fourteen fact depositions. In August 2021, the parties filed cross-motions for summary judgement which were heard in January 2022. In February 2023, Business Court Judge Earp granted in part and denied in part each parties' motion. Judge Earp held:

1. Intersal's motion for partial summary judgment is GRANTED that, after the effective date of the 2013 Agreement, NCDNCR's posting on the internet of non-commercial media of the QAR project produced without including a time code stamp, watermark and/or a link to the proper website constituted a breach of Paragraph 16(b)(1) of the 2013 Agreement.
2. Intersal's motion for partial summary judgment is GRANTED that, after the effective date of the 2013 Agreement, NCDNCR's posting of non-commercial media of the QAR project on websites other than its own constitutes a breach of Paragraph 16(b) of the 2013 Agreement.
3. NCDNCR's motion for summary judgment with respect to Intersal's First Claim for Relief is GRANTED to the extent that Intersal asserts that NCDNCR breached Paragraph 16(b)(1) of the 2013 Agreement by failing to mark digital media that predates the effective date of the QAR project prior to producing it in response to a public records request.
4. NCDNCR's motion for summary judgment with respect to Intersal's claim for breach of contract with respect to the El Salvador is GRANTED, and Intersal's second Claim for Relief is dismissed with prejudice.

Therefore, Intersal's remaining claims (absent some peripheral, smaller claims) are lost licensing fees/lost profits for photographs posted to the internet, lost profits from an exhibition tour and lost fees from improperly posting/producing videos. Additionally, NCDNCR has already been found to have breached the contract with Intersal. Therefore, the jury will be instructed that Intersal is entitled to damages, even if they are nominal damages. Intersal proffered several expert witnesses who intend to provide damages estimates. They have identified the bulk of Intersal's damages as relating to lost license fees for the photographs, approximately $365 million and lost profits from a commercial tour of QAR artifacts approximately $20 million. DNCR has already indicated to the trial court that it intends to file a Daubert motion challenging Intersal's experts opinions on both.

The court intends to hear and rule on the parties' Motions in Limine in December which will determine what, if any, lost profit or lost license fees damages Intersal is able to request from the jury. While Plaintiffs's estimate of damages is substantial per opinion of Plaintiff's expert and a judgment against the State is possible, it is unlikely that the actual fiscal exposure of the State is substantial.

Lake v. State Health Plan — The main issue is whether the State wrongfully charged a monthly premium to retired State employees for the State's 80/20 coinsurance health plan. The general theme of the complaint is that the State established vesting requirements under which if the employee fulfilled the requirements, the State contracted with each employee to provide 80/20 coinsurance insurance coverage at no monthly premium to the retiree for the duration of each retiree's retirement. Similarly, the plaintiffs allege that the State terminated an optional 90/10 coinsurance health plan to which they allegedly had vested rights. Plaintiffs claim (1) breach of contract; (2) unconstitutional impairment of contract; (3) unconstitutional denial of equal protection; and (4) unconstitutional denial of due process. The plaintiffs also allege a variety of equitable claims (e.g., specific performance, common fund) that piggy-back on the legal claims.

The State moved to dismiss and, after a hearing, the trial court denied the motion. On May 19, 2017, the trial court issued an order granting plaintiffs' motion for partial summary judgment and denying defendants' motion for summary judgment as to liability. The trial court held that plaintiffs, and all class members, are entitled to the version of the 80/20 coinsurance plan in existence in September 2011, or its equivalent, with no premium for their lifetime. The trial court's order would provide damages for retirees who remained on the 80/20 coinsurance plan at the amount of premiums they actually paid. Any method for determining damages for retirees who switched to the zero-premium 70/30 coinsurance plan is yet to be determined.

The State appealed. On March 5, 2019, a panel of the Court of Appeals unanimously reversed the order of the superior court and remanded for entry of summary judgment in favor of the State. The plaintiffs have petitioned to the North Carolina Supreme Court for discretionary review of the decision of the Court of Appeals. The petition for discretionary review was allowed and the case is now being briefed in the North Carolina Supreme Court.

