STATE OF SOUTH CAROLINA
In the Supreme Court

RECEIVED

APPEAL FROM THE PUBLIC SERVICE COMMISSION

MAR 25 2016

Docket No. 2014-346-WS

S.C. SUPREME COURT

Daufuskie Island Utility Company, Inc.,

Appellant,

v.

South Carolina Office of Regulatory Staff,
Haig Point Club and Community Association, Inc.,
Melrose Property Owner's Association, Inc.,
Bloody Point Property Owner's Association, and
Beach Field Properties, LLC,

Respondents.

NOTICE OF APPEAL

Daufuskie Island Utility Company, Inc. appeals the Decision and Order of the Public Service Commission entitled Order Approving Settlement Among Certain Parties and Ruling on Application for Adjustments in Rates Commission dated December 8, 2015, (Order No. 2015-846) and the Decision and Order of the Public Service Commission Denying Applicant's Petition for Reconsideration and/or Rehearing dated February 25, 2016, (Order No. 2016-50). Copies of the Orders are attached. Because the Orders set a public utility rate under Title 58 of the South Carolina Code of Laws, this Appeal is filed in the South Carolina Supreme Court pursuant to Rule 203(d)(2), SCACR. Appellant received written notice of entry of the Order Denying Applicant's Petition for Reconsideration and/or Rehearing on February 25, 2016.

March 22, 2016

Thomas P. Gressette, Jr.
G. Trenholm Walker
PRATT-THOMAS WALKER, P.A.
P.O. Drawer 22247
Charleston, SC 29413-2247
(843)727-2200

ATTORNEYS FOR APPELLANT
DAUFUSKIE ISLAND UTILITY
COMPANY, INC.

Other Counsel of Record:

Shannon Bowyer Hudson
Andrew M. Bateman
SOUTH CAROLINA
OFFICE OF REGULATORY STAFF
1401 Main Street, Suite 900
Columbia, SC 29201
T: (803)737-8440
ATTORNEYS FOR RESPONDENT
OFFICE OF REGULATORY STAFF

John J. Pringle, Jr.
ADAMS & REESE, LLP
1501 Main Street, 5th Floor
Columbia, SC 29201
T: (803)254-4190
ATTORNEYS FOR RESPONDENTS
HAIG POINT CLUB and COMMUNITY
ASSOCIATION, INC.,
MELROSE PROPERTY
OWNER'S ASSOCIATION, INC., and
BLOODY POINT PROPERTY OWNER'S ASSOCIATION

Margaret M. Fox
McNAIR LAW FIRM, P.A.
1221 Main Street, Suite 1800
Columbia, SC 29201
T: (803)799-9800
ATTORNEYS FOR RESPONDENT
BEACH FIELD PROPERTIES, LLC

STATE OF SOUTH CAROLINA
In the Supreme Court

APPEAL FROM THE PUBLIC SERVICE COMMISSION

Docket No. 2014-346-WS

Daufuskie Island Utility Company, Inc.,

Appellant,

v.

South Carolina Office of Regulatory Staff,
Haig Point Club and Community Association, Inc.,
Melrose Property Owner's Association, Inc.,
Bloody Point Property Owner's Association, and
Beach Field Properties, LLC,

Respondents.

PROOF OF SERVICE

I, Nancy Jane Dennis, an employee of Pratt-Thomas Walker, P.A., hereby certify that I have served this 22nd day of March, 2016, a copy of Appellant's Notice of Intent to Appeal on counsel of record, by placing same in the United States Mail, first class postage prepaid to the following:

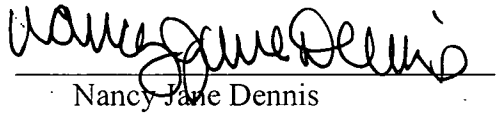
Hon. Jocelyn Boyd
David Butler
PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA
101 Executive Center Drive, Suite 100
Columbia, SC 29210
T: (803)896-5100
ADMINISTRATIVE TRIBUNAL

Shannon Bowyer Hudson
Andrew M. Bateman
SOUTH CAROLINA OFFICE OF REGULATORY STAFF
1401 Main Street, Suite 900
Columbia, SC 29201
T: (803)737-8440

ATTORNEYS FOR OFFICE OF
REGULATORY STAFF

John J. Pringle, Jr.
ADAMS & REESE, LLP
1501 Main Street, 5th Floor
Columbia, SC 29201
T: (803)254-4190
ATTORNEYS FOR HAIG POINT CLUB and COMMUNITY
ASSOCIATION, INC., MELROSE
PROPERTY OWNER'S ASSOCIATION, INC., and
BLOODY POINT PROPERTY OWNER'S ASSOCIATION

Margaret M. Fox
McNAIR LAW FIRM, P.A.
1221 Main Street, Suite 1800
Columbia, SC 29201
T: (803)799-9800
ATTORNEYS FOR BEACH FIELD PROPERTIES, LLC



Nancy Jane Dennis

Charleston, SC

BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 2014-346-WS - ORDER NO. 2015-846

DECEMBER 8, 2015

IN RE:	Application of Daufuskie Island Utility Company, Incorporated for Approval of an Increase for Water and Sewer Rates, Terms and Conditions	) ORDER APPROVING) SETTLEMENT AMONG) CERTAIN PARTIES AND) RULING ON) APPLICATION FOR) ADJUSTMENTS IN) RATES

I. Introduction

This matter is before the Public Service Commission of South Carolina (the "Commission") on the Application ("Application") of Daufuskie Island Utility Company, Incorporated ("DIUC" or "the Company") filed on June 9, 2015, seeking approval of a new schedule of rates and charges for water and sewer service that DIUC provides to its customers within its authorized service area in South Carolina. The Application was filed pursuant to S.C. Code Ann. Section 58-5-240 and 10 S.C. Code Ann. Regs. 103-712.4.A and 103.512.4.A.

In the Application, DIUC requested an increase in revenues for combined operations of $1,182,301, consisting of a water revenue increase of $590,454 and a sewer revenue increase of $591,847. The revenue increase utilizes a return on equity ("ROE") of 10.5% based on the rate of return on rate base methodology and a 2014 historical test year. Tariff changes to bring the rates between the Haig Point and Melrose communities to uniformity were also requested.

DIUC's last rate case before this Commission was in Docket No. 2011-229-WS. In that case, Commission Order No. 2012-515 approved a Settlement entered into by the Haig Point Club and Community Association, Inc. ("HPCCA"); Melrose Property Owner's Association, Inc. ("MPOA"); Bloody Point Property Owner's Association ("BPPOA") (collectively the "POAs"); and DIUC that was not objected to by the South Carolina Office of Regulatory Staff ("ORS"); whereby DIUC received a revenue increase of $291,485 based on a $5,000,000 rate base; an operating margin of 16.64%; and an ROE of 8.81%. DIUC also agreed not to seek another rate adjustment prior to July 1, 2014.

DIUC's South Carolina operations are classified by the National Association of Regulatory Utility Commissioners ("NARUC") as a Class B water and wastewater utility according to water and sewer revenues reported on its Application for the test year ending December 31, 2014. The Commission's approved service area for DIUC is on Daufuskie Island located in Beaufort County, South Carolina.

The Commission's Clerk's Office instructed DIUC to publish a prepared Notice of Filing, one time, in newspapers of general circulation in the area affected by DIUC's Application. The Notice of Filing described the nature of the Application and advised all interested persons desiring to participate in the scheduled proceedings of the manner and time in which to file appropriate pleadings for inclusion in the proceedings as a party of record. The Commission also instructed DIUC to notify each affected customer by mailing or, where the customer had previously agreed to electronic notice, by e-mailing each customer a copy of the Notice of Filing. DIUC filed Affidavits of Publication and

Mailing demonstrating that the Notice of Filing had been duly published and provided to all customers.

Petitions to Intervene were filed on behalf of the POAs on July 23, 2015, and Beach Field Properties, LLC ("Beach Field") on July 27, 2015.

Subsequent to their intervention, the POAs requested that the Commission schedule a public night hearing at a convenient time and location for customers of DIUC to present their comments regarding the service and rates of DIUC. In response, the Commission held a public night hearing pursuant to Order No. 2015-586. Under this Order, a public hearing was set and noticed by the Commission, and the Company provided an affidavit certifying that it had provided notice of the date, time and location of the local public hearing via publication in The Beaufort Gazette and The Island Packet. On September 15, 2015, the Commission held a night hearing beginning at 6:00 pm at the Haig Point Club Clubhouse, 130 Clubhouse Lane, Daufuskie Island, South Carolina.[1]

On October 28, 2015, the Commission, with Chairman Nikiya "Nikki" Hall presiding, heard the matter of DIUC's Application beginning at 10:30 am at the Commission Hearing Room located at 101 Executive Center Drive in Columbia, South Carolina.

DIUC was represented by G. Trenholm Walker, Esquire, and Thomas P. Gressette, Jr., Esquire. The POAs were represented by John J. Pringle, Jr., Esquire.

[1] Hearing Exhibit 1 consists of the night hearing sign-in sheets and Hearing Exhibit 2 consists of comments filed by public witness Andy Mason.

Beach Field was represented by Margaret M. Fox, Esquire. ORS was represented by Shannon Bowyer Hudson, Esquire, and Andrew M. Bateman, Esquire.

At the hearing on October 28, a Settlement[2] between the POAs and ORS was entered into the record after an objection to it by DIUC was overruled. DIUC, the POAs and ORS presented testimony and exhibits after one public witness, Mr. Reid Delaney,[3] testified. Mr. Delaney testified that he owns property on which assets are located and utilized by DIUC for its regulated water and sewer business.

DIUC presented the testimony of: John F. Guastella[4] (direct and rebuttal testimony), President of Guastella Associates, LLC ("GA"), a utility management, valuation and rate consulting firm headquartered in Boston, Massachusetts; Gary C. White (direct), Vice President and Director of Accounting at GA; Eric Johanson (direct), DIUC Chief Operator; and the Honorable Maria Walls[5] (rebuttal), Beaufort County Treasurer. Mr. Guastella and Mr. White testified as a panel about the management and finances of DIUC. Mr. Johanson's testimony addressed the operations of DIUC. Mr. Johanson was excused from the hearing without appearing before the Commission after

[2] The Settlement, denominated "Settlement Agreement," and containing five exhibits was entered into the record as Hearing Exhibit 3. Under the Commission Settlement Policy, a "settlement" is a document which fully or partially resolves a proceeding. In this case, the three Property Owners Associations and the Office of Regulatory Staff entered into an agreement which resolves issues among those parties. This agreement would be classified as a "settlement" under the Commission Settlement Policy, even though neither DIUC nor Beach Field Properties, LLC were parties to the agreement, and the document was originally referred to in the Motion approved at the Commission meeting as a "Stipulation." Pursuant to this reasoning, the document denominated as a "Settlement Agreement" by the settling parties will be referred to as the "Settlement" throughout the remainder of this Order.

[3] Hearing Exhibit 4 is a survey provided by Mr. Delaney.

[4] Hearing Exhibit 7 consists of Guastella Direct Exhibits A and B. Hearing Exhibit 8 consists of Guastella Rebuttal Exhibits 1 through 5. Hearing Exhibit 9 is the GA Management Agreement. Hearing Exhibit 10 consists of the ORS and POAs responses to DIUC's discovery requests.

