STATE OF SOUTH CAROLINA
In the Supreme Court

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S.C. SUPREME COURT

APPEAL FROM THE PUBLIC SERVICE COMMISSION

Appellate Case No. 2016-000652

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.

INITIAL BRIEF OF APPELLANT

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2. DID THE COMMISSION ERR IN REFUSING TO CONSIDER DIUC'S ENTIRE PETITION FOR RECONSIDERATION, INCLUDING THE INEVITABLE LOAN DEFAULT THAT DIUC WILL FACE IF THE INSUFFICIENT RATES ESTABLISHED BY ORDER 2015-846 ARE NOT MODIFIED?

3. SHOULD THIS COURT REVERSE OR MODIFY PUBLIC SERVICE COMMISSION ORDER 2015-846 BECAUSE ITS ADOPTION OF THE ADJUSTMENTS OF ORS AND ITS REJECTION OF DIUC'S ANALYSIS OF PROPERTY TAXES, MANAGEMENT FEES, RATE CASE EXPENSES, BAD DEBTS, AND RATE BASE ARE LEGALLY ERRONEOUS, NOT SUPPORTED BY SUBSTANTIAL EVIDENCE, AND PREJUDICE SUBSTANTIAL RIGHTS OF THE APPLICANT?

STATEMENT OF THE CASE

Daufuskie Island Utility Company, Inc., the sole provider of water and sewer service to a service area that encompasses Daufuskie Island, Beaufort County, South Carolina, ("DIUC") applied to the Public Service Commission (the "Commission" or "PSC") on June 9, 2015, for approval of a new schedule of rates and charges for water and sewer service ("the Application"). (Application) At the instruction of the Office of the Clerk of the Commission, DIUC published a Notice of Filing. (Notice of Filing) The Notice reported that DIUC "has not applied for rate relief since 2012" and that DIUC states "the proposed rates ... are essential for the company to continue to provide its customers adequate water and sewer service." (Notice of Filing at p. 1)

On July 23, 2015, the Haig Point Club and Community Association, Inc., Melrose Property Owner's Association, Inc., and Bloody Point Property Owner's Association, (collectively "Intervenors") filed a Petition to Intervene. (POA's Petition to Intervene) On July 27, 2015, a Petition to Intervene was filed by Beach Field Properties, LLC ("Beach Field"), an owner of property within the DIUC service area. (Petition to Intervene by Beach Field) Both petitions were granted. (S.C. Pub. Serv. Comm'n Order 2015-584 and Order 2015-585)

A hearing on the Application was scheduled for October 28, 2015. (Notice of Filing at p.1) Prior to the hearing DIUC, the Office of Regulatory Staff ("ORS"), and the Intervenors filed pre-filed testimony. Beach Field did not file any testimony. Subsequent to their intervention, the Intervenors requested a public night hearing to allow customers of DIUC to present any comments regarding the service and rates of DIUC. Pursuant to Order No. 2015-586, 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. (Order 2015-846) 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. (Order 2015-846 stating Hearing Exhibit 1 consists of the night hearing sign-in sheets and Hearing Exhibit 2 consists of comments filed by a public witness)

On the afternoon of October 27, 2015, the day before the scheduled hearing before the Commission, the Intervenors filed a document captioned "Settlement Agreement." (Cover Letter, Pringle to Boyd, with "Settlement Agreement" and Exhibits)

The only parties to the document submitted as a "Settlement Agreement" are ORS and the Intervenors. DIUC did not know about, did not consent to, and was not a party to the purported "Settlement Agreement." (Settlement Agreement at 1). The Settlement Agreement included those parties' agreement on adjustments to the application of DIUC, on the allowed rate of return and operating margin, and even on the matters that would be admitted into evidence.

On October 28, 2015, the Commission conducted its hearing on DIUC's Application for Approval of an Adjustment in Rates and Charges for Water and Sewer Services. Prior to any testimony, DIUC objected to the admission of the Settlement Agreement because, among other reasons, DIUC is not a party to the Settlement Agreement and therefore the purported settlement did not resolve or evidence resolution of any issue(s) presented by the Application. (Tr. at 42-44) The Commission overruled the objection. (Tr. at 48) The hearing proceeded and testimony was presented by DIUC, ORS, and the Intervenors.

On November 25, 2015, DIUC submitted a Proposed Order Approving Rates and Charges. (Proposed Order Approving Rates and Charges) ORS and the Intervenors submitted a joint proposed order requesting the Commission approve the Settlement Agreement between ORS and the Intervenors. (Joint Proposed Order Approving Rates)

On December 8, 2015, the Commission entered its decision, docketed as Order No. 2015-846, accepting the Settlement Agreement and making findings and conclusions implementing its terms as its ruling on DIUC's application. DIUC filed a timely Petition for Reconsideration and/or Rehearing on December 21, 2015. (Pet. Recon.) By Order No. 2016-50 dated February 25, 2016, the Commission denied the Petition for

Reconsideration and/or Rehearing. (Order 2016-50) On March 22, 2016, DIUC served its Notice of Appeal of Order No. 2015-846 and Order No. 2016-50. (Notice of Appeal)

STATEMENT OF FACTS

DIUC is classified as a Class B water and wastewater utility under the Uniform System of Accounts published by the National Association of Regulatory Utility Commissioners ("NARUC"). (Order 2015-846 at 2). The unique history and challenges facing this small water and sewer service provider as it struggles to provide safe and reliable service on an island accessible only by water are thoroughly described in the Report on Capital Improvements included with Hearing Exhibit 7. (Hearing Ex. 7)

The parties participated in exhaustive discovery before the hearing. DIUC was required to respond to in excess of 150 discovery requests (exclusive of multiple subparts), review the direct testimonies of nine witnesses, prepare rebuttal testimony and surrebuttal testimony, and prepare for the hearing on the Application. (Tr. at 218). By providing thorough responses to this overwhelming amount of discovery, DIUC established an ample basis for the methodology and rates requested. During this period DIUC also reviewed and analyzed the testimony submitted by ORS and the Intervenors.

In its Application, DIUC utilized a historic test year – the twelve months ending December 31, 2014, with known and measurable adjustments for 2015 expectations. (Order 2015-846 at p. 8) ORS and the Intervenors also proposed the Commission use a historical test year ending December 31, 2014. (Order 2015-846 at p. 8)

DIUC requested that its rates be determined in accordance with the rate of return on rate base methodology and requested the Commission specify, as required by. S.C. Code Ann. § 58-5-240(H), an allowable operating margin. No party contested the use of

the rate of return on rate base methodology. Given the size of DIUC's rate base, the Commission found the rate of return on rate base methodology appropriate in this case. (Order at p. 32)

DIUC summarized the necessity of the requested rate increases as follows:

> ...the current rates do not enable the Company to cover its cost of providing service and earn a fair return on its investment. The Company has not applied for rate relief since 2010 and has not yet established unified rates under its current consolidated status. The test year revenues, under current rates, produced net operating losses of $21,174 for the water operations or a negative .65% return on its investment. The sewer operations experienced net operating income of $59,890 or a 1.59% return on its investment. As this application demonstrates, the pro forma rate year under the current rates, would produce even less income and result in a negative 5.27% return for water and a negative 2.81% return for sewer. The proposed rates developed in this application are essential for the Daufuskie Island Utility Company to continue to provide its customers with adequate water and wastewater service.