The State Treasurer has stated that if the trial court's ruling stands – which would require reversal of the Court of Appeals – the costs to the State could exceed $100 million, not including the cost to the State Health Plan of complying with the plaintiffs' demands going forward.

On October 4, 2022, the North Carolina Supreme Court affirmed in part, reversed in part and remanded the Court of Appeals' decision. The Supreme Court concluded that the eligible retired State employees possessed a vested right protected under the Contracts Clause. The Court also held that genuine issues of material fact needed to be resolved in order to answer whether the General Assembly substantially impaired the retired State employees' vested rights. If so, it must be determined whether any such impairment was reasonable and necessary. The Supreme Court remanded to the trial court on these issues.

The matter is currently pending before the superior court on remand. The parties are in the process of discussing additional discovery to be conducted in this case based on the directives from the Supreme Court and developing a case management order to accommodate the issues identified by the Supreme Court. Written and oral discovery is likely to follow. Additionally, in November 2022, plaintiffs reached out to State defendants to entertain a possibility of settlement.

On March 24, 2023, the State defendants requested approval to retain private counsel, which was approved on April 4, 2023. The entire case file was subsequently transferred to private counsel. On April 18, 2023, the parties had a status conference with the judge to discuss a case management order for the case on remand, which was the last case activity in which Department of Justice (DOJ) attorneys participated. On April 27, 2023, the Order removing DOJ attorneys as counsel was filed. While the actual exposure amount or the likelihood of an unfavorable outcome is difficult to determine at this time, there is a reasonable or probable possibility that a substantial amount against the State may be awarded.

Legionnaires' Disease Litigation/2019 Mountain State Fair – North Carolina Department of Agriculture and Consumer Services. This litigation arises out of a Legionnaires' disease outbreak allegedly connected to the 2019 North Carolina Mountain State Fair. The 2019 North Carolina Mountain State Fair was hosted and organized by the North Carolina Department of Agriculture and Consumer Services (NCDA&CS) from September 6 to 15, 2019 on the grounds of the Western North Carolina Agricultural Center in Fletcher, North Carolina. On or about September 23, 2019, local public health officials began tracking an outbreak of Legionnaire's Disease. Following an investigation, the North Carolina Department of Health and Human Services and the Center for Disease Control found that the outbreak was likely caused by exposure to *Legionella* bacteria in aerosolized water vapor coming from hot tubs displayed by two vendors at the 2019 Mountain State Fair. The outbreak was believed to have resulted in 136 cases of Legionaries' disease, one case of Pontiac Fever, ninety-six hospitalizations, and four deaths.

Plaintiffs are individuals that alleged to have contracted Legionnaires' disease at the 2019 Mountain State Fair and the estates of two individuals that are alleged to have died as a result of contracting Legionnaires' Disease. In total, there are 78 individual Plaintiffs asserting claims. Plaintiff brought claims against the two hot tub vendors in a series of 19 lawsuits filed in Henderson, Buncombe, and Mecklenburg County Superior Court. The hot tub vendors then brought third-party claims against NCDA&CS and 7 other vendors that had been at the 2019 Mountain State Fair. Plaintiffs then amended their complaints to assert direct claims against NCDA&CS and the other vendors. NCDA&CS has also filed cross-claims and counterclaims for contribution and indemnity against the two hot tub vendors.

All of these cases have been consolidated under a single Superior Court Judge pursuant to Rule 2.1 and the parties are currently in the process of exchanging written discovery. Plaintiffs have not yet submitted a universal settlement demand or total estimate of their alleged damages. The maximum claimed exposure would be $78 million ($1 million per Plaintiff). However, it is too early to determine the actual exposure amount or the likelihood of an unfavorable outcome as the parties are just beginning written discovery. It does appear that Plaintiffs have shifted their focus to NCDA&CS as the primary target given that the hot tub vendors appear to have insufficient assets.