[5] Hearing Exhibit 5 consists of Walls Rebuttal Exhibit A.

his testimony was accepted into the record without objection from the other parties. Ms. Walls provided testimony on property taxes.

The POAs presented two panels of witnesses. The first panel consisted of Paul Vogel[6] (direct), Haig Point Club and Community Association resident; Doug Egly[7] (direct), Chief Operating Officer of the Haig Point Association; and Tony Simonelli (direct), real estate broker on Daufuskie Island. The second panel consisted of Lynn M. Lanier[8] (direct) and Charles Loy[9] (direct and surrebuttal), Principals of GDS Associates, Inc., a utility consulting and engineering firm with its principal offices in Marietta, Georgia; and Harry Jue[10] (direct), water and sewer consultant with Hussey Gay Bell Engineering. POA witnesses Vogel, Egly, and Simonelli presented testimony illustrating the points of view of their respective organizations, and each providing testimony opposing DIUC's request. POA witness Loy provided expert testimony regarding accounting and rate base issues. POA witness Lanier provided expert testimony on the overall Application and incorporated Mr. Loy's recommended adjustments. Beach Field did not pre-file or present testimony at the Commission hearing.

ORS presented the testimony of Douglas H. Carlisle[11] (direct), ORS Economist; Ivana C. Gearheart[12] (direct), ORS Audit Manager; and Willie J. Morgan[13] (direct and surrebuttal), ORS Deputy Director for the Water and Wastewater Department, in a panel.

[6] Hearing Exhibit 11 is Vogel Exhibit 1.
[7] Hearing Exhibit 12 is Egly Exhibit 1.
[8] Hearing Exhibit 14 consists of Lanier Exhibits 1 through 5. Exhibit 3 was revised at the hearing.
[9] Hearing Exhibit 15 is Loy Surrebuttal Exhibit 1. Hearing Exhibit 16 is Loy Direct Appendix A.
[10] Hearing Exhibit 13 is Jue Exhibit 1.
[11] Hearing Exhibit 17 is Carlisle Direct Exhibits 1 through 10.
[12] Hearing Exhibit 18 is Gearheart Direct Exhibits 1 through 8.
[13] Hearing Exhibit 19 is Morgan Direct Exhibits 1 through 8. Hearing Exhibit 20 is Morgan Surrebuttal Exhibits 1 and 2.

Dr. Carlisle's testimony included an analysis and recommendation for an ROE. Ms. Gearheart's direct testimony described ORS's examination of the Application and DIUC's books and records as well as the subsequent accounting and pro forma adjustments recommended by ORS. Mr. Morgan's direct testimony focused on DIUC's compliance with Commission rules and regulations, ORS's business office compliance review, inspections of DIUC's water and wastewater systems, test-year and proposed revenue, and performance bond requirements.

II. REVIEW OF THE EVIDENCE AND EVIDENTIARY CONCLUSIONS

Standards and Required Findings

DIUC's Application was filed pursuant to S.C. Code Ann. Sections 58-5-210 and 58-5-240 and 10 S.C. Code Ann. Regs. 103-712.4.A and 103.512.4.A. In considering the Application, the Commission must ascertain and fix just and reasonable rates, standards, classifications, regulations, practices, and measurements of service to be furnished. Thus, the Commission must give due consideration to the Company's total revenue requirements and review the operating revenues and operating expenses of DIUC to establish adequate and reasonable levels of revenues and expenses. The Commission will consider a fair rate of return for DIUC based on the record and any increase must be just and reasonable and free of undue discrimination. DIUC has also asked this Commission to establish revenues based on an authorized ROE which is established to allow DIUC the opportunity to earn a fair return.

After evaluation of the positions of the parties, the Commission reaches the legal and factual conclusions below based on its review of the facts and evidence of record.

The evidence supporting the Company's business and legal status is contained in the Application filed by DIUC, testimony, and in prior Commission orders in the docket files of the Commission, of which the Commission takes judicial notice.

Test Year

A fundamental principle of the ratemaking process is the establishment of a historical test year as the basis for calculating a utility's operating margin or, in this case, a return on rate base, and, consequently, the validity of the utility's requested rate increase. In order to determine what a utility's expenses and revenues are for purposes of determining the reasonableness of a rate, one must select a 'test year' for the measurement of the expenses and revenues. *Heater of Seabrook v. Public Service Commission of South Carolina*, 324 S.C. 56, 478 S.E.2d 826, 828 n.1 (1996). While the Commission considers a utility's proposed rate increase based upon occurrences within the test year, the Commission will also consider adjustments for any known and measurable out-of-test year changes in expenses, revenues, and investments, and will also consider adjustments for any unusual situations which occurred in the test year. Where an unusual situation exists which shows that the test year figures are atypical, the Commission should adjust the test year data. *See Southern Bell v. The Public Service Commission*, 270 S.C. 590, 244 S.E. 2d 278 (1978); *see also*, *Parker v. South Carolina Public Service Commission*, 280 S.C. 310, 313 S.E.2d 290 (1984), *citing City of Pittsburgh v. Pennsylvania Public Utility Commission*, 187 P.A. Super. 341, 144 A.2d 648 (1958).

In its Application, DIUC utilized a historic test year – the twelve months ending December 31, 2014, with adjustments for 2015 expectations. ORS also used the 2014 historical test year for two reasons: 1) because it was chosen by DIUC and 2) the underlying transactions in the 2014 books could be tested to ensure that the transactions were adequately supported, had a stated business purpose, were allowable for ratemaking purposes, and were properly recorded. (Gearhart Direct, R. p. 489). Consistent with generally accepted regulatory principles, ORS adjusted, as necessary, the revenues, expenditures, and capital investments to normalize the Company's operating experience and rate base. The POAs also utilized a 2014 historic test year with adjustments. (Loy Direct, R. p. 397).

Based on the information available to the Commission and the fact that all parties agreed to a calendar year 2014 test year, the Commission is of the opinion, and therefore concludes, that the test year ending December 31, 2014, is appropriate for the purposes of this rate request.

Rate of Return on Rate Base

DIUC requested that its rates be determined in accordance with the rate of return on rate base methodology. The determination of rate of return on rate base requires three components: 1) capital structure; 2) cost of debt; and 3) cost of equity (or return on equity). However, by statutory requirement, the Commission must specify an allowable operating margin in all water and wastewater orders. S.C. Code Ann. § 58-5-240(H). Although the Commission must specify an operating margin in its order, this does not mean that the operating margin methodology must be used in determining a fair rate of

return. *Heater of Seabrook* at p. 64 and 830. Operating margin "is less appropriate for utilities that have large rate bases and need to earn a rate of return sufficient to obtain the necessary equity and debt capital that a larger utility needs for sound operation." *Id.* No party contested the use of the rate of return on rate base methodology and given the size of DIUC's rate base the Commission finds the rate of return on rate base methodology appropriate in this case.

Capital Structure and Cost of Debt

With respect to the capital structure, DIUC recommended a pro forma capital structure of 41.2% debt and 58.8% equity. ORS witness Dr. Carlisle testified there are two concerns with the method DIUC used to calculate its capital structure: 1) DIUC included pro-forma long-term debt in its long-term debt calculation; and 2) DIUC proposed an inflated equity amount. (Carlisle Direct, R. p. 472). Dr. Carlisle noted that both result in an increase in the ROE. (Id.)

The pro forma debt is based on the cost of debt DIUC expects, and as Dr. Carlisle noted, the outcome of DIUC's negotiations with banks or lenders is unknown at this time; therefore, DIUC's pro forma debt should not be included. (Carlisle Direct, R. p. 473). The POAs also agreed that debt should not include future amounts. (Lanier Direct, R. p. 436, ll. 8-14). Dr. Carlisle further testified that DIUC's capital structure is weighted more heavily with equity, which is more expensive than debt. (Carlisle Direct, R. p. 473).

In contrast to a projected or pro forma capital structure, ORS recommended a hypothetical capital structure of 46% long-term debt and 54% equity calculated by

averaging the known capital structure used by water companies in the United States with publicly traded stock. (Id.) The POAs produced an adjusted capital structure of 57.55% debt and 42.45% equity (Hearing Exhibit 14, Amended Lanier Exhibit 3), based on a downward adjusted rate base, which is discussed later in this Order. In the Settlement, the POAs agreed to the capital structure proposed by the ORS.

As to the specific cost of debt rate, DIUC recommended 6.20%. The POAs testified that 6.20% is relatively high in the current interest rate environment, but is probably a reasonable rate given DIUC's precarious financial state. (Lanier Direct, R. p. 436). To calculate the 6.20% debt rate, DIUC included anticipated legal and GA fees in the financing fees. In support of the debt amount, Mr. Guastella testified the debt he used is based on his knowledge of prior financing costs applied to the costs expected to be incurred for future refinancing. (Guastella, R. p. 243). As a percentage of the total debt, the anticipated fees are 13.56% per ORS's calculations.

ORS did not incorporate the additional fees into the debt rate because the fees are a large percentage of the total debt and did not originate from a lending institution. ORS recommended that the actual debt rate being paid by DIUC to the current lending institution, 5.29%, be used. (Gearheart Direct, R. p. 497). In the Settlement, the POAs agreed to the 5.29% cost of debt recommended by the ORS.

Upon consideration of evidence, the Commission adopts the capital structure, 46% long-term debt and 54% equity, and debt rate, 5.29%, recommended by ORS since they are based on known data instead of expected events. The Commission declines to

use the POA's capital structure because it is based on adjustments to DIUC's rate base (discussed in the Rate Base section below) that this Commission declines to adopt

Cost of Equity/Return on Equity

DIUC witness Guastella testified that the requested 10.5% ROE is based on his experience and judgment. (Guastella Direct, R. p. 193). The POAs' witness Lanier testified, "This is the same rate the Company requested in its 2012 rate case[14], which was a specified rate, rather than a rate developed through justification of the ROE required to meet its needs for profit margin and to attract the needed debt capital." (Lanier Direct, R. p. 437, ll. 1-4).

In contrast to DIUC, ORS's Dr. Carlisle recommended an ROE of 9.31% based on a range of 8.91% to 9.71% using results from the Discounted Cash Flow model ("DCF"), Capital Asset Pricing Method ("CAPM") and the Comparable Earnings Model ("CEM"). (Carlisle Direct, R. pp. 471 and 474). Dr. Carlisle testified the DCF and CAPM are known and generally accepted methods for determining a recommended ROE. (Id.) The POAs testified that the DCF is the prevailing method used for determining appropriate ROEs. The POAs also testified that, while the DCF and CAPM are recognized as methods for calculating ROEs, the DCF and CAPM provide challenges since there are not many publicly traded companies similar to DIUC. (Lanier Direct R. p. 442).

For his analyses, Dr. Carlisle examined data on companies with publicly traded stock of which more data is available, because DIUC requested rates based on rate of

[14] The merits hearing for DIUC's last rate case in Docket No. 2011-229-WS was held in 2012.

return. (Carlisle Direct R. p. 475). Companies with publicly traded stock yield more data than what is available for privately held companies, according to Dr. Carlisle. (Id.) Specifically, Dr. Carlisle testified that he used publicly traded companies classified as "water utilities" by Value Line or *Yahoo! Finance* for his DCF and CAPM, since they are in the same line of business as DIUC and share similar risks. (Id.) For his CEM analysis, Dr. Carlisle used companies with comparable betas to those of the companies used in his DCF and CAPM group. (Id.)