(Application at 3)

The rates in effect at the time of the Application were those established in DIUC's prior rate proceeding, Docket No. 2011-229-WS. Specifically, via Commission Order No. 2012-515, the Commission approved a settlement inclusive of all the parties. As a compromise, DIUC agreed in that settlement to a negotiated revenue increase of $291,485; a $5 million rate base; an operating margin of 16.64%; and a Return on Equity of 8.81%. (Order 2015-846 p. 2). At the time of the settlement of the prior rate proceeding, DIUC was in dire funds to pay overdue bills, construct certain capital improvements, and conduct repairs including the breach of its wastewater treatment lagoon. (Hearing Exhibit 7 at pp.30-37)

On the afternoon of October 27, 2015, the day before the scheduled hearing on the Application, the Intervenors served and filed a document the purported "Settlement

Agreement." (Cover Letter, Pringle to Boyd, with Settlement Agreement and Exhibits) The Cover Letter submitted by Counsel for the Intervenors reported the Settlement Agreement was "the result of a great deal of communication and collaboration between the POAs and the ORS." (Id.) As plainly evident by its terms, DIUC did not consent to and is not a party to the purported "Settlement Agreement." (Settlement Agreement at 1)

On October 28, 2015, at the commencement of the hearing, counsel for the Intervenors informed the Commission that the Intervenors and ORS had filed with the Commission a "settlement agreement." (Tr. at 40) Pursuant to the purported "settlement agreement," ORS and the Intervenors agreed to stipulate to "all of the adjustments made by the ORS, with the exception that the ORS amended its bad debt allowance to utilize the allowance proposed by Daufuskie Island Utility Company, Inc. (the "Company") in its Application. No other changes were made by ORS in reaching the Settlement." (Tr. at p. 41-42) In other words, the Intervenors abandoned the rate structure and analysis proposed in their prefiled testimony and agreed to the calculations proposed by ORS. (Settlement Agreement and Rate Order at 10)

DIUC objected to the purported "settlement agreement" asserting that the Commission should not consider it, take notice of it, or admit it into the record. (Tr. at p. 42-44) DIUC objected on the grounds that the "settlement agreement" endorsed an even lower revenue number than originally proposed by ORS; that any agreement between ORS and Intervenors was irrelevant to the Application since the Company did not know about, much less agree to, the terms of the purported settlement agreement; and that admission of this "settlement Agreement was prejudicial to the Company. Id. DIUC's counsel further explained that because DIUC was not a party to the agreement, the

document did not resolve any issue(s) presented by DIUC's Application; the document merely reports that two parties to the proceeding have negotiated among themselves and come to agree that they will oppose DIUC's Application in a unified manner. (Tr. at pp. 42-44)

The Commission overruled DIUC's objection and accepted the Settlement Agreement into the record. (Tr. at p. 48) The hearing proceeded and testimony was presented by DIUC, ORS, and the Intervenors.

At the hearing DIUC presented the prefiled testimony of John F. Guastella, President of Guastella Associates, LLC and Gary C. White, Vice President of Guastella Associates, LLC. (Tr. at pp. 134-296 and 119-133) Guastella Associates LLC ("GA") provides management, valuation and rate consulting services to water and wastewater utilities around the country, and has been the contract manager of DIUC (and its predecessors) since July 9, 2008.[1] DIUC also presented the prefiled testimony of The Honorable Maria Walls, Treasurer of Beaufort County, and prefiled testimony of Eric Johanson, Chief Operator of DIUC. (Tr. at 73-111 and 112-118). These witnesses also testified in person.

In addition to testifying based upon his almost 50 years of experience as an expert on rate making for water and sewer utilities, Mr. Guastella testified about the specific facts and calculations included in the Application. (Tr. at 125). With regard to the issue of the looming default on the SunTrust loan, Mr. Guastella testified that if the

[1] The stock purchase of Haig Point Utility Company, Inc. (now DIUC) by CK Materials LLC on July 9, 2008, from Haig Point, Inc. (formerly International Paper Realty Corporation of South Carolina) was approved by the Commission. The stock of DIUC was transferred from CK Materials, LLC to Daufuskie Island Holding Company, LLC in 2013 when the Commission approved DIUC's financing with SunTrust Bank.

adjustments proposed by ORS were imposed, the resulting rates "***will not give us enough money to pay our debt service on our existing loan. We will be in default because of all of these adjustments...***" (emphasis added) (DIUC's Return to ORS's Answer to and Intervenors' Opposition to the Petition for Reconsideration and/or Rehearing at 2, citing Tr. p. 186) Neither the Intervenors nor ORS chose to cross-examine Mr. Guastella as to the basis of his statements that the rates proposed by the Settlement Agreement would result in default on the terms of the SunTrust loan. (DIUC Return at 2-3, citing testimony from Tr. p. 254, ll. 2-4; p. 255, ll. 8-10; p. 255, ll. 12-19; p. 256, l. 23 to p. 257, l. 7)

Mr. Guastella also testified as to each ORS adjustment incorporated into the Settlement Agreement that was ultimately adopted by the Commission. Of particular note to this appeal are the adjustments for property taxes, management fees, rate case expenses, bad debt, and rate base.

The Intervenors presented prefiled and summary testimony of Charles Loy and Lynn M. Lanier, both of whom are principals with GDS Associates, Inc., a utility consulting and engineering firm with its principal offices in Marietta, Georgia. (Tr. at 347-464). They also testified live as well.

The Intervenors also presented prefiled and summary testimony of the following DIUC customers: Doug Egly, Tony Simonelli, Paul Vogel, and Harry Jue, who also testified live. *See* Tr. at 305-347.

Beach Field did not present any witnesses. When the Commission queried as to whether any members of the public wished to be heard, one witness, Mr. Reed Dulaney, addressed the Commission. (Tr. at 58-72)

ORS presented prefiled and summary testimony of Ivana C. Gearheart, ORS Audit Manager; Willie J. Morgan, Deputy Director of the Water and Wastewater Division of ORS; and Dr. Douglas H. Carlisle, Economist at ORS. *See* Tr. at 466-543.