Map Act Litigation (Kirby v. North Carolina Department of Transportation and subsequent cases) — The Transportation Corridor Official Map Act (Map Act) was enacted in 1987 to provide the NCDOT with the authority to record corridor maps that imposed restrictions on a landowner's rights to improve, develop, and subdivide property within the corridor, which restrictions may remain indefinitely. The Map Act did not require NCDOT to purchase the property at the time of the filing of a future corridor map. Starting in 1989, NCDOT filed 27 separate maps that affected approximately 8,500 parcels of land. In June of 2016, the North Carolina Supreme Court ruled that the filing of a transportation corridor map pursuant to the Map Act resulted in a taking of the property owners' rights to improve, develop, and subdivide their property. Under state law, whether a property owner should be paid for the property, and how much, are determined on a case-by-case basis.

Since the last update, NCDOT has continued to acquire parcels and settle cases that have been filed in the Map Act corridors. The most current numbers as to remaining cases and dollar value are available from NCDOT.

Landowners' attorneys have also recently raised two new theories of recovery, one of which is raised in a case before the state Court of Appeals. If those theories prevail, NCDOT's potential liability will be expanded beyond the current number of known cases.

Buffkin v. Hooks — The American Civil Liberties Union of North Carolina and North Carolina Prisoner Legal Services, Inc., filed this class action on June 15, 2018, on behalf of three named individual offenders infected with hepatitis-C (HCV) against the North Carolina Department of Public Safety (DPS) and four individual state employees, including the Secretary of DPS. The suit seeks class certification for "all current and future prisoners in DPS custody who have or will have HCV and have not been treated with direct-acting antiviral drugs." The plaintiffs seek relief in the form of a declaratory judgment that DPS' policy for treating inmates infected with HCV violates the Eighth Amendment, and that failure to screen all persons in DPS for the virus violates the Eighth Amendment and the Americans with Disabilities Act. To that end, plaintiffs are requesting injunctive relief from the court ordering DPS to (1) formulate and implement an HCV treatment policy that meets the current standard of medical care, including identifying and monitoring persons with HCV; (2) treat the class members with appropriate direct-acting antiviral drugs; and (3) provide named plaintiffs and class members with an appropriate and accurate assessment of their level of fibrosis or cirrhosis, counseling on drug interactions, and ongoing medical care for complications and symptoms of HCV. The three individual plaintiffs are seeking compensatory and punitive damages. If the plaintiffs are successful in their suit, the defendant may be responsible for costs and attorneys' fees.

The plaintiffs moved for class certification, which was granted March 20, 2019. The plaintiffs also moved for preliminary injunctive relief, which was denied through the same March 20 order. The parties are currently engaged in the discovery process. Ranges of infected inmate populations vary greatly from state to state. More than 30,000 inmates are incarcerated in North Carolina prisons, with more than 30,000 being introduced into the system each year. If the certified class is successful in the litigation, potential costs of complying with the injunctive relief ordered could exceed $200 million.

The parties resolved this litigation through a negotiated resolution which the Court recently approved and entered as a consent decree. Plaintiffs' counsel are now seeking attorneys' fees just shy of $1 million.

The parties were able to resolve Plaintiffs' claim for attorney fees through a negotiated resolution wherein the Department of Public Safety paid $450 thousand in fees in exchange for a full and final release of such claims. The resolution of the attorney fees claim concludes all active litigation in this matter. However, the case will remain open for several more years as the Department of Public Safety is obligated (under the settlement agreement/consent decree) to meet certain benchmarks and make regular reports to Plaintiffs' counsel regarding treatment of HCV in state prisons.

Pasquotank Prison Litigation. In October 2017, four inmates at Pasquotank Correctional Institution murdered four employees and injured additional employees during an escape attempt. The estates of the four employees who were killed and two injured employees have brought multiple lawsuits in the Industrial Commission, state court, and federal court against individual state defendants as well as against state officials, the Department of Public Safety, and Correction Enterprises (a division of the Department of Public Safety). The State is defending the individual State defendants under the Defense of State Employees Act. While the State has limited insurance coverage for claims against individual defendants in excess of $1 million, the potential exposure to the State is nonetheless significant if the State does not prevail on available legal defenses.