DIUC did not provide analyses similar to those used by Dr. Carlisle; however, Schedule A-3 of DIUC's application shows the following references to ROE:

Connecticut DPUC Formula:

Average Large Company	9.69%
Small Company Adder	0.50%
Performance Adder	0.50%
	10.69%

Florida PSC Leverage Graph Formula:

5.6% + (2.279 / Equity Ratio)		= ROE
Range	100%	= 7.88%
	40%	=11.30%
Equity Ratio	58.8%	= 9.47%

There is no discussion of these components in Schedule A-3 or in testimony, with the exception of Mr. Guastella's rebuttal testimony containing the following single

sentence, "Under the Connecticut Public Utilities Regulatory Authority formula for return on equity for small companies, the rate of return on equity for DIUC is 10.69%." (Guastella Rebuttal, R. p. 221). ORS provided no testimony on either the Connecticut or Florida ROE formulas. The POAs could find no other reference to the Connecticut formula and challenged DIUC's portrayal of the Florida formula.

Witness Lanier for the POAs testified, "[S]imply including a formula on a schedule and a calculated number is not sufficient rationale to support a ROE, particularly of 10.5%, when the company is requesting a revenue increase of over 100% in order to achieve such return." (Lanier Direct, R. p. 439, ll. 7-9). The POAs acknowledged Dr. Carlisle as a source to support an appropriate ROE, and the POAs pre-filed direct testimony recommended an ROE in the range of 8.5% to 9.0% in consideration of a lower rate base and based on various examples of DIUC's "irresponsibility in its operations since the rate increase authorized in 2012 and in the use of debt funds, in view of the critical need for cash." (Lanier Direct, p. 441, ll. 2-3). The POAs did not provide their own analysis for an ROE using a commonly-accepted and widely-accepted methodology such as DCF or CAPM.

In summary, DIUC requested an ROE of 10.5%; ORS recommended an ROE of 9.31% based on a range of 8.91% to 9.71%; and the POAs recommended an ROE in the range of 8.5% to 9.0%.

Upon consideration of the testimony of the various witnesses, the Commission adopts the range set forth in evidence as produced by ORS. ORS used the well-known and commonly-accepted DCF method, CAPM, and CEM for developing its range of

8.91% to 9.71%. Those methods, as applied by ORS, are grounded in sound analysis. While the POAs also considered the well-known analyses and some different analyses for determination of the rate of return on equity, the POAs did not actually perform the DCF, CAPM, and CEM studies that ORS performed. Therefore, this Commission finds the ROE range proposed by the POAs and DIUC's ROE recommendation lacking in support and analysis. Also, in the Settlement, the POAs and the ORS agreed to an ROE that falls within the range of Dr. Carlisle and rounds to his recommended ROE of 9.3%.

Rate Base

The rate base proposed by DIUC for combined operations was $7,085,475. [15] In support of its rate base, DIUC included several plant assets, particularly a 125,000 gallon elevated water storage tank, well and facilities (the "facilities") which are located on real property not owned by DIUC. Specifically, the facilities are located on real property (the "Site") that, as described below, was sold at a delinquent tax sale. DIUC does not dispute that it is not the owner of the Site.[16] However, DIUC offered testimony and evidence that it owns these facilities, and asserts that 1) the tax sale did not include the storage tank, well and facilities, only the Site; 2) DIUC pays property taxes to Beaufort County for the facilities; 3) DIUC has the right to operate those facilities on any parcel of land in the

[15] See Application Schedule A-4; however the December 31, 2014 rate base total from Application Schedules W-B and S-B totals $6,914,024.

[16] A 10,000 gallon ground level storage tank is located on another piece of property and excluded from rate base by ORS for lack of proof of ownership. (Morgan Direct R. p. 511 and Hearing Exhibit 19 - Exhibit WJM-8).

Haig Point development[17]; and 4) these facilities are "used and useful" in providing water service. (Guastella Direct, R. p. 195, Walls Rebuttal, R. pp. 82-83). DIUC offered the testimony of the Beaufort County Treasurer Maria Walls who stated the Company is paying a utility tax on water system infrastructure. (Walls Rebuttal, R. p. 83).

Both ORS and the POAs excluded the facilities from rate base. ORS testified that DIUC did not provide enough information for ORS to determine whether or not DIUC is the owner of those facilities. (R. p. 502 and Morgan Surrebuttal, R. p. 517). ORS excluded the facilities from rate base in Docket No. 2011-229-WS. (Morgan Surrebuttal, R. p. 516 and Gearheart Direct, R. p. 496). In support of its position that DIUC had not supplied sufficient information to demonstrate ownership of the facilities, ORS entered into evidence a December 2011 Beaufort County government Tax Deed ("Tax Deed") conveying the Site in a delinquent tax sale. (Hearing Exhibit 19 – Exhibit WJM-7). The delinquent tax sale occurred as a result of DIUC's failure to pay taxes. The Tax Deed describes the property sold as the "Elevated Tank Site" and further states the "Elevated Tank Site's" "premises" and "appurtenances" are granted to Mamdouh Sabry Abdelrahman ("Mr. Sabry"). Mr. Sabry, the grantee, is not associated with DIUC. (R. p. 156).

With respect to the overall rate base, the POAs recommended that DIUC's rate base as proposed $7,085,475 be reduced by $3,745,530 as a result of 1) increased accumulated depreciation, 2) contributions in aid of construction ("CIAC") and 3) CIAC

[17] With respect to DIUC's access to the facilities on land it does not own, DIUC testified it has a perpetual easement to the facilities, however, no evidence was produced of a perpetual easement or any easement recorded after the sale of the property. (R. p. 156 and Hearing Exhibit 8).

amortization. (Loy Direct, Table 1, R. p. 371). Witness Mr. Loy for the POAs testified that Generally Accepted Accounting Principles ("GAAP") and appropriate regulatory accounting required that accumulated depreciation be calculated on a straight-line basis from the "in service" date through the end of the test year. (Loy Direct, R. p. 371). In addition, Mr. Loy testified that an adjustment increasing accumulated depreciation "reflects the proper age and condition of the utility property," (Loy Direct, R. p. 371).

POAs witness Mr. Jue echoed Mr. Loy's conclusion, opining that the DIUC system "would be expected to reflect accumulated depreciation of approximately 30%." (Jue Direct, R. p. 362). Mr. Loy also testified that certain DIUC plant purchased from Haig Point Utility Company ("HPUC") should be classified as CIAC rather than invested plant. According to Mr. Loy, International Paper (the original owner of HPUC) and later Haig Point, Inc. ("HPI") treated the utility plant in HPUC as inventory, expensed those costs, and donated those assets to HPUC. (Loy Direct, R. p. 380). As support for this conclusion, Mr. Loy testified that HPUC Water Annual Reports for the years 2000-2003 showed no plant balances at all. (Loy Direct, R. p. 381). Mr. Loy asserts that the failure to classify plant as CIAC requires adjustments to both net plant and CIAC amortization. Mr. Loy also testified that the appropriate characterization of DIUC plant as CIAC would greatly reduce the DIUC property tax burden, both for back taxes (a reduction of $402,108 for tax years 2011-2013) and in the test year (a reduction of $115,995 for tax year 2014). (Loy Direct, R. p. 396).

In sum, the POAs recommended adjustments, largely to net utility plant, accumulated depreciation, contributions in aid of construction, and accumulated

amortization to CIAC that would reduce the rate base for combined operations to $3,276,311.

By contrast, ORS used the carryforward rate base from the last rate case in Docket No. 2011-229-WS, $4,615,755, and made adjustments through December 31, 2014[18]. (R. p. 524.) Using DIUC's utilization factor method with ORS's adjustments, ORS recommended that $1,932,858 be deducted from the Company's December 31, 2014, Application rate base. Of the amount deducted, $1,624,696 is gross plant in service representing non-allowable plant, adjustments from the previous case not carried forward by DIUC in this Application, and retirements. (Gearheart Direct, R. p. 496.)

ORS Audit Exhibit ICG-5 (Hearing Exhibit 18) shows the specific items composing the $1,624,696. ORS also increased accumulated depreciation by $141,198 and deducted $254,853 from Construction Work in Progress ("CWIP"). Accumulated amortization of CIAC added $213 to the above gross plant in service, accumulated depreciation, and CWIP adjustments to arrive at a total net plant deduction of $2,020,534. When $87,676 in working capital was added, the total rate base reduction became $1,932,858. (R. ORS Audit Exhibit ICG-1, Hearing Exhibit 18). After deducting the rate base adjustment from the Application Schedule W-B and S-B December 31, 2014, rate base of $6,914,024, ORS's recommended rate base for combined operations was $4,981,166. In summary, DIUC's recommended rate base was $7,085,475, the POAs' was $3,276,311, and ORS's was $4,981,166.

[18] For the carryforward amount, ORS used the rate base it calculated in the prior rate case instead of using the Settlement rate base in Docket No. 2011-229-WS.

After reviewing the evidence presented by DIUC, ORS, and the POAs, the Commission accepts the rate base determination methodology and adjustments proposed by ORS. The Commission cannot accept the rate base as proposed by DIUC, given the murky status of the equipment on the tax sale land. (See discussion below.) The ORS methodology is logical in its steps and sets forth sound methods for determining a proper rate base on which a return may be granted. Considering the number of rate cases and all that has occurred since International Paper owned the utility, the Commission declines to adopt the rate base proposed by the POAs, However, the Commission's conclusions regarding DIUC's rate base do not preclude the parties from taking a different position in future proceedings if appropriate.

The Facilities

DIUC bears the burden of demonstrating the reasonableness of the plant values included in its proposed rate base, particularly when, as here, ORS and the POAs have challenged some of those values. *Utility Services of South Carolina, Inc. v. SCORS*, 392 S.C. 96, 109, 708 S.E.2d 755 (2011). The Commission agrees that DIUC has not met its burden in demonstrating the reasonableness of the plant values associated with the facilities. DIUC is permitted to earn a return only on the plant that it owns. 10 S.C. Code Ann. Regs. 103-702.16 defines "plant" as "[a]ll facilities *owned* by the utility for the collection, production, purification, storage, transmission, metering, and distribution of potable water." (Emphasis added). It is undisputed that DIUC does not own the Site, the real property upon which the elevated storage tank is located.

With respect to the facilities, although it is uncontested those assets are used and useful for DIUC, DIUC has not demonstrated that it "owns" these facilities for purposes of including their values in rate base. First, the late-filed Exhibit 6, a Letter from Gary N. James, Assessor for Beaufort County, states that in 2009 the Beaufort County Assessor's Office showed the property "as having a water tank/tower." Second, the Tax Deed states the "appurtenances to the" "Elevated Tank Site" were conveyed to Mr. Sabry. While "appurtenances" is not defined in the Tax Deed, the Black's Law Dictionary (9th ed.) definition of the term "appurtenance"- "[s]omething that belongs or is attached to something else"-- suggests that the facilities were "appurtenances."