Pursuant to motions by each party, all prefiled testimony was read into the record as if given orally. The hearing adjourned at 7:30pm. (Tr. at 545)

On November 25, 2015, DIUC submitted a Proposed Order Approving Rates and Charges. (Proposed Order Approving Rates and Charges) ORS and the Intervenors submitted a joint proposed order requesting the Commission approve the Settlement Agreement between ORS and the Intervenors. (Joint Proposed Order Approving Settlement Agreement and Ruling on Application for Adjustments in Rates)

On December 8, 2015, the Commission entered its Order Approving Settlement Among Certain Parties and Ruling on Application for Adjustments and Rates. (Order 2015-846) Making this determination, the Commission adopted every adjustment proposed by ORS in the testimony and the "Settlement Agreement," effectively rejecting all DIUC testimony, evidence and analysis. (Order 2015-846 p.32)

In an effort to explain the errors inherent in the Commission's Order adopting the Settlement Agreement and the calculations of ORS, on December 21, 2015, DIUC filed a Petition for Reconsideration and/or Rehearing. (Pet. Recon.) In its Petition for Reconsideration, DIUC addressed the adjustments for property taxes; management fees; rate case expenses; bad debts; and rate base, including evidentiary matters as well as the Commission's failure to include the values of DIUC's elevated storage tank and related facilities as well as other utility plant in service. (Id.) In summary, the Petition for Reconsideration explained that the Order's adjustments are without factual foundation

and ignore measurable expenses and the rate of return and operating margins stated in the Order are entirely illusory. (Pet. Recon at 1)

Highlighting the evidence in support of its Application, DIUC's Petition for Reconsideration cited testimony from DIUC regarding the impact of the Order's approved rates upon DIUC; specifically, the Petition pointed out that the "approved rates do not provide DIUC sufficient income to pay debt service (principle and interest) on [its] existing Suntrust Bank loans and to pay necessary operating expenses." (Pet. Recon at 1)

The Petition for Reconsideration also included a one-page summary of the income allowed by the Order alongside the expenses submitted by DIUC in support of the Application. (Pet. Recon, Attachment A) ORS and Intervenors both objected to the inclusion of this exhibit, arguing that they did not have the opportunity to test the data contained in Attachment A to the Petition. (DIUC's Return at 4) This position was unfounded because Attachment A merely presented the combined water and sewer revenues permitted by the Commission's Order adopting the Settlement Agreement and subtracts the actual cost of operations that DIUC will incur. (DIUC Return at 4 and Attachment A) The actual operating expenses listed in the Attachment are the same as those reflected in DIUC's filings in the case, including the proposed Order submitted on November 25, 2015. (Application, DIUC Proposed Order Approving Rates and Charges, and DIUC Return to ORS and Intervenors Resp. to Pet. for Recon.)

In response to the Petition for Reconsideration's highlighting of the evidence regarding imminent default on DIUC's financing obligations, ORS and the Intervenors both filed responses asserting the Petition for Reconsideration's references to the pending default should be disregarded by the Commission. (Intervenors' Response in Opposition

to Petition for Reconsideration and ORS Answer to DIUC Petition for Reconsideration and/or Rehearing) By Order No. 2016-50 dated February 25, 2016, the Commission denied DIUC's Petition for Reconsideration and/or Rehearing. (Order 2016-50)

This Appeal followed.

DIUC now seeks this Court's review of the Commission's errors including, but not limited to, its consideration of and "approval" of the Settlement Agreement between ORS and the Intervenors; the Commission's refusal to consider the imminent default of DIUC on its financing obligations which was fully presented to the Commission as part of DIUC's Application and was therefore properly included with the Petition for Reconsideration; and the Commission's adoption of the ORS and Intervenors' Settlement Agreement with its downward adjustments to property taxes, management fees, rate case expenses, bad debts, and rate base, none of which are not supported by the evidence in the record and constitute legal error.

STANDARD OF REVIEW

South Carolina appellate courts employ a deferential standard of review when reviewing a decision of the Public Service Commission, but affirm a Commission decision only when substantial evidence supports it. Porter v. S.C. Pub. Serv. Comm'n, 333 S.C. 12, 21, 507 S.E.2d 328, 332 (1998). The party challenging a Commission order "bears the burden of convincingly proving the decision is clearly erroneous, or arbitrary or capricious, or an abuse of discretion, in view of the substantial evidence on the whole record." Duke Power Co. v. PSC of S.C., 343 S.C. 554, 558, 541 S.E.2d 250, 252 (2001) citing Porter v. S.C. Pub. Serv. Comm'n, 333 S.C. 12, 507 S.E.2d 328 (1998) and S.C. Code Ann. § 1-23-380(A)(6) (Supp. 1999). "Substantial evidence is not a mere scintilla;

rather, it is evidence which, considering the record as a whole, would allow reasonable minds to reach the same conclusion as the agency." Chisolm v. S.C.Dept. of DMV, 402 S.C. 593, 609, 741 S.E.2d 42, 51 (Ct. App. 2013) citing Friends of Earth v. Pub. Serv. Comm'n of S.C., 387 S.C. 360, 366, 692 S.E.2d 910, 913 (2010).

This Court "may affirm the decision of the agency or remand the case for further proceedings." S.C. Code Ann. § 1-23-380. The Court may also reverse or modify the decision of the Commission "if substantial rights of the appellant have been prejudiced because the administrative findings, inferences, conclusions, or decisions" are:

(a) in violation of constitutional or statutory provisions;
(b) in excess of the statutory authority of the agency;
(c) made upon unlawful procedure;
(d) affected by other error of law;
(e) clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record; or
(f) arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion.

S.C. Code Ann. § 1-23-380.

Additionally, in order for an appellate court "to determine whether the findings are supported by the evidence and whether the law has been applied properly to those findings," the Commission "must make findings which are sufficiently detailed." Porter v. S.C. Pub. Serv. Comm'n, 333 S.C. 12, 21, 507 S.E.2d 328, 332 (1998). Those findings of fact "must be sufficiently detailed to enable the reviewing court to determine whether the findings are supported by the evidence and whether the law has been properly applied to those findings. Able Commc'ns. Inc. v. S.C. Pub. Serv. Comm'n, 290 S.C. 409, 411, 351 S.E.2d 151, 152 (1986).

ARGUMENT

I. THE PUBLIC SERVICE COMMISSION ERRED WHEN IT ADMITTED INTO EVIDENCE A PROPOSED SETTLEMENT AGREEMENT THAT INCLUDES ORS AND INTERVENORS BUT EXCLUDES THE APPLICANT AND THE COMMISSION ERRED WHEN IT ENTERED AN ORDER APPROVING THE SETTLEMENT AGREEMENT BINDING THE APPLICANT OVER ITS OBJECTIONS.

The Commission committed an error of law in receiving and adopting as its final decision the purported Settlement Agreement between two of the parties but not the Applicant. As previously stated, the Applicant timely objected to the admission of the Settlement Agreement and set forth the several reasons why it was legal error for the Commission to receive and adopt it.

In presenting the Settlement Agreement counsel for the Intervenors stated:

> Yesterday afternoon, the POA Intervenors and the ORS filed a settlement agreement with the Commission. That settlement agreement includes a settlement document somewhat similar to the ones that the Commission has seen in the past, as well as several exhibits that describe the settlement entered into by the POA Intervenors and the ORS, in terms of a rate of return, or return on equity, and as well as the additional revenues to which at least my clients and the ORS have determined to be a reasonable settlement. And just to be clear, this is between my clients and the ORS. It does not include the Applicant .... .
>
> [...]
>
> [T]he adjustments – and this is described, to some extent, in the exhibits – and the numbers that are used, as well as the final number, are all the result of ORS' testimony in this case. And the exhibits [to the Settlement Agreement] reference that and discuss, you know, how those numbers were arrived at.

(Tr. at 41-42)

Counsel for the Applicant objected to the Commission considering or admitting the Settlement Agreement explaining:

> ...we do not believe it's appropriate for the Commission to consider [the Settlement Agreement], to take notice of it, or to incorporate it into the Record.
>
> The reason for that is that it is not a settlement. We, on behalf of Daufuskie Island Utility Corporation, have filed a rate application. ORS provided its input. There were a set of Intervenors. And now the Intervenors and ORS have reached an agreement as to what they purport to be a reasonable resolution of my client's Application. So, it's not a settlement, because if it were a settlement, we wouldn't all be here.