The State has resolved the lawsuit filed by one of the estates (Howe), and the parties are in the process of seeking necessary court approval for that settlement. Several other federal court lawsuits and actions in the Industrial Commission remain pending.

Monarch v. Penny, Secretary of Department of Revenue. Monarch formed structured investment partnerships for investment by North Carolina taxpayers related to renewable energy, mill restoration, and historic redevelopment. Its business model used partnerships to aggregate investments to fund such projects, and to then attempt to allocate to investors tax credits for the projects. Monarch claims that the Department of Revenue has unconstitutionally administered North Carolina tax law in a manner that has caused Monarch business damages and denied North Carolina taxpayers, including but not limited to Monarch customers, the benefit of the investment tax credits. The Department of Revenue denies liability. Plaintiffs' most recent estimate of damages was $344 million.

Lexington/AIG v. NC, POELIC, et al. This matter is related to McCollum and Brown v. Red Springs, et al., which is a Section 1983 action filed against a local police department, a county sheriff's office, and two former State Bureau of Investigation (SBI) agents. The plaintiffs in that case alleged various constitutional violations by the law enforcement defendants related to their confessions, subsequent convictions, and incarceration. A jury returned a verdict of $75 million dollars against the two SBI agents (all other defendants settled out before a jury reached a verdict). That verdict is now on appeal with briefing in that matter closing this past spring. After the jury's verdict and while the matter has been on appeal, Lexington Insurance Company (AIG) filed a declaratory judgement action against POELIC seeking a determination that the excess policies it provided to POELIC do not provide coverage (or provide limited coverage) for the jury's verdict against the SBI agents. We approached AIG about a consent stay of the declaratory judgment action pending the full and final resolution on the appeal of the underlying litigation—pointing out that obligations under an indemnity only policy (like the policies at issue in the declaratory judgment action), coverage is dictated by the determinations made by the finder of fact. Since those are currently on appeal, coverage litigation is premature. AIG agreed and we secured a stay in the case.

Lannan v. UNC Board of Governors and Dieckhaus v. UNC Board of Governors. Students who attended constituent institutions in the UNC System have sued seeking a refund of all or a portion of their tuition and fees for the spring 2020 and fall 2020 semesters when the schools moved to on-line instruction due to the COVID outbreak. While the UNC System has been successful in *Dieckhaus* in defending against the claims related to the spring 2020 semester, the matter is pending before the NC Supreme Court and could possibly be reviewed and overturned for the case to continue into litigation. In the *Lannan* case, which stems from the pivot to online classes in fall 2020 at certain campuses, the universities were unsuccessful in having the case dismissed and will be heard before the NC Supreme Court seeking that the decisions by the NC Carolina Court of Appeals and trial court be reversed. Given how many individuals were impacted by the move to online classes and the decisions made to close campus facilities, if the plaintiffs are successful the damages could be in the millions of dollars.

Samantha R. v. NC and DHHS**,** filed in state court in May 2017 in Wake County Superior Court. The six individual plaintiffs and plaintiff organization Disability Rights North Carolina (DRNC) assert that the State of North Carolina and DHHS have violated the North Carolina Persons with Disabilities Act and the State Constitution. Plaintiffs seek an injunction requiring the defendants to administer publicly funded behavioral health programs in compliance with the Act and the North Carolina Constitution. As Plaintiffs do not seek monetary damages, it is hard to put a dollar amount on the litigation. However, if the Court does enter some sort of injunction, DHHS anticipates that substantial funds would be needed for implementation of any service or systems modification. Attorney General (AG) staff attorneys are representing DHHS and the State. DHHS' motion to dismiss was denied. After the completion of discovery, all parties filed Motion for Summary Judgment. The trial court denied the State's Motion for Summary Judgment and granted Plaintiff's partial Motion for Summary Judgment by order dated February 4, 2020. The Court ruled that the State was in violation of North Carolina General Statute 169A-7(b) of the North Carolina Persons with Disabilities Protection Act. At the Court's direction, the parties briefed the question of the proper remedy for the violation of the integration mandate. The Court heard the issue on May 12, 2022. On July 21, 2022, the Court directed the parties to submit a proposed order adopting specific and measurable goals along the lines of the proposal submitted by plaintiff; the Court also will consider the State's proposed alternate timelines, numbers, or percentages. The parties filed a proposed order with redlines on August 15, 2022. The parties filed competing proposed orders and arguments in August of 2022 and are awaiting the Court's decision. On November 2, 2022, the Court entered its Order, in the form of an injunction directing North Carolina and DHHS to transition individuals from institutions to community settings; to reduce the Registry/Wait List; and to collect and report data to DRNC on direct care professionals. On November 30, 2022, North Carolina and DHHS filed a Notice of Appeal and Motion to Stay the Court's decision.