Similarly, the evidence in the record is conflicting regarding what property was transferred by the Tax Deed. DIUC witness Walls testified in her pre-filed testimony that the Tax Deed did not include any DIUC utility property, and further that Mr. Sabry is not taxed for the facilities. (R. p. 83). However, on cross examination by ORS, Ms. Walls stated she could not answer the question of whether the elevated storage tank is an "appurtenance" that would have been conveyed in the grant to Mr. Sabry. (Walls, R. p. 100). Further, Hearing Exhibit 19 (Exhibit WJM-7), a printout from the Beaufort County website and describing the Elevated Tank Site, shows that Beaufort County is taxing Mr. Sabry, not DIUC, for at least one building on the property (described as a "UTLSHED").

With respect to the question of whether DIUC pays property taxes to Beaufort County based upon the value of the facilities, the record is also unclear. ORS witness Morgan testified that based on conversations with the SC Department of Revenue ("DOR"), Beaufort County and DIUC, ORS understands that DOR utilizes the utility

plant-in-service values DIUC lists on Schedule 201 (Utility Plant-in-Service) of the Water Annual Report to value the amount of property subject to tax by Beaufort County. (Morgan Surrebuttal, R. p. 516). DIUC submitted Revised Water Annual Reports to ORS and the Commission for years 2012 and 2013. (Hearing Exhibit 20). In the Revised Water Annual Reports filed by DIUC, DIUC made adjustments on Schedule 201, adjusting the value of the utility plant-in-service by ($1,110,715) for 2012 and ($893,781) for 2013. ORS testified these amounts appear to correspond to the plant asset value of $863,379 removed by ORS for the elevated storage tank in Docket No. 2011-229-WS. (Id.)

ORS witness Morgan testified that he understood that DIUC specifically filed Revised Water Annual Reports for 2012 and 2013 to reflect the rate base allowed in Docket No. 2011-229-WS which would likely result in a reduction of the property valuation computed by DOR for DIUC. (Id.) Mr. Morgan stated it also appears that the Water Annual Report filed by DIUC for 2014 includes similar adjusted plant-in-service values. ORS's position is that DIUC should not be allowed to earn a return on the elevated storage tank for ratemaking purposes while at the same time having taken action that could reduce property taxes by revising annual reports to deduct a value corresponding to the elevated storage tank value. (Id. at 516-517).

The Commission agrees with ORS that DIUC's adjustments reducing plant-in-service values for property tax purposes, as well as the uncertainty regarding what DIUC owns as a result of the delinquent tax sale, support removing the value of the facilities from DIUC's rate base in this case. DIUC's actions in removing plant for reporting

purposes and thereby removing the corresponding tax obligations associated therewith, are inconsistent with the proposition that DIUC owns those assets for ratemaking purposes. While DIUC may not have adjusted its utility plant-in-service by the exact value of the elevated storage tank, in at least two tax years DIUC has reduced its total utility plant-in-service by a value very similar to (and actually exceeding) that of the elevated storage tank.

In other words, and contrary to its testimony, DIUC does not pay taxes on all of its utility plant-in-service that it claims to be part of its rate base in this Docket. The Commission concludes that removal of the facilities from rate base is therefore appropriate in these circumstances at this time. DIUC has attempted to condemn the real property at issue, however, the legality of the Company's condemnation of the land which was sold at a Tax Sale is presently before the South Carolina Court of Appeals for a ruling. Should the Court rule in favor of the Company, then the issue of ownership of this property and possible inclusion in rate base may be clearer for further examination in a future rate case.

Also, regarding the question of Company facilities located on the real property of private owners, public witness Delaney raised the issue of a treatment plant on his private property in Bloody Point which has not been addressed by the Company. We believe that the Company should attempt to resolve this issue as soon as possible, and file the general status reports on utility property located on private land as required by our "ordering section" below.

Property Taxes

Since the last DIUC rate case in 2011, all parties agree that DIUC has had difficulties concerning property taxes DIUC did not pay 2009 and 2010 property taxes when due. As discussed above, DIUC lost property in a delinquent tax sale as a result. DIUC testified that Beaufort County mailed the tax bills to the wrong address. (Guastella, R. p. 139). In addition, the Company's 2012, 2013, and 2014 Beaufort County property taxes were significantly higher than what they had been in years prior. (Id.) At issue among the parties is how much property taxes should be paid by the ratepayers.

After learning about the delinquent taxes, DIUC and the Beaufort County Treasurer entered into a settlement agreement that was entered into evidence. The settlement agreement allowed DIUC to pay Beaufort County monthly payments of $5,487.95 to cover property taxes totaling $526,843.39 for 2012, 2013, 2014, and 2015. The Beaufort County Treasurer testified that the monthly payment was derived by amortizing the $526,843.39 over eight years. (Walls Rebuttal, R. p. 83, *see also* Hearing Exhibit 5). Originally the amount was $651,267.27, but the settlement agreement was amended to the reduced amount of $526,843.39 after the SC Department of Revenue ("DOR") submitted lower asset values to Beaufort County. (Id.)

With respect to its property tax request in this case, DIUC requested additional annual property tax expense of $65,856 for the 2012, 2013, 2014 and 2015 taxes and $ 188,093 for the annual amount of taxes going forward. DIUC's property tax expense request totaled $258,158 ($4,209 per books plus $65,856 plus $188,093). (Guastella Rebuttal, R. p. 212). The POAs recommended that DIUC's tax expense be based on the

POAs' downward-adjusted rate base. (Loy Direct, R. p. 367). ORS testified that DIUC's current books reflected approximately $4,000 annually for property taxes and, with the ORS adjustments, DIUC would have $171,492 annually to cover property taxes.

Specifically, ORS recommended that DIUC receive $30,612 annually for the 2012 and 2013 taxes totaling $244,899 amortized over 8 years and $140,880 for the 2014 or test year taxes. (Gearheart Direct, R. p. 495). ORS based its 2012 and 2013 adjustment amount and amortization period on DIUC's settlement with Beaufort County. The 2014 adjustment was based on the actual tax bills/assessment. ORS witness Gearheart testified that ORS allowed amounts for the 2012 and 2013 taxes, because DIUC did not have an opportunity to request a rate increase to cover the taxes after agreeing to a moratorium through July 1, 2014, in the settlement in Docket No. 2011-229-WS. (Id.). ORS declined to allow property taxes for 2015 since ORS utilizes a historical test year.

Based on the evidence in the record and adopting the property tax analysis in the section entitled "The Facilities" above, the Commission adopts the property tax amounts as computed by ORS as they are based on known and measurable amounts. The Commission acknowledges that the 2015 property taxes appear to be set pursuant to the Settlement; however, we do not believe the 2015 amounts should be covered by ratepayers. The 2015 tax bill is not due until 2016 and this Commission notes that the Company's settlement agreement with Beaufort County has already been amended once, and could be amended in the future. We decline the POAs property tax recommendation since the POAs based their recommendation on a lower rate base amount that we do not

adopt. Also, the POAs agreed to the ORS property tax recommendations in the Settlement. Further, we reject the Company's property tax recommendation, since it is based in part on the questionable ownership status of real property as noted above.

Management Fees, Rate Case Expenses, and Other Expenses

DIUC has a contract with GA for management services which was entered into evidence. (Hearing Exhibit 9.) In it, and confirmed through cross examination by the POAs and ORS, DIUC acknowledged that it agrees to pay GA a management fee of $13,596.85 a month with an annual 3.5% increase; a finance fee of 2% of the principal amount of any loan or GA's actual total hourly rates for handling the loan, whichever is greater; a capital fee of 10% for the first $50,000 of construction and 8% for construction costs over $50,000; an incentive fee of 20% of the total net utility operating income; an incentive fee if DIUC is sold; rate case expenses; travel expenses; and expenses related to regulatory investigations and proceedings.

In its Application, DIUC requested that ratepayers cover $171,364 for management services paid to GA. Per ORS, DIUC also included an incentive fee in its test year management fees. (Gearheart Direct, R. p. 493). POA witness Lanier testified that the Commission should not allow DIUC to use its higher expenses related to GA to justify the need for a rate increase. (Lanier Direct, R. pp. 421-422). ORS recommended that GA's management fees be limited to the previously Commission-approved amount of $132,211 a year. (Gearhart Direct, R. p. 539). ORS testified that it found no apparent increases in the management services provided by GA and did not find the requested increase justified.

DIUC requested $191,200 for current and unamortized rate case expenses to be recovered over 4 years. (Guastella Rebuttal, R. p. 218). DIUC also testified that it would update its rate case expenses at the hearing to show the additional expenses incurred since the Application. (Guastella, R. p. 181). ORS proposed that rate case expenses total $97,500 and be amortized over five years. (Gearheart, Direct R. p. 494). The $97,500 consists of capped current rate case expenses in the amount of $75,000 for GA's preparation of the Application, developing rate models, calculating test year data, filing other rate case documents and legal expenses. ORS recommended $75,000 as a reasonable amount for rate case expenses in the last rate case. The remaining $22,500 is unamortized rate case expenses from the previous rate case. (Gearheart, Direct R. p. 495).

ORS excluded from operating and maintenance expenses the incentive fee[19] included in the test year and $25,439[20] representing GA's management fee, legal expenses related to the property tax appeal and tax sale of the water tower, and other expenses not allowable for rate making purposes. (Gearheart, Direct R. p. 493). DIUC witness Guastella disputed all exclusions noting "[GA's] efforts reflect an unequivocal commitment to provide adequate service to the customers, some of which were achieved because of GA's rate setting expertise that is not typical of other managers." (Guastella Rebuttal, R. p. 198). "Having consulted for some 600 developer-related water and sewer utilities, I am not aware of any that had managers with the regulatory, utility accounting, valuation, or rate setting experience that GA applied in meeting the challenges of

[19] *See* ORS Adjustment 4(m).
[20] *See* ORS Adjustment 4(g).

managing DIUC." (Guastella Rebuttal, R. p. 218). DIUC witness Guastella also testified, contrary to ORS's testimony, that the existing and proposed rates do not include any allowance for GA's incentive fee. (Guastella Rebuttal, R. p. 216).

Upon review of the evidence, the Commission adopts ORS's adjustments for management fees, rate case expenses, and non-allowable expenses. We agree that GA provides services to the ratepayers, but disagree that the services are at a level that warrant the amount set forth in the management services contract. We think it is appropriate for DIUC stockholders to have responsibility for the difference. While customer service complaints are few in number, this Commission did hear testimony at the merits hearing that GA was an absentee management company.. Mr. Guastella testified that he and his son live in Florida, the Vice President and Director of Accounting Mr. White lives in New York or Florida, and the accounting and billing for the Company is performed in Boston. (Guastella Direct, R. p. 256.) Further, he stated that the Company's books are in either Boston, Florida, or New York at various times. (Guastella, R., p. 255.) *See also* Lanier, R. p. 461.

It is undisputed that DIUC did not pay property taxes under GA's tenure (resulting in the tax sale described above), that required regulatory reports and fees have been filed and paid late (R. p. 244), and that the South Carolina Department of Health and Environmental Control ("DHEC") issued a notice of violations against DIUC (Vogel Direct, R. p. 319, ll. 14-16). We conclude the ORS-recommended amount for management expenses strikes a reasonable balance. The Commission agrees with ORS's judgment that $75,000 in rate case expenses is a reasonable amount to pass to ratepayers

for this rate case. We also agree that the amortization period and the inclusion of unamortized rate case expenses from the last rate case are reasonable. The reasons set forth for excluding the non-allowable expenses are persuasive, and those costs should not be passed on to ratepayers. The Commission is in agreement with ORS as to the removal of these expenses in the present case, which complies with sound regulatory treatment.