(Tr. at 42-43)

Further explaining the Applicant's position, counsel for DIUC stated:

> If there are issues remaining between the Applicant for the Commission to hear, it's not a settlement. If the Commission takes into account and incorporates into the Record the Settlement Agreement, our concern is this: that not only will it be unfair to our client because, essentially, it purports to assert that a number less than even what ORS originally proposed through its adjustments is the appropriate resolution of this matter, it attempts to bootstrap the two parties' positions together and support them in front of the Commission.

(Tr. at 43)

There were multiple reasons the Settlement Agreement should have been neither admitted nor adopted, and the Commission's decision to admit and adopt it as the Commission's final decision constitutes an error of law under S.C. Code § 1-23-380.

A. Admission of the Settlement Agreement was an error of law contrary to S. C. Code Ann. Regulation 103-846.

Evidentiary questions at a Commission hearing are governed by South Carolina Code of Regulations 103-846, which states "irrelevant, immaterial or unduly repetitious evidence shall be excluded. The rules of evidence as applied in civil cases in the Court of Common Pleas shall be followed." S.C. Code Ann. Regs. 103-846.

The Settlement Agreement proposed at the hearing was both irrelevant and immaterial to the Commission's decision on the Application of DIUC. Quite simply, an

agreement between ORS and petitioning Intervenors that is, as explained by Intervenors' counsel, an agreement only between ORS and the Intervenors, to the exclusion of the Applicant, is as a matter of law irrelevant and immaterial because it does not involve the Applicant. The purported Settlement Agreement was not probative evidence of any fact at issue. It was a collusive agreement between ORS and the Intervenors in an effort to unduly influence the Commission.

A hearing on an Application for Rate Increase is to assist the Commission in determining a fair rate of return "based exclusively on reliable, probative, and substantial evidence on the whole record" then "documented fully in its findings of fact." S.C. Code Ann. § 58-5-240. When, as in this case, ORS and a set of three intervening parties have privately met and determined that they agree to the withdrawal of the Intervenors' position and promised each other to collectively support the ORS position, that collusive agreement is not probative of any fact at issue; it is not relevant to the facts to be determined. The only purpose of submitting the purported Settlement Agreement between ORS and the intervening parties is to try to influence the Commission on the merits with a non-evidentiary document that the agreed-to position is reasonable and would not result in an appeal by the parties to it, all to the prejudice of the Applicant. (Tr. at 42-43) ORS and the Intervenors sought through the Settlement Agreement to usurp the fact finding of the Commission and suggest to the Commission that it need not do its job of sorting through and weighing the evidence to arrive at its final decision on the merits. It is no different from a defendant in a personal injury case seeking to enter into evidence before the fact finder a settlement agreement between plaintiff and another party, which this Court has determined to be reversible error. See Powers v. Temple, 250

S.C. 149, 156 S.E.2d 759 (1967) (Reversible error for trial court to have allowed jury to consider covenant not to sue between plaintiff and other party).

As a matter of law, a collusive contract on the merits of the proceedings between ORS and intervening parties to the exclusion of the Applicant, is unfairly prejudicial to the Applicant because it purports to demonstrate some validity by virtue of the parties' agreement to it; there is no other reason for the agreement to be offered by ORS and the Intervenors. The prejudice is clearly demonstrated by the settling Intervenors' inability to articulate whether the purported Settlement Agreement was, in fact, a settlement or if it was not. Specifically, counsel for the Intervenors in responding to DIUC's objection to testimony, stated:

> The amounts and whatever we did with ORS is not binding in terms of what we are doing with the Applicant.
>
> We are still presenting a case as Intervenors, as parties of record – as you can see by the cross examination that took place – that is something wholly separate from what is going on with the – what's happening and what we agreed to in the Settlement Agreement. It doesn't bind – in the same way it doesn't bind DIUC, it doesn't bind us vis-à-vis DIUC in this case [...] I think it's pretty clear that this case has not been settled today, you know, by the seven hours that we've been here discussing it.

Tr. at 303-305.

In other words none of the issues were settled. The self-described settling parties proceeded to present their witnesses and arguments the same as they would if there were no agreement between them.

There is only one case proceeding before the Commission in an Application for Rate Adjustment, such as this one. The positions between and any private agreements between ORS and the Intervenors are irrelevant, immaterial, confusing, and therefore unfairly prejudicial to the Applicant. If, as the Intervenors explained at the hearing, the

Settlement Agreement is not in fact a settlement but is instead something "wholly separate from what's going on with" the Applicant, then it has no purpose in being considered by the Commission. Admission of the Settlement Agreement constitutes an error of law in violation of S. C. Code Ann. Reg. 103-846.

B. Admission of the Settlement Agreement was an error of law contrary to the South Carolina Rules of Evidence 401, 402, and 403.

The South Carolina Rules of Evidence are to be followed in hearings before the Commission. See S. C. Code Regs. 103-846(A). Further, the presiding officer at a Commission hearing "shall...control the reception of evidence so as to confine it to the issues in the hearing." S. C. Code Regs. 103-846(B). By allowing the admission of the "Settlement Agreement," the Commission received evidence in a matter contrary to the South Carolina Rules of Evidence and in violation of S. C. Code Regs. 103-846(B)'s directive that evidence before the Commission "shall be limited to evidence of issues in the hearing." The Settlement Agreement was not relevant evidence nor probative of any fact. It should not have been admitted, and even if it were relevant, the prejudice and confusion of the Settlement Agreement should have prevented its admission. See Rules 401, 402, and 403, SCRE.

Counsel for the Intervenors noted this issue of relevance when discussing this matter and stated "the Commission's charge in this case is to determine what is a reasonable rate or set of rates or a rate of return or you know what is the proper result in this case, taking into consideration all the factors in 58-5-240 and elsewhere." (Tr. at 45) This is precisely the reason that an agreement between ORS and an intervening party

should not be admitted. It has no relevance to the factors or considerations for the Commission.[2]

While the potential for prejudice in admitting such settlement agreements is significant, in the instant case the Commission's ultimate Order Approving Settlement Among Certain Parties and Ruling on Application for Adjustments in Rates is itself the best evidence of prejudice. After ORS and Intervenors privately agreed to support the ORS adjustments and presented their position via the "Settlement Agreement," the Commission accepted the settlement and entered every single adjustment requested by the Agreement without making sufficient factual findings based on the evidence to support each of those adjustments. See Order 2015-846 (stating "After reviewing the evidence in this case, we adopt and approve the Settlement and its exhibits.")