Halikierra Community Services, LLC; Dwaylon Whitley; Michael Scales v. NC DHHS, DHB; Medical Review of North Carolina, Inc. d/b/a Carolinas Center for Medical Excellence; Kay Cox in her individual capacity; Patrick Piggott in his individual capacity**,** (Wake Co. Superior Court; case certified for Business Court). Two State Constitutional claims are asserted against DHHS: 1) Violation of Substantive Due Process (Art. I, Sec. 19); and 2) Violation of Equal Protection (Art. I, Sec. 19). Plaintiffs also sued two DHHS employees (Cox and Piggott) in their individual capacities; both employees requested Attorney General Office representation, which has been approved. The claims against Cox and Piggott in their respective individual capacities are Conspiracy in Restraint of Trade, Civil Conspiracy, and Punitive Damages. Damages requested are in excess of $100 million. DHHS disputes the claims and damages. Motions to Dismiss and Answers were filed on behalf of Defendants DHHS, Patrick Piggott, and Brenda Kay Cox. The hearing on Defendants Motions to Dismiss occurred November 18, 2020. Per the judge's request, Defendants submitted supplemental briefing on December 16, 2020 and Plaintiffs submitted supplemental briefing on January 4, 2021. DHHS served Plaintiffs with its discovery responses on January 6, 2021. Plaintiffs deposed Pat Meyer on February 25, 2021, and plan to depose Patrick Piggott and Kay Cox on April 7, 2021 or April 9, 2021. Mediation is scheduled for April 6, 2021. The case management order issued on October 7, 2020 set discovery deadlines throughout 2021 and a trial date for fall 2021. The trial court granted in part our motions to dismiss, but many claims remain. DHHS and the DHHS employees are represented by the AG's office. The parties filed a joint motion to extend discovery 90 days until November 1, 2021. On August 31,

2021, the Business Court transferred the matter from Judge Adam Conrad to Judge Michael Robinson without explanation. Halikierra's owners, Whitley and Scales, were deposed on September 10, 2021 and September 13, 2021, respectively. A Motion for Summary Judgment was filed on December 1, 2021 on behalf of North Carolina DHHS, Cox and Piggott. Plaintiff's Memorandum in Opposition to the Motion for Summary Judgment was filed on January 10, 2022. The court granted the motion for extension of time to file Reply Brief and to increase the word limit for Defendant. Defendant filed Reply Brief on January 27, 2022. Hearing on Motion for Summary Judgment was heard on April 12, 2022. On September 26, 2022, the Court issued an Order granting North Carolina DHHS's Motion for Summary Judgment and dismissed the case. On October 27, 2022, Plaintiff filed a Notice of Appeal with the North Carolina Supreme Court.

UNC School of the Arts Litigation, NC Industrial Commission and Forsyth County Civil Superior Court. More than fifty plaintiffs have sued the UNC School of the Arts in the North Carolina Industrial Commission and Forsyth County Civil Superior Court alleging that they were sexually abused by faculty at the School and that the administration was negligent in preventing and responding to this conduct. The allegations arise over a large number of years. While the NC Industrial Commission has cap of $1 million for an award, plaintiffs are arguing that each offense is separate and potentially the cap could be awarded numerous times to the same plaintiff. Given the number of plaintiffs and their many allegations of conduct, if plaintiffs were successful and the School was found liable, damages could possibly be in the tens or hundreds of millions of dollars. The matters are currently stayed pending litigation in a similar action where the constitutionality of the Safe Child Act (which revived the statute of limitations for the plaintiffs to file their claims for a period of time) is litigated.