Bad Debt Expense

In its Application, DIUC proposed bad debt expense associated with its proposed *pro forma* revenues to equal $16,090. Initially, ORS provided testimony proposing to adjust that expense upward to $108,349. (Gearheart Direct, R. p. 498). In the Settlement between the ORS and the POAs, and consistent with DIUC's request in its Application, ORS revised its adjustment to bad debt expense to utilize the methodology proposed by DIUC in its Application. (R. pp. 502-503). The bad debt expense is included in operation and maintenance expenses reflected in Settlement Exhibit ICG-3. The Commission accepts the bad debt expense methodology proposed by DIUC and adopted by ORS and the POAs in their Settlement. We conclude that this bad debt expense methodology is just and reasonable, particularly because it encourages DIUC to collect those debts it is owed.

Other Adjustments

The remaining ORS adjustments are accepted by this Commission without discussion. They either were not disputed by the parties or were caused by carrying out the effects of the adjustments adopted above.

Performance Bond

DIUC is currently providing the maximum amount required for its performance bond in the amount of $350,000 for water and $350,000 for sewer operations. Using the criteria set forth in 10 S.C. Code Ann. Regs. 103-512.3.1 and 103-712.3.1, ORS recommended that DIUC be required to continue the current performance bond amounts. DIUC and the POAs did not challenge the performance bond amounts. Accordingly and pursuant to S.C. Code Ann. § 58-5-720 and 10 S.C. Code Ann. Regs. 103-512.3 and 103-712.3, the Commission requires that DIUC maintain its performance bond in the amount of $350,000 for water and $350,000 for sewer operations.

Settlement

On October 27, 2015, the POAs and ORS filed with the Commission a Settlement, whereby the POAs and ORS agreed to recommend to the Commission a revenue increase of $462,798 for DIUC's combined water and sewer operations. The Settlement includes five exhibits based on the revenue stated in the document, with the first exhibit setting forth a proposed rate structure, the second exhibit showing the percentage increase for the proposed rates and the third, fourth, and fifth exhibits showing the operating experience, rate base and rates of return. The Settlement and its exhibits are hereby incorporated into this Order as fully as if repeated verbatim herein. The revenue was determined by accepting all of ORS' recommended adjustments, with the exception that ORS agreed to recalculate its recommended bad debt expense to adopt the calculation methodology utilized by DIUC in its Application. No other changes were made by ORS to its adjustments. The Settlement states the $462,798 revenue increase

produces an ROE of 9.28% and an operating margin of 16.18% for the combined operations. The Settlement's proposed revenue increase, $462,798, is 39.1% of the Company's requested revenue.

At the outset of the hearing and after counsel for the POAs introduced the Settlement into the record, DIUC objected to its inclusion stating that it would be improper for the Commission to consider or rule upon its terms without hearing all evidence. The objection was duly noted and overruled, since it was decided that the better practice is to accept a Settlement when presented, but continue to hear all evidence in the case prior to making a ruling on the merits of the case.

The Commission finds, based on the testimony of DIUC, the POAs and ORS, that an increase in rates is supported by the evidence presented. DIUC has not applied for a rate increase in several years as it was prevented from doing so pursuant to the Settlement approved in its last rate case in Docket No. 2011-229-WS. Expenses have increased during the last four years, and the Company is entitled to a fair and reasonable return to allow it to serve its customers at the same level.

After reviewing the evidence in this case, we adopt and approve the Settlement and its exhibits. The Settlement includes all ORS adjustments with the exception of the bad debt expense. ORS testified that it recalculated its bad debt expense to reflect the calculation recommended by DIUC in its Application. The use of the Company's bad debt expense calculation methodology causes a downward adjustment of working capital and therefore rate base. The rate base ORS recommended in its direct testimony changes from $4,981,166 to $4,962,927 in the Settlement as a result. We find the use of the

Company's recommended bad debt expense calculation reasonable and approve the resulting rate base and Settlement in its entirety. The Settlement revenue amount produces an operating margin of 16.18%. Further, the 9.28% ROE is within the ORS-recommended range adopted by this Commission of 8.91% to 9.71% and is within 3/100's of a point to the ORS-recommended ROE of 9.31%. The Settlement will permit the Company to cover operating costs and provide an opportunity to earn the approved rate of return on rate base. The resulting ROE allows DIUC the opportunity to earn a fair return and we agree with ORS that the Settlement is in the public interest.

III. FINDINGS OF FACT

1. DIUC is a water and sewer utility providing water and sewer service in its assigned service area on Daufuskie Island, Beaufort County, South Carolina. The Commission is vested with authority to regulate rates of every public utility in this state and to ascertain and fix just and reasonable rates for service. S.C. Ann. §58-5-210, *et. seq.* DIUC's operations in South Carolina are subject to the jurisdiction of the Commission.

2. DIUC requested in its Application to increase revenues for combined operations by $1,182,301, consisting of a water revenue increase of $590,454, and a sewer revenue increase of $591,847, based on the rate of return on rate base methodology utilizing an ROE of 10.5% and a 2014 historical test year.

3. The appropriate test year period for this proceeding, selected by the Company, is January 1, 2014 through December 31, 2014.

4. The Commission will use the return on rate base methodology in determining and fixing just and reasonable rates.

5. The return on rate base methodology requires three components: capital structure, cost of debt, and cost of equity (or return on equity).

6. The Commission adopts and approves the Settlement in its entirety as it sets forth a fair return along with just and reasonable rates, and its terms are based on the evidence of record. The approved rates are attached hereto as Order Exhibit 1.

7. The approved Settlement utilizes a capital structure of 46% long-term debt and 54% equity; a cost of debt rate of 5.29%; and an ROE of 9.28%.

8. The Settlement ROE of 9.28% produces additional operating revenue of $462,798 consisting of a water revenues increase of $278,903 and a sewer revenue increase of $183,895.

9. The Settlement sets DIUC's rate base at $4,962,927.

10. The approved Settlement's revenues and expenses establish a fair and reasonable operating margin of 16.18%, and a return on rate base of 7.44%.

IV. CONCLUSIONS OF LAW

Based upon the Discussion, Findings of Fact as set forth herein, and the record of the instant proceeding, the Commission makes the following Conclusions of Law:

1. DIUC is a public utility as defined in S.C. Code Ann. § 58-5-10(3) and as such is subject to the jurisdiction of this Commission.

2. The appropriate test year on which to set rates for DIUC is the twelve month period ending December 31, 2014.

3. Based on the information provided by the parties, the Commission concludes the appropriate rate setting methodology to use as a guide in determining the lawfulness of DIUC's proposed rates and for the fixing of just and reasonable rates is return on rate base.

4. In order for DIUC to have the opportunity to earn the 9.28% ROE, found fair and reasonable herein, DIUC must be allowed additional revenues of $462,798.

5. The rates as set forth in the attached Order Exhibit 1 are approved for use by DIUC and are designed to be just and reasonable without undue discrimination and are also designed to meet the revenue requirements of DIUC.

6. Pursuant to S.C. Code Ann. § 58-5-720 and 10 S.C. Code Ann. Regs. 103-512.3 and 103-712.3, DIUC shall post a performance bond of $350,000 water and $350,000 for sewer operations.

V. ORDERING PROVISIONS

IT IS THEREFORE ORDERED THAT:

1. The Settlement is in the public interest, constitutes a reasonable resolution of this proceeding, and is supported by the evidence in this case. The Settlement is therefore approved.

2. The proposed rates, fees, and charges in Order Exhibit 1 are both fair and reasonable and will allow DIUC to continue to provide its customers with adequate water and wastewater services. We further find that the additional terms and conditions set forth in the Settlement are reasonable and fair.

3. The Company is to provide thirty (30) days' advance notice of the increase to customers of its water and wastewater services prior to the rates and schedules being put into effect for service rendered. The schedules shall be deemed to be filed with the Commission pursuant to S.C. Code Ann. § 58-5-240.

4. A return on equity of 9.28%, return on rate base of 7.44%, and operating margin of 16.18%, based on the new rates, fees, and charges, is approved for DIUC.

5. The Company shall continue to maintain current performance bonds in the amounts of $350,000 for water operations and $350,000 for wastewater operations pursuant to S.C. Code Ann. § 58-5-720.

6. The Company's books and records shall be maintained according to the National Association of Regulatory Utility Commissioners ("NARUC") Uniform System of Accounts. The Company is directed to make any necessary adjustments to its accounting system to conform to the NARUC Uniform System of Accounts.

7. The Company should promptly address all property ownership issues wherein utility facilities are located on private property, and notify the Commission and ORS in writing as to the status of ownership within six months of the date of this Order and every six months thereafter until resolved.

8. This Order shall remain in full force and effect until further order of the Commission.

BY ORDER OF THE COMMISSION:

Nikiya Hall, Chairman

ATTEST:

Swain E. Whitfield, Vice Chairman

(SEAL)

Settlement Exhibit WJM-1

Daufuskie Island Utility Company, Inc.
Schedule of Current and Proposed Rates
Docket No. 2014-346-WS

		Haig Pt. Settlement Rates	Melrose Settlement Rates
I. Residential Rates			
A. Water:			
1) Tapping Fees & 3/4" Meter Box		$500.00	$500.00
2) Base Quarterly Charge		$80.81	$105.05
3) Consumption Charge (per 1,000 gallons)	0 to 22,500 gallons per quarter	$4.41	$4.41
	Over 22,500 gallons	$4.41	$4.41
B. Sewer:			
1) Tapping Fees & Service Lateral		$500.00	$500.00
2) Base Quarterly Charge		$143.65	$105.05
3) Volumetric Charge (per 1,000 gallons)	0 to 22,500 gallons per quarter	$2.38	$2.38
	Over 22,500 gallons	$2.38	$2.38
C. Irrigation:			
1) Tapping Fees & 3/4" Meter Box		$500.00	$500.00
2) Consumption Charge (per 1,000 gallons)	0 to 18,000 gallons per quarter	$4.85	$4.85
	18,001 to 60,000 gallons	$5.73	$5.73
	Over 60,000 gallons	$6.61	$6.61
II. Commercial Rates			
A. Water:			
1) Tapping Fees per Hotel or Inn Room		$250.00	$250.00
2) Tapping Fees up to 1-1/2" Meter		$500.00	$500.00
3) Tapping Fees 2" or 3" Meter		$1,500.00	$1,500.00
4) Tapping Fees for 6" Meter		$3,500.00	$3,500.00
Note: Larger meters on a case by case basis.			
5) Base Quarterly Charge		$113.17	$177.77
6) Consumption Charge (per 1,000 gallons)	0 to 22,500 gallons per quarter	$4.41	$4.41
	Over 22,500 gallons	$4.41	$4.41
B. Sewer:			
1) Tapping Fees per Hotel or Inn Room		$250.00	$250.00
2) Tapping Fees 4" - 8" Sewer Pipe		$500.00	$500.00
3) Base Quarterly Charge		$231.93	$177.77
4) Volumetric Charge (per 1,000 gallons)	0 to 22,500 gallons per quarter	$2.38	$2.38
	Over 22,500 gallons	$2.38	$2.38
C. Irrigation:			
1) Tapping Fees & 3/4" Meter Box		$500.00	$500.00
2) Consumption Charge (per 1,000 gallons)	0 to 18,000 gallons per quarter	$4.85	$4.85
	18,001 to 60,000 gallons	$5.73	$5.73
	Over 60,000 gallons	$6.61	$6.61

Settlement Exhibit WJM-1

III. Availability Rates (Quarterly)

A. Water	$40.40	$99.38
B. Sewer	$71.83	$110.72

III. Special Conditions

A. Tapping Fees:

Haig Point - Capacity in the water and sewer systems has been reserved for purchasers of lots and/or building sites at Haig Point. Tapping Fees must have been paid and water and sewer charges commenced within five years from purchase date.* *This applies to lots purchased prior to date of this order, but not to lots sold after the date of this order. (See Commission Order No. 93-761 in Docket No. 87-333-WS)

Melrose - Capacity in the water and sewer systems has been reserved for purchasers of lots and/or building sites at Haig Point. Tapping Fees must have been paid and water and sewer charges commenced within five years from purchase date.