C. Admission of the Settlement Agreement was an error of law contrary to the South Carolina Rule of Evidence 408.

South Carolina Rule of Evidence 408 prohibits the admission of evidence regarding attempts "to compromise a claim which was disputed as to either validity or amount" and states that evidence of offers to resolve such claim are "not admissible to prove liability for or for ... the claim or its amount. Evidence of conduct ... made in compromise negotiations is likewise not admissible." South Carolina Rule of Evidence 408. By presenting the Settlement Agreement to the Commission and the Commission's review of the same, it is clear that DIUC did not agree with the mediated result supported by the Intervenors and ORS. As the outside party, the impression is that DIUC was either unreasonable or unwilling to participate in the "Settlement Agreement." Therefore,

[2] S.C. Code Ann. § 58-5-210, et seq., S.C. Code Ann. Regs. 103-712.4 and 103-512.4.

admission of the document runs afoul of Rule of Evidence 408 in that it asserts DIUC would not compromise inasmuch as two of the parties have agreed otherwise.

> Particularly in this case, counsel for ORS was allowed to provide the Commission with what amounts to testimony regarding the process involved in the ORS and Intervenors Settlement Agreement that excludes the Applicant. Specifically, ORS counsel stated: When ORS approaches a rate case, as it does with anything, it looks to its statutory mandate and that is to represent the public interest. There's a three prong – three prongs to that definition: to protect all classes of customers, the using – and consuming public, make sure the utility can maintain its infrastructure, also to encourage economic development. We think the settlement ticks all those boxes, so, of course, we would want to present that to you. We are proud of the settlement.

Tr. at 47-48.

Another wayward purpose in placing the Settlement Agreement before the Commission was to suggest that DIUC was unreasonable and not acting in the public's interest since it was not a party to it. The Settlement Agreement improperly and prejudicially suggested that DIUC was unreasonable because it did not agree with and would not "settle with" ORS and Intervenors on the same terms. The Commission's ruling should be reversed since it rests on its improper consideration of the actions of ORS and Intervenors in settlement negotiations as well as the inactions of the Applicant regarding settlement negotiations, all of which should be excluded under South Carolina Rule of Evidence 408.

D. The Commission erred in allowing ORS and Intervenors to present testimony after submission of the Settlement Agreement.

Once the Commission accepted the purported Settlement Agreement in the record as a binding agreement, the Commission committed reversible error in allowing the Intervenors to proceed to present testimony contrary to their position in the "Settlement Agreement." As explained by DIUC counsel at the hearing, there was no

need for testimony from the Intervenors. (Tr. at 302-303) DIUC counsel explained, "It's no longer relevant, since they've agreed to all the adjustments of ORS, except for the bad debt adjustment." (Tr. at 302-3)

In response, counsel for the Intervenors stated:

> The settlement is not something that the Commission is deciding an up – or – down on right now, at all, and we've not asked you to do that, because if we would have done that, we would have asked to have been excluding what's going on with the Applicant, and we're not taking that approach, at all. [...] Even the testimony in the settlement is largely what's involved in the ORS testimony, and the amounts and whatever we did with ORS is not binding in terms of what we're doing with the Applicant.

Tr. at 303-5.

ORS and the Intervenors cannot have it both ways; ORS cannot represent to the Court that it is proud it reached a binding settlement with the Intervenors and that is why the Commission should consider it, while the Intervenors are allowed to argue that it is not binding on the Intervenors thereby permitting the Intervenors to continue to present their testimony in an attempt to defeat the Application. This is, of course, the issue – whether there was, or there was not, a "settlement." Interestingly, counsel for the Intervenors in addressing the issue of testimony asserts "I think it's pretty clear that this case has not been settled today, you know, by the seven hours that we've been here discussing here." (Tr. at 305) ORS then represented to the Commission, "I agree with everything Mr. Pringle said." (Tr. at 305)

The "settling parties" cannot have it both ways. Either they have settled a dispute and it should be admissible to the Court or they have not.

In overruling DIUC's objection to the presentation of testimony by the Intervenors, Commissioner Hall stated "Mr. Walker, your motion is denied. I don't see

how the Intervenors or ORS could present their case-in-chief without presenting their witnesses." (Tr. at 305) This is precisely the issue; if these parties have in fact "settled" then they have no case-in-chief to present. By admitting the Settlement Agreement then also allowing testimony, the Commission erred.

E. The Commission violated its own Settlement Policies and Procedures in admitting and approving the Settlement Agreement.

According to the "Public Service Commission of South Carolina Settlement Policies and Procedures, Revised 6/13/2005," the Commission has prescribed the procedures necessary for consideration of settlement agreements so that the Commission can "carry out its statutory duty of assuring cases brought before it are resolved in a manner consistent with the public interest." (Comm'n. Pol. and Pro. p. 2).

The purpose of the Settlement Policies and Procedures is to explain the "procedures [that] will be followed by the Commission in evaluating the settlements and stipulations presented by parties appearing before the PSC." (Comm'n. Pol. And Pro. p. 2). With regard to those procedures, under Section V. entitled "Settlement Procedures," the Commission has stated "when *all* parties to a proceeding reach agreement with regard to *all* issues in the form of a settlement signed by *all* parties or their representative the following procedures shall be followed..." As has been explained repeatedly herein, the Settlement Agreement admitted in this matter by the Commission did *not* involve *all* parties and as such was not a settlement.[3] Therefore, when the Order Approving

[3] To the extent that ORS and the Intervenors purport in their agreement to stipulate to certain findings, this agreement is not a binding stipulation in this proceeding as to the Commission or the Company as a matter of law. A binding stipulation requires the written concurrence of all the parties to the proceedings. See Rule 39(a), SCRCP (a binding stipulation is one that is entered by all the parties and entered on the record). Here, DIUC was not a party to the purported agreement and stipulation.

Settlement Among Certain Parties and Ruling on Application for Adjustments in Rates states that the agreement between ORS and the Intervenors "would be classified as a 'settlement' under the Commission's settlement policy, even though neither DIUC nor Beach Field Properties, LLC were parties to the agreement," it is erroneous as a matter of law and erroneous as a violation of the Commission's own Settlement Policies. The Commission's Settlement Policies do not envision, because it should not, a "settlement" that involves only limited participants within the action. Particularly, the Commission's Settlement Policies do not anticipate a settlement to include a private agreement by ORS and Intervenors that seeks to resolve an application for water and sewer rates without the participation of the Applicant. A reading of the Commission's Settlement Policies and Procedures makes this abundantly clear. As such, the Commission's acceptance of, consideration of, and ultimate approval of the Settlement Agreement constitutes a violation of its own Settlement Policies and therefore the decision must be reversed.

The Commission's decision to admit the Settlement Agreement and then to allow testimony from the purportedly settled parties violated S.C. Code Regs. § 103-846; S.C. Rules of Evidence 401, 402, 403, and 408; the Commission's own Settlement Policies and Procedures. As a result, the Commission entered an Order that does not provide sufficient revenue for DIUC thereby depriving it of substantial rights which, pursuant to S.C. Code § 1-23-380, requires the Order be reversed. Additionally, by wholly adopting the Settlement Agreement despite its disastrous impact on DIUC's revenue, Order 2015-846 is clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record. Finally, the acceptance of the Settlement Agreement despite the fact it did not comply with the requirements of the Commission's Settlement Procedures and

Policies was an additional error of law and unlawful procedural decision, both of which required remand of this matter pursuant to S.C. Code § 1-23-380.