Vidant Hospital, UNC Hospitals, DHB/Provider Audit. Vidant filed annual cost reports for fiscal years 2010 through 2016. Provider Audit (Jim Flower's team) disagreed with certain issues on the cost reports and made audit adjustments in Notices of Program Reimbursements dated January 12, 2017, April 13, 2018, March 18, 2019, and May 31, 2019. Vidant appealed all in 2017 through 2019 by requesting reconsideration. The parties were not able to resolve one issue, known as "zero paid claims." Vidant has appealed this issue for all seven fiscal years. Vidant and Division of Health Benefits (DHB) have both submitted position papers to the hearing officer. DHB's defense is based on the State Medicaid Plan, the Centers for Medicaid Services (CMS) Provider Manual, informal guidance received from CMS, and concurrence from DHB's outside auditing firm. Note also that UNC has appealed the same "zero paid claims" issue for multiple cost years, and Department of Health and Human Services (DHHS) leadership has participated in several high- level discussions with UNC. UNC estimates the value of these claims is about $13 million. The situation with UNC is complicated as UNC may have received some overpayments from DHB. On November 3, 2022, the Hearing Officer issued a decision upholding DHB's audit findings and rejecting Vidant's challenge. On December 29, 2022, Vidant appealed to the Office of Administrative Hearings disputing claims of $22.9 million for fiscal years 2010-2016 and $13.35 million for fiscal years 2017-2021. Discovery was completed including 12 depositions and expert witness disclosures. On August 8, 2023, the parties reached agreement to resolve the total $36.25 million of claims in dispute through a settlement payment of $14 million to Vidant. The agreement resolves all of Vidant's past and future claims relating to the treatment of zero paid claims. The UNC appeal with claims in dispute of about $13 million has not been resolved.

Other Litigation. The State is involved in numerous other claims and legal proceedings, many of which are normal for governmental operations. A review of the status of outstanding lawsuits involving the State by the North Carolina Attorney General did not disclose other proceedings that are expected to have a material adverse effect on the financial position of the State.

C. Federal Grants

The State receives significant financial assistance from the federal government in the form of grants and entitlements, which are generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal regulations, including the expenditure of the resources for eligible purposes. Under the terms of the grants, periodic audits are required and certain costs may be questioned as not being appropriate expenditures. Any disallowance as a result of questioned costs could become a liability of the State.

An audit conducted by the United States Department of Health and Human Services Office of Inspector General concluded that the State did not comply with Federal and State requirements when making Medicaid claims for school-based Medicaid administrative costs. Based on the audit, the Office of Inspector General recommended that the State refund $53.8 million to the federal government for non-compliant claims. The State disagrees with the findings and recommendation. Once a final determination of liability is made, the amount will be paid to CMS. As of June 30, 2023, the State had not received a demand for recovery from CMS.

For the fiscal years 2011-2013, the State received more than $34.8 million in unallowable performance bonus payments under the Children's Health Insurance Program Reauthorization Act. The overpayments were the result of the overstatement of the enrollment numbers in its request. CMS has issued a disallowance and a demand for recovery. The State disagrees with the findings and has appealed. Other states also appealed, and the matters were consolidated for a decision by the Departmental Appeals Board (DAB). The DAB issued its decision on, finding that CMS had erred in its interpretation of the statute, but also remanded the case to CMS to determine if there were overpayments made. The State is awaiting further information and guidance from CMS.

As of June 30, 2023, the State is unable to estimate what liabilities may result from additional audits of Federal grants and entitlements.

The State refunds federal shares of drug rebate collections to CMS. As of June 30, 2023, the amount due to CMS was $215.53 million.