B. Backflow Prevention: All irrigation systems and pipes running from potable water lines must have approved backflow prevention devices installed.

C. System Development Charge: Should new customers or their agent(s) petition to connect to the systems where there are no existing lines, pumps, hydrants, etc.; and should such petitions be approved, the following requirements shall apply:

1. New customers or their agent(s) shall be responsible for the cost of installation of the new water and sewer systems, including points of connection with existing systems and effluent return systems. The installation shall be according to the requirements and satisfaction to the utility company, and costs shall include observation, testing, and certification services provided by utility company.

2. New customers or their agent(s) who install their systems must pay an amount equal to their share of the net investment in the existing plant and system facilities. This payment, on a cost per gallon of design flow, will be made according to the System Buy-in Pricing Basis (AWWA Manual 26, First Edition), based on the following formula.

a. System Original Cost - Accumulated Depreciation = Net Cost

b. Net Cost - Outstanding Debt = Total Equity*

$$\text{c. Flow (Total design gallons per day)} = \frac{\text{Total Equity Investment}}{\text{System Water or Sewer}} = \$/\text{gallons}$$

*For these calculations, the utility company's annual report to the PSC for the preceding year shall be used. Extra strength wastewaters will be charged accordingly.

BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 2014-346-WS - ORDER NO. 2016-50

FEBRUARY 25, 2016

IN RE:	Application of Daufuskie Island Utility Company, Incorporated for Approval of an Increase for Water and Sewer Rates, Terms and Conditions	))))	ORDER DENYING PETITION FOR RECONSIDERATION AND/OR REHEARING

I. INTRODUCTION

This matter comes before the Public Service Commission of South Carolina ("the Commission") on the Petition for Reconsideration and/or Rehearing of Order No. 2015-846 ("the Petition") filed by Daufuskie Island Utility Company, Inc. ("DIUC," "the Company" or "the Utility").

The Company argues that, if forced to implement rates as established by the Commission's December 8, 2015 rate order, it will default on its obligations and its ability to provide service will be threatened. DIUC further states that its operating results and adjustments showing gross revenues and expenses are the only numbers that should be considered in judging whether the Company can meet its obligations on its loan from SunTrust Bank, or whether the various expense amounts allowed by the Commission in Order No. 2015-846 are reasonable. See Order No. 2015-846 at 1. DIUC states that "The DIUC Proposed Order must be substituted in its entirety so as to prevent a host of problems, including DIUC's loan default." The Company characterizes the Commission's decision as being inadequate to allow it to service its debt, and also complains that the Commission

approved inadequate amounts for property taxes, management fees, rate case expenses, bad debts, and rate base. Based on the reasoning stated below, the Petition is denied.

By law, this Commission must examine a utility's proposed figures during a test year, and make adjustments to those numbers when appropriate. The Commission will consider adjustments for any known and measurable out-of-test year changes in expenses, revenues, and investments, and will also consider adjustments for any unusual situations which occurred in the test year. Where an unusual situation exists which shows that the test year figures are atypical, the Commission should adjust the test year data under the case law. See Heater of Seabrook v. Public Service Commission of South Carolina, 324 S.C. 56, 478 S.E.2d 826, 828 n.1 (1996). Southern Bell v. The Public Service Commission, 270 S.C. 590, 244 S.E. 2d 278 (1978); see also, Parker v. South Carolina Public Service Commission, 280 S.C. 310, 313 S.E.2d 290 (1984), citing City of Pittsburgh v. Pennsylvania Public Utility Commission, 187 P.A. Super. 341, 144 A.2d 648 (1958). See also Order No. 2015-846 at 7. The testimony presented to the Commission showed several atypical test year figures, which are discussed further below. Clearly, this Commission may determine that some portion of an expense actually incurred by a utility should not be passed on to consumers. See Utilities Services of South Carolina, Inc. v. The South Carolina Office of Regulatory Staff, 392 S.C. 96, 708 S.E. 2d 755 (2011).

In this case, the Office of Regulatory Staff ("ORS"), consistent with accepted regulatory principles, proposed adjustments to the Company's proposed revenues, expenditures, and capital investments to normalize the Company's operating experience and rate base, using a 2014 test year in conformance with these principles, and proffered

testimony accordingly. The three Property Owners Associations ("POAs"), which are Haig Point Club and Community Association, Inc., Melrose Property Owner's Association, Inc., and Bloody Point Property Owner's Association, also utilized a 2014 historic test year with proposed adjustments. The Commission outlined this process in detail in Order No. 2015-846, and ultimately made a determination to accept an agreement between ORS and the POAs which utilized mostly ORS adjustments, with one exception, which was an adjustment proposed by the Company's Application. These adjustments were based on relevant evidence and were accepted by the Commission for ratemaking purposes to determine the appropriate adjustments to the Company's rates in the case as explained in Order No. 2015-846. Many of the expense figures proposed by the Company were adjusted downward, consistent with the evidence.

The operating results and adjustments showing gross revenue and expenses discussed by the Company are unadjusted numbers and are inappropriate for determining a utility's level of revenue and expenses for ratemaking purposes without adjustment under Commission procedures. Thus, it is unrealistic and contrary to regulatory principles for the Company to state that its operating results and adjustments are the "actual" numbers, and must be the only numbers used for ratemaking purposes, and that the Company's operating results and adjustments are the only numbers that should be used for determining whether certain ratios are met to determine proper service of the Company's SunTrust loan. The "book" methodology proposed by the Company assumes that the Company's ratepayers are responsible for 100% of all expenses incurred by the Company. The Commission's procedure in ordering just and reasonable rates ensures that the Company

collects only what should reasonably be paid by the Company's customers. The Utility's shareholders are responsible for the remainder in cases where proposed expenses are found to be unreasonable under Commission procedures.

II. SPECIFIC COMPANY ARGUMENTS

A. DEFAULT AND LOAN COMPLIANCE

With regard to specific points raised by the Company in its Petition, DIUC has stated that it will default on its obligations with SunTrust Bank, and that its ability to provide service will be threatened if it is forced to implement rates required by Order No. 2015-846. The witnesses for the Company testified extensively with regard to a new loan that it hoped to obtain, which would replace the present SunTrust loan discussed in the Company's Petition. There is very little testimony in the case about the present loan.

With regard to the loan at issue, the Utility alleges in its Petition that the loan documents for the SunTrust Bank financing approved by this Commission in Docket No. 2012-397-WS, Order No. 2013-605, include covenants that put DIUC in default if it does not maintain a minimum debt service coverage and minimum Earnings Before Interest, Taxes, Depreciation, and Amortization ratio. (Petition at 3.)

Unfortunately, these referenced loan documents are not in the record of this case. They were not pre-filed, nor were they offered as evidence. Further, a review of Docket No. 2012-397-WS, Order No. 2013-605, in the loan approval Docket shows that no loan documents were filed or placed into evidence in that case either. The record of this case only contains bare assertions by the Company that the Company will be unable to service its debt under the rate schedule required under Order No. 2015-846. The Petition and

Attachment A to the Petition attempt to characterize the effect the Order will have on the Company's compliance with the Covenants, offering detailed additional opinions that were not offered via testimony during the hearing. As such, no party could test those opinions, or the inputs or assumptions leading to those opinions by cross-examining a witness making them, nor could a party inquire or cross-examine a Company witness about the figures contained in the loan documents or the effect of utilization of the Commission-approved numbers to determine various ratios required by SunTrust. This raises major due process concerns for the opposing parties. See Vora v. Lexington Medical Center, 354 S.C. 590, 582 S.E. 2d 413 (2003). At the very least, these issues were prejudicial to the parties.

In general, a party cannot raise issues in a Petition for Reconsideration that were not raised during the proceeding. See Kiawah Prop. Owners Group v. Pub. Serv. Comm'n, 359 S.C. 105, 113, 597 S.E.2d 145, 149 (2004); Hickman v. Hickman, 301 S.C. 455, 456, 392 S.E.2d 481, 482 (Ct. App 1990); Patterson v. Reid, 318 S.C. 183, 185, 456 S.E.2d 436, 437 (Ct. App. 1995). While Company witness Guastella made a bare assertion at the hearing, which is referenced in the Petition, regarding the effect of adoption of the rates approved in the Settlement Agreement, the specific issues and characterizations of the Covenants, DIUC's operation under the Covenants, and SunTrust's putative actions pursuant to the Covenants raised in the Petition and discussed in Attachment A were not raised during the hearing. As a result, the Commission cannot address these issues on reconsideration.

Further, in the alternative, even if the documents on the loan were part of the record in the case, there is no present justiciable controversy with regard to the SunTrust Bank

loan. A court is obligated to inquire in every action whether a justiciable controversy exists in a matter. Treatment and Care of Luckabaugh, 351 S.C. 122, 568 S.E. 2d 338 (2002); Byrd v. Irmo High School, 321 S.C. 426, 468 S.E. 2d 861 (1996). "A justiciable controversy is a real and substantial controversy which is ripe and appropriate for judicial determination, as distinguished from a contingent, hypothetical or abstract dispute." Pee Dee Elec. Coop., Inc. v. Carolina Power & Light Co., 279 S.C. 64, 66, 301 S.E. 2d 761, 762 (1983). In the present case, DIUC states the following: ".....when SunTrust analyzes DIUC's books to determine if DIUC is in compliance with the terms of its loan, SunTrust will review the books DIUC presented to the Commission that reflect the Utility's actual expenses and bad debts." Petition at 4. This language highlights the contingent or hypothetical nature of the issue.

Further, the Company argues that collecting at the approved rates, there will be no money for equity return and DIUC will fail SunTrust's tests for debt service coverage and the Earnings Before Interest, Taxes, Depreciation, and Amortization ratio. Also, "the lack of income allowed to DIUC by the recent Order will put DIUC in default on its $2,500,000 term loan and will preclude DIUC's ability to repay its $500,000 line of credit." Petition at 3. Again, the Utility is describing a future contingent or hypothetical event. The only information provided is a bare assertion by the Company as to what could happen in the future. There is no evidence that SunTrust Bank has examined these issues. Loan provisions that may have some negative impact in the future cannot constitute a present, justiciable controversy. See Kiawah Property Owners Group v. The Public Service Commission of South Carolina, 357 S.C. 232, 593 S.E. 2d.148 (2004)

Further, it is important to point out that even if the matter constituted a justiciable controversy, and the relevant documents had been filed by the Company, the usefulness and propriety of those documents under ratemaking principles may not have had any bearing on the outcome of this case. The Company's long-term debt and capital structure were fully considered in this case by ORS witness Dr. Douglas H. Carlisle (Carlisle Direct, R. pp. 472-473), and the Commission considered these factors in its deliberations in this case. An examination of long-term debt and capital structure take into consideration debt such as that incurred with the Utility's SunTrust Bank loan. Therefore, even if the specific SunTrust loan documents had been in the record, the evidence may not have justified any other rates than the rates that were set in our original order in this case, Order No. 2015-846.