II. THE COMMISSION ERRED IN REFUSING TO CONSIDER THE ENTIRE PETITION FOR RECONSIDERATION, INCLUDING THE INEVITABLE LOAN DEFAULT THAT DIUC WILL FACE IF THE INSUFFICIENT RATES ESTABLISHED BY ORDER 2015-846 ARE NOT MODIFIED.

After entry of the Commission's December 8, 2015, Order Approving Settlement Among Certain Parties and Ruling on Application for Adjustments in Rates, DIUC filed a Petition for Reconsideration and/or Rehearing pointing out that "DIUC will default on its obligations and its ability to provide services will be threatened" if the rates allowed by the Order are not altered. (Pet. Recon. p. 1)

To illustrate the errors inherent in the Commission's Order adopting the Settlement Agreement between ORS and the Intervenors, DIUC pointed out in its Petition for Reconsideration that during the hearing on behalf of DIUC, Mr. Guastella testified specifically about this inevitable default as follows:

> [T]he proposed settlement between ORS and the property owners of $462,000 will give this utility no return on equity – none, and it will not give us money to pay our debt service on our existing loan. We will be in default because of all of these adjustments and failure to include what are real costs of providing service in terms of capital and our real cost of providing service in terms of operating the utility.

(Tr. at 186, cited in Pet. Recon. p.3)

The Petition also attached a schedule "demonstrating the impact of the Commission's Order on DIUC's operations" and illustrating the allowed income that will result from the Commission's Order. (Petition at 3 citing Attachment A thereto) The schedule attached as Attachment A to the Petition demonstrated that the revenue allowance allowed by the Commission's Order will result in a negative cash flow, i.e. the

utility will actually lose money under the Commission's Order. (Attachment A to Pet. Recon.) The impact of the Order on DIUC operations demonstrated by Attachment A is not new information that requires testing or analysis; Attachment A simply shows the $1,536,375 of combined water and sewer revenues allowed by the Order and then subtracts the actual costs of operations previously provided by DIUC to the parties. The Petition then explains how the rates in the Order will result in DIUC's default under the Suntrust loan.

In denying the Petition for Reconsideration, the Commission ruled that the information in the record regarding the SunTrust loan was insufficient to allow it to consider the mechanism of and inevitability of default. (Order 2016-50 at 21) However, as discussed below and as pointed out in the Petition for Reconsideration and the DIUC Return to Opposition to the Petition for Reconsideration, there were more than ample references to the SunTrust loan, the impact of ORS's proposed rates upon the Utility's ability to pay its loans, and the inevitable default that would result from the ORS adjustments. The Commission's failure to consider and heed these facts demonstrates Order 2015-846 is clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record. Also, pursuant to S.C. Code § 1-23-380, this procedural decision to ignore the complete Petition and Attachment A constitutes an error of law.

At the hearing DIUC's manager, John Guastella, testified specifically about the impact on DIUC if the Commission were to adopt the ORS-Intervenors "Settlement Agreement." He stated:

> [T]he proposed settlement between ORS and the property owners of $462,000 will give this utility no return on equity. None.

> **And it will not give us enough money to pay our debt service on our existing loan.**
>
> **We will be in default because of all of these adjustments** and failure to include what are real costs of providing service in terms of capital and our real cost of providing service in terms of operating the utility.

(Tr. p. 186, emphasis added). As Mr. Guastella explained, because the Settlement Agreement (and therefore the Order adopting it) does not incorporate the actual costs of providing services, the rates will not generate sufficient income for DIUC to meet its debt service obligations. One of those debt service obligations is the SunTrust loan.

Mr. Guastella further testified about the loan:

> Daufuskie Island Utility has an obligation to SunTrust Bank. And with our rate increase, we're going to be in shape to continue to serve the customers without the danger....But the rate increase of the proposed settlement, that $462,000, we're not going to be able to make debt service payments, stockholders get no return on equity. (Tr. at 257)
>
> The bank is looking at our operations now, and they are seeing us with a shortfall in meeting their coverage requirements. (Tr. at 254)
>
> If the Settlement Agreement is adopted, "We are then not going to get the rate of return that ORS told you in that proposed settlement between those two parties. **We're not going to have any return on equity, and we're not going to be able to make our debt service payments of principal and interest**. It would put us right into bankruptcy. We need to have a real decision based on our real costs. (Tr. at 255, emphasis added)

ORS and the Intervenors both had the opportunity to cross examine Mr. Guastella as to the basis of these statements, the precise "coverage requirements" at issue, and his testimony for DIUC that under the rate increases in the proposed Settlement Agreement DIUC would surely default on the terms of the SunTrust loan.

ORS simply did not want to explore this issue at the hearing or otherwise, as demonstrated by its Responses to DIUC'S Interrogatories served upon ORS immediately after ORS produced its proposed adjustments. Interrogatory 13 specifically asked ORS:

> **Interrogatory 13**
> If the PSC were to accept Dr. Carlisle's recommended rate of return as well as the combined adjustments of other ORS witnesses in this case, has ORS analyzed:
>
> a. Whether DIUC would be able to meet the requirements of the existing SunTrust loan that was approved by the PSC? If so, please produce those analyses and all related source documents.
>
> b. Whether DIUC will be able to attract capital to refinance the short term line of credit and make further capital improvements that are necessary to provide adequate service to DIUC's customers? If so, please produce those analyses and all related source documents.
>
> **ORS Response: No for all of the above.**

(Tr. Ex. 10) ORS never analyzed the impact of its adjustments on DIUC's financing and when the Petition for Reconsideration made that impact clear, ORS and Intervenors were left only to argue somehow the issue had not been raised – when, in fact, it had clearly been the subject of discovery and extensive testimony at the hearing.

The failure by ORS and Intervenors to ask a single question about the specifics of the default does not mean the issue of default is not part of the record. To the contrary, because DIUC's position as to inevitable default went unchallenged by ORS or Intervenors, that conclusion is the only evidence in the record as to this point.

In denying DIUC's Petition for Reconsideration, the Commission erroneously asserted that the issue of default was not raised during the proceeding, which is absolutely incorrect. (Order 2016-50 at 5-6) This ruling ignores the totality of the record which clearly demonstrates that the issue was raised at multiple times during the

proceedings and that all parties were aware of DIU's position regarding the loan. The entire Petition for Reconsideration, including Attachment A, should have been considered by the Commission.

III. THE COMMISSION ERRED IN ITS FINDINGS, INFERENCES, CONCLUSIONS, AND DECISIONS IN ORDERS 2015-846 AND 2016-50 WHICH REJECTED THE APPLICANT'S ANALYSIS OF PROPERTY TAXES, MANAGEMENT FEES, RATE CASE EXPENSES, PLANT IN SERVICE, AND BAD DEBTS. S. C. CODE ANN. § 1-23-380 REQUIRES THIS COURT TO REVERSE THE ORDER.

In Order 2015-846, the Commission refused DIUC's analysis of its own books, records, and expenditures then adopted the Settlement Agreement and its reduced values for Property Taxes, Management Fees, Rate Case Expenses, Bad Debt, and Rate Base. Each of these adjustments is discussed below to demonstrate how the Order's findings, inferences, conclusions, and decisions on each of these adjustments warrants reversal or modification by this Court pursuant to S.C. Code § 1-23-380.