D. Highway Construction

The State has placed on deposit in court $265.10 million for a potential liability to property owners for contested rights-of-way acquisition costs in condemnation proceedings. The State may also be liable for an additional $83.77 million in these proceedings. As of June 30, 2023, the State had no outstanding verified contractor's claims.

E. Construction and Other Commitments

At June 30, 2023, the State had commitments of $6.42 billion for construction of highway infrastructure. Of this amount, $3.68 billion relates to the Highway Fund, $178.58 million relates to the N.C. Turnpike Authority, and $2.56 billion relates to the Highway Trust Fund. The other commitments for construction and improvements of state government facilities totaled $330.48 million, including $192.72 million for the Department of Administration, $38.027 million for the Department of Agriculture, $30.194 million for the Department of Natural and Cultural Resources, and $17.16 million for the Department of Public Safety, and $14.387 million for the Department of Adult Correction.

At June 30, 2023, the University of North Carolina System (component unit) had outstanding construction commitments of $567.13 million (including $156.99 million for University of North Carolina Chapel Hill, $104.47 million for University of North Carolina Health Care System, $58.67 million for North Carolina State University, $48.17 million for Western Carolina University, and $44.64 million for the University of North Carolina at Wilmington).

At June 30, 2023, community colleges (component units) had outstanding construction commitments of $112.49 million (including $41.56 million for Wake Technical Community College, $15.6 million for Western Piedmont Community College, $10.39 million for South Piedmont Community College, $7.88 million for Fayetteville Technical Community College, and $7.25 million for Central Piedmont Community College).

The Department of Environmental Quality has other significant commitments of $378.73 million for clean water and other cost reimbursement grants. At June 30, 2023, the Department of Natural and Cultural Resources had other outstanding commitments of $161.89 million for clean water grants to nongovernmental organizations and local and state government. The Department of Public Instruction has other significant commitments of $803.27 million for needs-based public school building capital fund cost reimbursement grants awarded to Local Education Agencies (LEAs) for school capital projects.

The 911 Board (Board), part of the Department of Information Technology Services, sets aside a portion of its fund balance annually to support local Public Safety Answering Points (PSAPs). The PSAPs apply to the Board for the funds with improvement project proposals that the Board evaluates and either approves or denies. At June 30, 2023, the 911 Fund (special revenue fund) had outstanding commitments on these cost-reimbursement grants and contracts to the PSAPs totaling $31.29 million.

At June 30, 2023, the Administrative Office of the Courts had outstanding software in development contract commitments of $7.06 million. During the same period, Project Kitty Hawk had similar contractual commitments of $5.57 million.

The State Treasurer has entered contracts with external fund managers of several investment portfolios within the North Carolina Department of State Treasurer External Investment Pool (External Investment Pool), where the State Treasurer agrees to commit capital to these investments. More detailed information about the External Investment Pool is available in a separate report (See Note 3A).

The UNC Investment Fund, LLC (UNC Investment Fund) at the University of North Carolina at Chapel Hill has entered into agreements with limited partnerships to invest capital. These agreements represent the funding of capital over a designated period of time and are subject to adjustments. As of June 30, 2023, the UNC Investment Fund had approximately $1.9 billion unfunded committed capital.

F. Tobacco Settlement

In 1998, North Carolina, along with 45 other states, signed the Master Settlement Agreement (MSA) with the nation's largest tobacco companies to settle existing and potential claims of the states for damages arising from the use of the companies' tobacco products. Under the MSA, the tobacco companies are required to adhere to a variety of marketing, advertising, lobbying, and youth access restrictions, support smoking cessation and prevention programs, and provide payments to the states in perpetuity. The amount that North Carolina will receive from this settlement remains uncertain, but projections are that the State will receive approximately $4.74 billion from the inception of the agreement through the year 2025. Since the inception, the State has received approximately $3.74 billion in MSA payments. In the early years of MSA, participating states received initial payments that were distinct from annual payments. The initial payments were made for five years: 1998 and 2000 through 2003. The annual payments began in 2000 and will continue indefinitely. However, these payments

are subject to a number of adjustments including an inflation adjustment and a volume adjustment. Some adjustments (e.g., inflation) should result in an increase in the payments while others (e.g., domestic cigarette sales volume) may decrease the payments. Also, future payments may be impacted by continuing and potential litigation against the tobacco industry and changes in the financial condition of the tobacco companies. At year-end, the State recognizes a receivable and revenue in the government-wide statements for the tobacco settlement based on the underlying domestic shipment of cigarettes. This accrual estimate is based on the projected payment schedule in the MSA adjusted for historical payment trends.