To summarize, the Commission cannot now consider that portion of the Petition characterizing the effect of Order No. 2015-846 on the Covenants, or the entirety of Attachment A to the Petition, since the documents were not submitted into the record under Commission rules, nor was a Company witness presented to explain and present the documents. This is tantamount to not raising the issue at all during the hearing on the merits. Moreover, even if this Commission considered DIUC's bare assertions in the record as sufficient to raise the matter at the hearing, the Company failed to meet its burden of proof, since it presented no detailed testimony and no exhibits concerning its position on the matter. Further, a matter cannot be raised for the first time on reconsideration, nor can the Commission rule on a matter that is not a justiciable controversy. In addition, even if the Company had furnished the requisite documents, and the SunTrust loan was squarely

before the Commission, the Company's long-term debt and capital structure, which included the debt incurred by the SunTrust Bank loan, were considered by the Commission through the testimony of ORS witness Carlisle. Consequently, we reject the Company's arguments on this issue.

B. ADJUSTMENTS FOR RECONSIDERATION

In the alternative, the Company requests rehearing or reconsideration of adjustments granted in Order No. 2015-846 for property taxes, management fees, rate case expenses, bad debts, and also asks for rehearing/reconsideration on two rate base matters. The Company failed to provide any new arguments on these matters, so we affirm our original holdings, and comment further in the paragraphs below.

Clearly, with the exception of affiliate transactions, a utility is entitled to a presumption in a ratemaking proceeding that its expenditures were reasonable and incurred in good faith. Nevertheless, the presumption in a utility's favor clearly does not foreclose scrutiny and a challenge. In these circumstances, the burden remains on the utility to demonstrate the reasonableness of its costs. Utilities Services of South Carolina, 392 S.C.at 110 and 708 S.E. 2d at 763. See also Hilton Head Plantation Utilities, Inc. v. The Public Service Commission of South Carolina, 312 S.C. 448, 441 S.E.2d 321 (1994). As in Utilities Services, the Utility in the present case wants the presumption of reasonableness to be dispositive. However, as in Utilities Services, it is not. The Company failed to meet its burden in the face of substantial evidence presented by ORS and other parties challenging its expenditures. Further, in the case of the management fees, the Utility is not entitled to the presumption, as will be explained further below.

i. Property Taxes

DIUC asks the Commission to reconsider the property tax expenses allowed for DIUC. ORS's recommendation supports DIUC recovering $171,492 annually from ratepayers to cover taxes utilizing the per book amount, the 2012 and 2013 tax amounts, and the 2014 test year amount. It is undisputed that DIUC did not pay Beaufort County taxes in 2009 and 2010. Unpaid property taxes were the cause of the delinquent tax sale of DIUC property in 2011. In addition, Beaufort County and DIUC entered into a Property Tax Settlement Agreement, amended once, for the payment of taxes for years 2012, 2013, 2014, and 2015. ORS recommended that DIUC receive $30,612 annually for the 2012 and 2013 taxes totaling $244,899 amortized over 8 years and $140,880 for the 2014 or test year taxes. ORS allowed amounts for the 2012 and 2013 taxes, because DIUC did not have an opportunity to request a rate increase to cover the taxes after agreeing to a moratorium through July 1, 2014, in the settlement in Docket No. 2011-229-WS.

With respect to the 2015 taxes, of which ORS declined to support recovery by DIUC, ORS testified that in the normal course taxes are due the following tax year, 2016. Specifically, ORS witness Gearheart testified that 2015 taxes were not allowed because 2014 was the test year, 2015 is a future year, DIUC has not been billed for the 2015 taxes, and ORS does not know what the future taxes will be. (R. p. 518, ll. 14-25; p. 519, ll. 1-16). Because of this testimony, the Commission declined to allow an amount for 2015 taxes, because the amount was outside the test year, was not known and measurable, and the 2014 property tax amount was properly included in the test year expenses.. Although this Commission could have considered and allowed this out of test year amount if

appropriate evidence had been presented, this Commission declined to do so, based on the ORS testimony described above. Under normal application of the use of a test year, the Company would have been granted one year's property tax expense. The fact that the Company has delinquent taxes is not the fault of the customers. ORS supported over $170,000 annually for property taxes which is well in excess of one year's expense (= $140,880). The Commission did consider and allow out of test year amounts already for property taxes in general.

Further, as discussed in Order No. 2015-846 at 21, the Company does not pay taxes on all of its utility plant-in-service that it claims to be part of its rate base in this Docket. In at least two tax years, DIUC has reduced its total utility plant-in-service by a value very similar to (and actually exceeding) that of the disputed elevated storage tank which is located on former utility property sold at a tax sale for failure to pay property taxes. (See further discussion in Rate Base section below.) Clearly, the property tax situation with this Utility was, and still is, in great disarray. The overall ORS adjustment to property taxes was accepted by this Commission as part of the approval of the agreement between ORS and the POAs in Order No. 2015-846, because we held that it was the best analysis of the Company's property taxes available in the case. The Commission still believes that the property tax adjustment adopted in that Order was proper, and was supported by the evidence in this case, even though the Company asserts that only the full amount claimed would be appropriate. We reaffirm our findings in Order No. 2015-846 on this issue.

ii. Management Fees

DIUC asserts that the Commission should have approved recovery of 100% of the management fees of Guastella Associates, LLC ("GA"). The GA Management Contract with DIUC shows GA charges DIUC the following:

1. a management fee of $13,596.85 a month ($163,162 annually) with an annual 3.5% increase;
2. a finance fee of 2% of the principal amount of any loan or GA's actual total hourly rates for handling the loan, whichever is greater;
3. a capital fee of 10% for the first $50,000 of construction and 8% for construction costs over $50,000;
4. an annual incentive fee of 20% of the total net utility operating income;
5. an incentive fee if DIUC is sold;
6. rate case expenses;
7. travel expenses (all of GA's out-of-pocket traveling expenses (including without limitation, transportation, room and board) and mileage reimbursement at the then current rate).
8. expenses related to regulatory investigations and proceedings.

See Hearing Exhibit 9.

In its Application, DIUC requested that ratepayers cover $171,364 for outside management expenses. Per ORS, DIUC also included an incentive fee in its test year

management expenses. POA witness Lanier testified that this Commission should not allow DIUC to use certain expenses related to GA to justify the need for a rate increase. His reasoning is that the GA management contract expenses allow for an inflation-based increase of 3.5% per year, whereas the actual inflation rate over the last three years was less than 2.0% per year. (Lanier Direct, R. pp. 432-433). ORS recommended that GA's management fees be limited to the previous Commission-approved amount of $132,211 a year. (Gearheart Direct, R. p. 493).

ORS testified that it found no apparent increases in the scope of management services provided by GA and did not find the requested increase justified, contrary to the position taken by the Company. Id. The Company has not persuaded this Commission that the allowable amount of expense for the Company's management fees should be increased. We believe that the amount allowed in Order No. 2015-846 was proper. The ORS adjustment was a reduction of $25,439 to the Company's per books amount of $157,650. We adopted the ORS adjustment as fair and reasonable. ORS also excluded from operating and maintenance expenses the incentive fee paid to GA of 20% of net operating income included in the test year, legal expenses related to the property tax appeal and tax sale of the water tower, and other expenses not allowable for rate making purposes, all adjustments which were adopted by this Commission.

Further, although expenses of a public utility are presumed to be reasonable when incurred in good faith, the presumption does not apply to affiliate payments. When payments are made by a regulated public utility to an affiliate, mere showing of actual payment does not establish a prima facie case of reasonableness. Clearly, Daufuskie Island

Utility Company, Inc. and its management company Guastella Associates, LLC are affiliates, as per the Agreement between the two dated June 18, 2015. See Hearing Exhibit 9. (An "affiliate" is defined by Black's Law Dictionary Free Online Legal Dictionary 2nd edition as "Companies that have a shared resources, interests, or business dealings.") In addition, further evidence of affiliation between GA and DIUC is shown in the Utility's 2014 Annual Report to the Commission and ORS. John Guastella, the Managing Member of Guastella Associates, LLC, has been a member of the Board of Directors of DIUC since July 9, 2008.[1] Further evidence of Mr. Guastella's membership on the DIUC Board of Directors is found at page 227 of the Transcript of Record, wherein Mr. Guastella admitted that he was still a DIUC Board of Directors member at the time of his testimony in this case.

The payment of unexplained expenses to affiliates does not entitle a regulated water and sewer utility to a requested increase in rates and charges. The rule is that if there is an absence of data and information from which the reasonableness and propriety of the services rendered and the reasonable cost of rendering such services can be ascertained by the Commission, allowance is properly refused. Hilton Head Plantation Utilities v. The Public Service Commission of South Carolina, supra. This language from the Hilton Head Plantation Utilities case requires the PSC to review and analyze these intercompany dealings and determine if they are reasonable. Kiawah Property Owners Group v. The Public Service Commission of South Carolina, 338 S.C. 92, 525 S.E. 2d 863 (1999). Again,

[1] The Company's 2014 Annual Report on file with the Commission is deemed to be part of the Company's Application, which is part of the record of this case, pursuant to the procedures set out by the South Carolina Code of Laws. See S.C. Code Ann. Regs. 103-512.4.A15, 103-712.4.A.15 and S.C. Code Ann. Section 1-23-320 (G) (3) (Supp. 2015).

ORS found no apparent increases in the amount of management services provided by GA since the last rate proceeding, and, accordingly, recommended that no increased amount be granted in the present case, and this Commission adopted the ORS finding. Since the Company did not provide a reasonable explanation for its request for an increase in this area, the extra expense was properly denied. Our findings in Order No. 2015-846 are correct.

iii. Rate Case Expenses

With respect to rate case expenses, DIUC requested $191,200 for current and unamortized rate case expenses to be recovered over four years. (Guastella Rebuttal, R., p. 218). ORS recommended $75,000 as a reasonable recovery amount for rate case expenses in the present case, and $22,500 in unamortized rate case expenses from the previous rate case. (Gearheart Direct R. pp. 494-495). Pursuant to the GA Management Agreement (Hearing Exhibit 9), rate case expenses are charged separately by GA to DIUC and during its audit, ORS alerted DIUC to concerns related to the large amount of rate case expenses attributed to GA. Accordingly, ORS recommended the same amount of rate case expenses, $75,000, as granted in the Company's last rate order, along with $22,500 for previously unamortized rate case expenses. (Gearheart Direct R. pp. 494-495). ORS saw no justification for additional rate case expenses in the present case. Again, the rate case expenses submitted by GA were from an affiliate of the utility. The Commission agrees with ORS as to the unreasonableness of additional rate case expenses charged by GA over and above what GA was already charging the utility in a monthly management fee of over

$13,000. We adopted the ORS adjustment through adoption of the ORS-POA agreement in the present case, and nothing has persuaded us that this amount should be modified.

iv. Bad Debt

DIUC asks the Commission to adopt the bad debt adjustment set forth in ORS's direct testimony instead of the Settlement Agreement. The Settlement Agreement bad debt adjustment simply uses the methodology proposed by the Company in its Application (Schedule A-4) which results in a lower number than the one put forth in the ORS direct testimony. We agree with the Company that DIUC's adjustment was $16,090 with a total *pro forma* amount of $30,852. The Company's Petition makes the following statement: "There is no proof that $30,852 is realistic or anywhere close to the actual amount." (Petition at 18). If this is the case, then one must query why the Company included the amount in its Application in the first place. Company witness Guastella's explanation at the hearing seems to be that the Company came up with a conservative adjustment for its Application, but on second thought, the ORS proposed adjustment was more favorable to the Company. (Guastella, R. pp. 136-137). However, ORS later entered into an Agreement with the POAs that the Company's original adjustment in its Application was a more accurate adjustment for bad debt.