A. The reliable, probative, and substantial evidence on the whole record demonstrates the actual, known and measurable amounts for DIUC's Utility Property Taxes is $258,227.40.

Soon after August 15, 2012, the effective date of its last rate case, DIUC received a "Utility Property Tax" bill from Beaufort County for the years 2010, 2011, and 2012 at a combined total of some $363,000, with 2012 at $132,398. (Tr. at 78) DIUC had previously received property tax bills annually for individual parcels, totaling about $10,000 for each year, but neither DIUC nor its predecessors had ever been assess or received a Utility Property tax bill of such magnitude. (Tr. at 78, 96-98) In fact, this was the first time that SCDOR had ever assessed and Beaufort County had ever billed DIUC for a Utility Property Tax. (Tr. 96-98) For this reason, Beaufort County billed DIUC for taxes in arrears even though the DIUC had not been billed in those prior tax years.

The Honorable Maria Walls, Beaufort County Treasurer, explained the Utility Property Tax had never been assessed to DIUC or its predecessors and therefore DIUC had never been billed for the tax. (Tr. at 78) At some point, it apparently came to the attention of the SCDOR that it had not assessed DIUC for Utility Property taxes, as it does for other utilities, and SCDOR sent its assessment to Beaufort County for the first time in mid-2012 for the years 2010, 2011, and 2012; Beaufort County then simply applied its tax rate and sent the bills to DIUC. (Tr. at 77-80)

On behalf of DIUC, Mr. Guastella met with Ms. Walls and explained the impact of this surprising new tax bill; Guastella testified he explained the rate setting process, DIUC's cash flow problem, and the tremendous impact that this recently imposed tax liability would have on the Company's customers. (Guastella Rebuttal Exhibit B and Tr. at 82) As a result, on February 18, 2015, DIUC and Beaufort County entered into a Settlement Agreement that allows DIUC to pay $651,423.27 in past taxes for tax-years 2012, 2013, 2014 and 2015 over an eight year period without penalty or interest at a monthly payment of $6,784.04. (Walls Exhibit A, Hearing Ex. 5) The Agreement also allowed for a possible revision to reduce the total past amount due in the event DIUC could convince the SCDOR to reduce its assessment to reflect the value of the rate base allowed in DIUC's last rate case, instead of its book value (cost less depreciation). The Utility Property taxes for 2010 and 2011 were forgiven in this one-time special arrangement. (Tr. at 80 and 212)

Working next with SCDOR, the Company submitted revised documentation enabling the reduction of the Utility Property Tax assessment amount to reflect the last allowed rate base and agreed basis, which was set pursuant to a settlement agreement in

that case. (Walls Exhibit A, Hearing Ex. 5) On April 28, 2015, DIUC and Beaufort County entered into a Settlement Agreement Addendum, reducing the past due Utility Property taxes by $124,423.88 (from $651,423.27 to $526,843.39). (Order 2015-846 at 22) DIUC's monthly payment was reduced from $6,784.04 to its current payment of $5,487.95. (Hearing Ex. 5, Addendum; Order 2015-846 at 22)

The property tax expense requested by DIUC has two components: (1) rates sufficient to recover the monthly payments of $5,487.95 for eight years pursuant to DIUC's Settlement Agreement and Addendum with Beaufort County Treasurer for past due 2012-2015 taxes; and (2) rates sufficient to address DIUC's ongoing annual accrual of $192,372 for the 2016 Utility Property taxes. (Tr. at 168-170)

In denying DIUC's request for rates sufficient to address these tax obligations, the Commission agreed with ORS that it was appropriate to only allow recovery of 2012, 2013, and 2014 taxes and denied "property taxes for 2015 since ORS utilizes a historical test year."[4] (Order at 23-24). Even though "the Commission acknowledges that the 2015 property taxes appear to be set pursuant to the Settlement," it goes on to find:

> [W]e 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.

Order 2015-846 at 23.

First, the Commission cannot lawfully refuse to allow recovery of taxes due and payable. See Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff, 392 S.C. 96, 107 n.8, 708 S.E.2d 755, 761 (2011) citing Bluefield Waterworks & Improvement Co. v. Public

[4] The Order also relies upon ORS's flawed analysis of DIUC's ownership of certain real property and utility property. This issue is addressed in Section III. D.

Service Comm'n of W. Va., 262 U.S. 679, 690, 43 S. Ct. 675, 67 L. Ed. 1176 (1923) (explaining that where the rates charged by a public utility company "are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service . . . their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment"). As such, the ruling is a clear error of law and contrary to the evidence. Likewise, the disallowance based upon a reference to previous modification of the Settlement Agreement with Beaufort County is also contrary to the evidence.

ORS recommended and the Order "declined to allow property taxes for 2015 since ORS utilizes a historical test year." (Order 2015-846 at 23) The Order's reduced property tax allowance denies DIUC the ability to recover actual expenses. (Tr. at 213) Such a result is contrary to established law.

Even when the Commission considers a utility's proposed rate increase based upon occurrences within a test year, the Commission may also consider adjustments for any known and measurable out of test year changes in expenses, revenues, and investments, and the Commission will also consider adjustments for any unusual situations which occurred in the test year. See 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 PA Super. 341, 144 A.2d 648 (1958); Southern Bell v Public Service Commission, 270 S.C. 590, 244 S.E.2d 278 (1978)). Additionally, the Order actually notes that Utility and Beaufort County have already agreed to the 2015 taxes and DIUC has a legal obligation to pay that amount. (Order 2015-846 at 23 stating "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.")

At the hearing, Treasurer Walls testified, "This [negotiation for installment payments] is not a practice that we will continue." (Tr. at 95) Regarding the 2016 taxes due in January 2017, Ms. Walls further testified that, "Beaufort County cannot offer DIUC an installment payment option for these upcoming taxes, I am concerned that if DIUC is not able to collect sufficient revenues in 2016 for the taxes due in January 2017." (Tr. at 85) Therefore, the Order's reference to potential modification of DIUC's agreement with Beaufort County is not only hypothetical, it is contrary to the record.

The Utility Property tax amount at the 2014 level proposed by ORS and accepted by the Commission does not reflect the known and measurable amount that DIUC will clearly have to pay under the new rates. In order to cover the 2016 Utility Property taxes, DIUC must collect sufficient revenue during 2016 under rates high enough to provide for payment of these taxes due in January 2017. Recognizing this fact, Maria Walls testified about her concerns:

> Q. Do you have any concerns about DIUC's ability to pay its upcoming taxes?
>
> A. Yes. In working with DIUC I have come to understand that DIUC's rates are set by the Public Service Commission. If the rates are not sufficient to allow DIUC to collect enough money prior to January 15th of a given year to pay the tax bill due on that date, then DIUC will not be able to pay its taxes. Of particular concern to me is the payment that will be due January 15, 2017, and whether DIUC will be allowed to charge rates sufficient to collect the funds necessary to make that payment in 2017.
>
> Q. What will happen if DIUC does not pay the taxes due on January 15, 2017?

