



**NORTH CAROLINA
PUBLIC STAFF
UTILITIES COMMISSION**

March 21, 2022

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

Re: Docket No. W-1300, Sub 60 – Application for General Rate Increase
for Old North State Water Company, LLC
Public Staff Late-filed Exhibit No. 1

Dear Ms. Dunston:

In connection with the above-referenced docket, I transmit herewith for filing
Public Staff Late-filed Exhibit No. 1. By copy of this letter, I am forwarding a copy
of the above to all parties of record.

Sincerely,

Electronically submitted
/s/ Reita D. Coxton
Staff Attorney
reita.coxton@psncuc.nc.gov

Attachment

cc: Parties of Record

Executive Director
(919) 733-2435

Accounting
(919) 733-4279

Consumer Services
(919) 733-9277

Economic Research
(919) 733-2267

Energy
(919) 733-2267

Legal
(919) 733-6110

Transportation
(919) 733-7766

Water/Telephone
(919) 733-5610

PUBLIC STAFF LATE-FILED EXHIBIT NO. 1
Docket No. W-1300, Sub 60

During the hearing in this matter, held on March 8, 2022, Commissioner Clodfelter asked the following of Public Staff witness John R. Hinton:

Given the structure of this affiliation [between Old North State Water Company and Integra Water, LLC], not in the sense you use for ratemaking purposes, but the legal affiliation that exists here between these two entities that are under common ownership and common management, how is this debt classified under the FERC uniform system of accounts, or under GAAP? (Tr., vol. 2, p. 322).¹

In his response, Mr. Hinton indicated that the question should probably have been asked of Public Staff witness Iris Morgan.

At the end of the hearing, Counsel for the Public Staff requested permission for the Public Staff to file a late-filed exhibit to “expound upon and respond to Commissioner Clodfelter’s question;” the Commission granted that request. This document contains the Public Staff’s response.

During the course of its ratemaking investigation of Old North State Water Company, LLC (ONSWC or the Company), the Public Staff did not discover any direct evidence that the notes payable of ONSWC to Integra Water, LLC (Integra) were not properly classified for accounting purposes as debt per Generally Accepted Accounting Principles (GAAP) or the National Association of Regulatory Utility Commissioners Uniform System of Accounts for Class B Water Utilities

¹ The transcript indicates that the question referred to the Federal Energy Regulatory Commission’s Uniform System of Accounts (FERC USOA). However, the governing set of accounting rules for ONSWC, per Commission Rule R7-35, is the National Association of Regulatory Utility Commissioners Uniform System of Accounts for Class B Water Utilities (NARUC USOA), a document similar in effect to the FERC USOA.

(NARUC USOA). However, the Public Staff did not focus its investigation on whether the notes were, in fact, classified as debt for GAAP and NARUC USOA accounting purposes, nor whether such classification was reasonable, for the following reasons:

1. In the course of its audits and investigations of utilities' applications to the Commission for changes in rates, and in fact for most of its regulatory work on behalf of the using and consuming public, the Public Staff does not, as a matter of course, perform an audit of the financial statements for compliance with GAAP. Instead, the Public Staff investigates the utilities' applications, plus their books and records (often including financial statements prepared or presented to support the applications), to determine if the classification and amounts of revenues, expenses, assets, and liabilities presented to support the utilities' proposed rate changes are appropriate and reasonable for ratemaking purposes.
2. Likewise, in the course of its ratemaking audits and investigations, the predominant concern of the Public Staff is not whether the classification and amounts of revenues, expenses, assets, and liabilities presented to support the utilities' proposed rate changes are directly compliant with the NARUC USOA, but, instead, whether these classifications and amounts are appropriate and reasonable for ratemaking purposes. Although the NARUC USOA is the set of accounting rules adopted by the Commission (per Commission Rule R7-35), this adoption does not mean that the NARUC USOA is controlling for Commission ratemaking purposes; instead,

individual Commission orders take precedence over and, in fact, can supersede the NARUC USOA. This principle is best illustrated by the more recently modified Commission Rule which establishes the Federal Energy Regulatory Commission (FERC) USOA as the accounting rules for electric utilities (Commission Rule R8-27). Rule R8-27(a)(1) states:

All orders and practices of the Commission in effect as of the effective date of this Rule with any accounting impacts that conflict with provisions of the Uniform System of Accounts shall remain in effect, and future such orders and practices with such impacts shall supersede the provisions of the Uniform System of Accounts for North Carolina retail jurisdictional purposes.

This statement is consistent with one of the fundamental principles of accounting; namely, that substance should rule over form. If the Commission should issue an order that requires ratemaking treatment differing from the accounting treatment prescribed by the NARUC USOA, the economic substance of that order supersedes the provisions of the USOA, at least for ratemaking purposes. It is then a matter of judgment, and ultimately the discretion of the Commission, whether such a superseding action for ratemaking purposes also requires a change in the accounting for the applicable item in the utility's ongoing accounting records or financial statements filed under the Commission's Rules and for other purposes.

Notwithstanding the above, during the investigation of a utility's ratemaking application, the fundamental characteristics of debt and equity for GAAP and NARUC USOA purposes can be useful and important for purposes of determining

how a utility's financings should be treated for ratemaking purposes, as at least the establishment of a baseline classification to use as a measure of whether such classification is appropriate and reasonable for ratemaking purposes. However, if it is clear that the classification of the financings proposed by a utility is not reasonable for ratemaking purposes, even if it were to match GAAP and NARUC USOA guidance, then the Public Staff must determine the appropriate classification and cost rates for purposes of setting rates, and the GAAP or NARUC USOA requirements or guidelines become largely irrelevant for ratemaking purposes. Such is the case in this proceeding, as explained in the testimony of Public Staff witness Hinton. Because it was evident that a hypothetical capital structure and cost rates were appropriate for use in this case, the Public Staff did not attempt to determine whether the accounting for the actual debt and equity instruments underlying the capital structure and cost rates proposed by the Company was compliant with GAAP and the NARUC USOA. Under the approach taken by the Public Staff, the quantification of the amount of rate base treated as being financed by debt was determined by the application of the hypothetical debt ratio to the Company's original cost rate base, not by the specific association of actual debt instruments to rate base investment.

Given the Public Staff's approach to reaching its rate recommendation in this proceeding, a determination as to whether the specific notes payable from ONSWC to Integra were appropriately classified as debt for GAAP or NARUC USOA purposes would require additional information from the Company regarding the specific notes and an examination of the Company's late-filed exhibits filed on

March 11, 2022. Important to this determination would be the evaluation of whether each of the notes constitutes a payable representing a contractual obligation to pay money on fixed or determinable dates, as is generally required by the Financial Accounting Standards Board (FASB) to meet the definition of debt.² If a note meets that requirement, the long-term portion of it (that portion maturing more than one year into the future) would likely be appropriately recorded in the NARUC USOA as Long-Term Debt in Account 223 – Advances from Associated Companies.³ Under the NARUC USOA, the term “associated companies” is defined as “companies or persons that, directly or indirectly, through one or more intermediaries, control, or are controlled by, or are under common control with, the accounting company.” [Emphasis added.]⁴

² See the FASB Accounting Standards Codification, Subtopic ASC 470-60-15-4a.

³ NARUC USOA for Class B Water Utilities (1996), p. 64.

⁴ NARUC USOA for Class B Water Utilities (1996), p. 8.