The explanation for the original DIUC bad debt adjustments under both water and sewer expenses appears in both Schedules WC-1 and SC-1and states as follows: "Adjust bad debt expense to reflect revenue write-off percentages established in prior case applied to pro forma revenue under present rates." The adjustment and percentages appear to be reasonable, and the adjustment is therefore reasonable, above and beyond the fact that the

bad debt adjustment was a product of the agreement between ORS and the POAs. Interestingly, the language belies the Company's position in its Petition that information in the prior rate case should not be used as a basis for adjustment in the present rate case. The Company did exactly that with its original Application adjustment for bad debt expense. In any event, we discern no error in adopting the bad debt expense from the Company's Application, since the Company gave a reasonable explanation for its original adjustment, and ORS and the POAs subsequently agreed with the Company. The original bad debt adjustment is clearly supported by the evidence.

a. References to the Previous Rate Case

DIUC maintains that it was error, based on Utilities Services of South Carolina v. The South Carolina Office of Regulatory Staff, Id. ("Utilities") for the Commission to "rely on" Order No. 2012-515 in Docket No. 2011-229-WS (DIUC's most recent rate case) for its reasoning in the present case (Petition at p. 13) in considering ORS's adjustments to the management fees of Guastella Associates, as well as DIUC's rate case expenses. DIUC's application of Utilities is misplaced, as this Commission did not "rely on" Order No. 2012-515 in approving ORS's adjustments, but rather used the adjustments approved by Order No. 2012-515 as a baseline for determination, and then relied on the evidence provided by ORS and the POAs to arrive at a final decision.

While Utilities does stand for the proposition that it is erroneous to use a previous rate increase as justification for denying a rate increase, Utilities, 392 S.C. 115, 708 S.E.2d 765, that case also recognizes that "a previous rate increase may provide a baseline for the PSC to use in determining whether a utility has incurred additional expenses requiring

additional revenue." Id. This Commission used the information from Docket No. 2011-229-WS as a baseline for consideration of DIUC's proposal, but used the evidence in this Docket to justify the decisions in Order No. 2015-846.

In other words, a previous rate increase is typically a "starting point" in a new rate case. Accordingly, the only way for DIUC to attempt to justify an increase in expenses (or for the ORS or the POAs to attempt to rebut a proposed increase) is to "compar[e] the expense from the test year used in the previous rate case with those from the test year in this case...." Heater of Seabrook, Inc. v. Public Service Comm'n of S.C., 324 S.C. 56, 61, 478 S.E.2d 826, 828 (1996). Furthermore, amounts for management fees and rate case expenses in Docket No. 2011-229-WS provide the "baseline" or standard against which to compare DIUC's proposed expenses for those items in this Docket, because those fees and expenses previously were deemed reasonable by the Commission.

However, DIUC cannot satisfy its burden of proof simply by comparing the current test year expenses with those in the previous rate case. Utilities, 392 S.C. 109, 708 S.E.2d 762. Instead, when the reasonableness of proposed fees and expenses are challenged (as was the case here), "the burden remains on the utility [DIUC] to demonstrate the reasonableness of its costs." Id. And as Order No. 2015-846 makes clear (pp. 26-27), the Commission determined, based on substantial evidence in the record (including the testimony of POA witnesses), that DIUC did not satisfy that burden to demonstrate that those challenged costs were reasonable. In sum, this Commission followed the procedure contemplated by South Carolina law, and Utilities in particular, in making adjustments to

DIUC's proposed fees and expenses, and no basis to grant rehearing or reconsideration of the Order exists, based on references to the prior rate order.

v. Rate Base Issues

In its Petition, DIUC asserts that the elevated storage tank located on the Utility's land sold at a tax sale should be included in DIUC's rate base. ORS excluded the elevated storage tank from rate base for the following reasons:

1. The property on which the elevated storage tank sits was sold in 2011 during a delinquent tax sale and the property is no longer owned by DIUC.
2. The elevated storage tank was excluded from the last rate case, Docket No. 2011-229-WS, for the same reason in item #1 above.
3. The delinquent tax sale deed states that all "appurtenances" convey to the delinquent tax sale purchaser, Mr. Sabry. Treasurer Walls of Beaufort County was unable to opine whether or not the elevated storage tank is an appurtenance. If the elevated storage tank is an appurtenance, it would follow that the tank was conveyed to Mr. Sabry by means of the Beaufort County delinquent tax sale deed. Ms. Walls provided testimony that DIUC is paying utility taxes on the elevated storage tank to Beaufort County; however, testimony showed that while Mr. Sabry is not paying taxes on the elevated storage tank, he is paying Beaufort County taxes on a building located on the same property the County describes as a "UTLSHED."
4. DIUC has not proven it owns the elevated storage tank.

5. ORS understands DIUC is pursuing condemnation proceedings for the property and such condemnation proceedings are not within the jurisdiction of this Commission.

6. DIUC revised its Annual Reports to the Commission and ORS by lowering property values in apparent efforts to have its property taxes reduced. The values by which DIUC revised its Annual Reports appear to correspond to the value of the elevated storage tank and other property excluded for utility ratemaking purposes. ORS does not fault DIUC for revising its Annual Reports. Instead, it is ORS's position that DIUC cannot reap benefits of being the owner of the elevated storage tank for ratemaking purposes, but not the owner for property tax purposes. The Commission adopted this reasoning in Order No. 2015-846.

See Walls Rebuttal, R. pp. 101-102; Morgan Direct, R. p. 511; Morgan Surrebuttal, R. pp. 515-517; R. p. 529 and Hearing Exhibit 20.

ORS states that, if DIUC produces a deed stating that it is the owner of the property on which the elevated storage tank sits or if a court issues an order in DIUC's condemnation proceedings stating it owns the elevated storage tank, then ORS would fully support the value of the elevated storage tank being in rate base in DIUC's next rate case. (See, for example, R. p. 529.) This Commission also adopted this position. In the meantime, there is sufficient uncertainty regarding the elevated storage tank's ownership causing ORS to decline recommending that ratepayers pay DIUC a return on it, and this Commission agreed that there was a lack of substantial evidence supporting the Utility's position.

DIUC asserts that the record lacks evidence on the ORS rate base adopted by the Commission. To the contrary, ORS fully supported its recommendations in testimony and exhibits and was available for cross-examination to answer any questions on its recommendations. (See also R. p. 202, ll. 21-23; p. 203, ll. 1-5). For these reasons, this Commission adopted the ORS adjustments by way of the Agreement with the POAs in Order No. 2015-846, and this Commission continues to support them. Neither rehearing nor reconsideration is appropriate.

III. RATE OF RETURN

As a general allegation, the Company's Petition also alleged that the Commission failed to grant a reasonable rate of return in this case. The Commission approved a return on equity of 9.28%, a return on rate base of 7.44%, and an operating margin of 16.18%, based on the new rates, fees, and charges approved for the Utility, so the argument that the rates set are not sufficient to yield a reasonable return is without merit. Under ratemaking principles, the Commission fully considered the Company's long-term debt and cost of debt when determining the required return on equity. The operating experience, rate base and rate of return approved in this case are sufficient to provide adequate revenues for the Company to service its debt and provide an appropriate return to the shareholders.

This Commission only allows a utility an opportunity to earn a reasonable rate of return, and the opportunity has been presented in this case. Such a return is not, however, guaranteed. Order No. 2015-846 set rates sufficient to yield a reasonable return on the value of the property found to meet utility ratemaking standards which is used to render service to the Company's ratepayers.

IV. CONCLUSION

Based on the evidence presented in the case, the Petition for Reconsideration and/or Rehearing of Order No. 2015-846 must be denied in its entirety. Other than presenting bare assertions, DIUC failed to provide any relevant documents or other materials supporting its position on the SunTrust loan issue. Accordingly, there was nothing before the Commission that would allow it to make the determination as to whether the Company could achieve its financial requirements under that loan. Even if the materials had been submitted into the evidence, it is questionable if the outcome would have changed. Also, matters may not be presented to the Commission for the first time on reconsideration, even if a present justiciable controversy exists. Moreover, no present justiciable controversy exists in this case with regard to the SunTrust Bank loan, according to South Carolina case law.

Further, DIUC did not make any additional arguments that would support a change of our position on the five adjustments outlined in the Company's Petition. References to prior rate orders are reasonable under the law when used as a baseline for development of adjustments in present rate orders. Order No. 2015-846 set rates sufficient to yield a reasonable return on the value of the property found to meet utility rate-making standards which is used to render service to the Company's ratepayers. This Commission granted the Company an opportunity to earn a reasonable rate of return.

The information provided by the Company in its Petition with regard to the adjustments had largely been heard and rejected previously by this Commission. If proposed expenses are found to be unreasonable, as the management fees and rate case

expenses were in this case, the utility's shareholders are responsible for these expenses, not the customers. Although we are aware that we are not required to "rubberstamp" the evidence presented by the Office of Regulatory Staff, as described by the Utilities case, neither are we required to reject competent evidence presented by that agency, or from other parties. The evidence presented by ORS in the present case was competent and credible, and we reasonably accepted it on its own merits. The only adjustment accepted by us as part of the Settlement Agreement that was not an ORS adjustment was the Company's original bad debt adjustment. The Company provided support for the original adjustment in its Application, separate and apart from its testimony and the Settlement Agreement between ORS and the POAs. For all of these reasons, we must deny the Petition brought by DIUC.

This Order shall remain in full force and effect until further order of the Commission.

BY ORDER OF THE COMMISSION:

Nikiya Hall, Chairman

ATTEST:

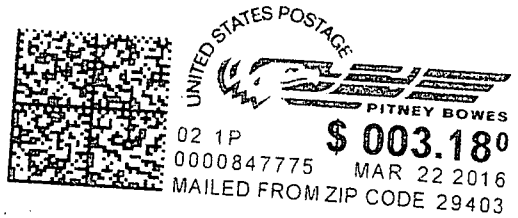
Swain E. Whitfield, Vice Chairman

(SEAL)

PRATT-THOMAS | WALKER
ATTORNEYS AT LAW
PROFESSIONAL ASSOCIATION

16 CHARLOTTE STREET
CHARLESTON, SC 29403

PO DRAWER 22247
CHARLESTON, SC 29413-2247



Hon. Daniel E. Shearouse
Clerk of Court
Supreme Court of South Carolina
P.O. Box 11330
Columbia, SC 29211