G. Other Contingencies

The Civil Rights Division of the U.S. Department of Justice investigated the state's mental health system and found the State to be in violation of Title II of the Americans with Disabilities Act of 1990 (ADA), 42 U.S.C. Sec 12131, and the following, as interpreted by the U.S. Supreme Court in *Olmstead v. L.C.*, 527 U.S. 581 (1999), and Section 504 of the Rehabilitation Act of 1973 (Rehab Act), 29 U.S.C. Sec 794(a). On August 23, 2012, the Civil Rights Division and the State entered into an agreement that addresses the corrective measures that will ensure that the State will willingly meet the requirements of the ADA, Section 504 of the Rehab Act, and the *Olmstead* decision. Through the agreement, it is intended that the goals of community integration and self-determination will be achieved. Both parties of the agreement have selected a reviewer to monitor the State's implementation of this agreement. The reviewer has authority to independently assess, review, and report annually on the State's implementation of and compliance with the provisions of this agreement. The potential liability to the State cannot be reasonably estimated. If the State fails to comply with this agreement, the United States can seek an appropriate judicial remedy. To date, the State has demonstrated good faith effort by providing sufficient funding essential to meeting the settlement requirements. The State is responsible for determining and identifying the amount of appropriation funding that is needed to fulfill this agreement which was originally going to be phased in over eight years (2013-2020). The settlement agreement was first extended for an additional year to July 1, 2021 in order to give the State more time to meet the requirements. In March of 2021, the parties signed an agreement acknowledging the State's compliance in some areas of the agreement but extending other items for an additional two years. In March 2023, the parties entered into another two-year extension of the agreement, which included the development and approval of an Implementation Plan to outline how the State will come into substantial compliance by July 2025. In Session Law 2012-142 Section 10.23A.(e), $10.3 million was appropriated as recurring funds to support the Department of Health and Human Services in the implementation of its plan for transitioning individuals with severe mental illness to community living arrangements, including establishing a rental assistance program. In Session Law 2013-360, additional money was appropriated in the expansion budget for $3.83 million for fiscal 2014 and $9.39 million for fiscal 2015. Funding has continued each budget year at appropriate levels to meet the terms of the agreement.

In Session Law 2015-241, the North Carolina Housing Finance Agency (NCHFA), in consultation with the Department of Health and Human Services (DHHS), was authorized to administer the Community Living Housing Fund (CLHF) in order to provide permanent community-based housing in integrated settings appropriate for individuals with severe mental illness and severe and persistent mental illness. The funds are first transferred from DHHS and then must be appropriated by the General Assembly in order for the NCHFA to expend the funds. DHHS transferred $2.89 million to the Community Living Housing Fund in fiscal 2015. House Bill 1030 authorized the NCHFA to expend receipts of $5.52 million transferred from DHHS to the CLHF in fiscal 2017. Session Law 2017-57 and Session Law 2018-5 provided funds of $4.2 million and $3.96 million, respectively, transferred from DHHS to the CLHF. In fiscal years 2019 through 2021, DHHS transferred $10.47 million to the CLHF and Session Law 2020-97 appropriated those funds for the State to meet its commitment to the supported housing requirements of the agreement. At present, the work continues with the funds available through continuing budget provisions. DHHS did not transfer any funds to the CLHF for fiscal year 2022 or fiscal year 2023 as no funds remained in accordance with the law.

The State is liable for an ongoing worker's compensation claim for a former employee who was severely injured and will require care for life. The estimated total cost of care is currently $25.6 million.