A. If DIUC misses a payment on January 15th of 2017 (or any subsequent year), a 3% penalty on the total taxes due would be assessed. If the taxes are not paid by February 1st, an additional 7% penalty is assessed. If the taxes are still not paid by March 15th an additional 5% penalty is assessed. So, in total DIUC would incur a 15% delinquency penalty by not paying the taxes on time. Since Beaufort County cannot offer DIUC an installment payment option for these upcoming taxes, I am concerned that if DIUC is not able to collect sufficient revenues in 2016 for the taxes due in January 2017 then DIUC will begin a cycle of incurring 15% penalty every year. Plus, if DIUC's taxes are not timely paid then DIUC will suffer the other ramifications of nonpayment of taxes.

(Tr. at 84 – 85)

ORS proposed and the Order adopted an annual amortization of $30,612 related to the 8 year amortization of past taxes, which only allows payment of $244,899 for the 2012 and 2013 portion of the total of $526,843.39 due per the Settlement Agreement Addendum. (Order 2015-846 at 23-24) Or, stated differently, the ORS adjustment excludes $281,944 of currently owed taxes, even though the Company is contractually bound to make those payments. The $65,856 annual payment is a known cost under the Beaufort County Settlement Agreement that reflects significant cost savings to DIUC and its customers from the total amount of past-due taxes the County originally billed DIUC. The Utility must be allowed revenue sufficient to pay its taxes.

Accordingly, the Order's approved allowance of $30,612 is less than the actual annual payments of $65,856 that DIUC is required to make under the Amended Settlement Agreement with Beaufort County; and the Order's approved annual level of $140,880 based on 2014 taxes is less than the $192,302 that must be paid in January 2017 and accrued during 2016 for 2016 Utility Property Taxes. Ignoring the reality of taxes results in an Order that is unsupported by law, evidence, and fact. In this case, the Order

also guarantees DIUC will owe additional penalties and interest which will ultimately have to be borne by the rate payers. Such an order cannot be sustained.

This Court should modify Order 2015-846 to include DIUC's actual, known and measurable legal obligation of $258,227.40 for Annual Property Tax Expense.

B. The Commission erred as a matter of law ruling that Guastella Associates is an affiliate of DIUC. As such, the management fees incurred are presumed to be reasonable and the reliable, probative, and substantial evidence on the whole record demonstrates the requested management fees of $174,364 are appropriate.

1. The Commission erred in finding the Commission previously approved an amount for Guastella Associates' management fees.

The Order found that DIUC is entitled to $132,211 for GA's management expenses, which is significantly less than the $174,364 actually being incurred and requested by DIUC. (Order 2015-846 pp. 23 and 26) In making this determination, the Commission erroneously relied upon ORS's request that "GA's management fees be limited to the previously Commission-approved amount of $132,211 a year." (Order 2015-846 p. 24)

However, the management fee of $132,211 was not a "Commission-approved" management fee in the previous case, as asserted by ORS. DIUC's last rate case, Docket No. 2011-229-WS, Order No. 2012-515, was settled by agreement of DIUC, ORS and the Intervenors (the same Intervenors in this case). SC Public Service Comm'n. Order 2012-515. Neither the settlement agreement in that case nor the Commission's approval of it mentions the management fees or the amount of $132,211. Id. The Commission erred by relying on the previous amount as the entire basis for adoption of the ORS position.

Pursuant to S.C. Code 1-23-380, the Commission's arbitrary and unsupported conclusion requires reversal and entry of the requested amount of $174,364 for management fees.

2. Even if it was factually accurate that $132,211 for DIUC's management fees were approved by the Commission in conjunction with a previous rate determination, the Order's reliance solely upon a prior rate decision is an error of law.

The adjustments adopted in the Order regarding management fees due GA under its management agreement are not based on a complete or accurate analysis of the record. The Order fails to address the issues of whether performance under GA's management agreement was beneficial to DIUC's customers and whether GA's fees were reasonable. As such, the Order fails to demonstrate a reliable, probative basis for accepting the adjustment proposed by ORS. See Porter v. S.C. PSC, 333 S.C. 12, 21, 507 S.E.2d 328, 332 (1998) (When ruling, "the PSC must fully document its findings of fact and base its decision on reliable, probative, and substantial evidence on the whole record.").

As previously stated, in making this determination the Commission erroneously relied upon ORS's request that "GA's management fees be limited to the previously Commission-approved amount of $132,211 a year." (Order 2015-846 at 24 citing Gearhart Direct, Tr. p. 539 (emphasis added)). However, even if the fees were incorporated into a previous PSC Order, the Commission cannot reach back into a previous case for the lone support of a ruling in a later case. As the Supreme Court has explained, figures from past test year(s) are only probative, if at all, as a starting point for analysis by the Commission. The discussion below explains the rule.

> Utility argues, however, that the PSC used Utility's recent rate increase as part of its justification for denying the current rate application. To the extent the PSC did so, this was error. Cf. Heater of Seabrook II, 332 S.C.

> at 29, 503 S.E.2d at 743 (finding it was "inappropriate" for the PSC to rely in a 1997 order on its reasoning in a 1992 order granting an increase to the same company because "this order . . . was based on evidence, and a prior test year, completely different from [the utility's] financial condition at the time of the current application."). The PSC must not use the simple fact of a recent rate increase as a reason to deny a utility's rate application. ***An application for a rate increase must stand or fall on its own merits.*** A recent rate increase provides only a starting point for determining whether a utility's rate base or expenses have increased, such that additional revenues are required.

Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff, 392 S.C. 96, 115, 708 S.E.2d 755, 765 (2011) (emphasis added).

In violation of this principle of law, ORS's conclusion (*and its **only** reason*) that there were no increases in the management services provided by GA fails to provide any analysis of what services were provided at the time of the last rate case or in the present. There is no "starting point" from which the analysis proceed and therefore the conclusion fails. See Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff, 392 S.C. 96, 115, 708 S.E.2d 755, 765 (2011). Second, there was no proof that the services Guastella Associates provided were identical to those provided before the last rate case. Finally, Mr. Guastella provided proof of new projects and efforts in a report that described extensive services provided since the last rate case related to the repair, maintenance, and upgrade of the Utility, and its efforts to address new and unique issues that reduced property taxes and made improvements to the water and sewer systems that were praised by DHEC. (Tr. Exhibit 7, Report on Capital Improvements) The DIUC Report on Capital Improvements provides a detailed history of DIUC and its predecessor entities and it highlights the multitude of complex issues inherited by DIUC which has been dedicated to solving these problems while maintaining reliable and safe services. (Id.)

Likewise, the record does not support the Commission's inference that GA's management fees are excessive; as such, the inference requires remand pursuant to S.C. Code § 1-23-380. DIUC actually provided unrefuted testimony to the contrary by demonstrating that on a comparable basis, and taking into account the costs and rates proposed in this rate application, DIUC's cost of operations, including management fees, is less than four of eight municipal water and wastewater utilities in South Carolina, and far less than the average, even though DIUC's costs should be higher because it serves an island with no road access, has far fewer customers, and has to pay taxes that these municipal utilities escape. (Tr. Ex. 8, Average Monthly Water and Sewer Costs - Based on Monthly Usage of 11,000 Gallons). Regarding the reasonable fees related to the capital improvements, Mr. Guastella testified that the GA capital fee structure under the management agreement is about half of such typical charges. (Tr. at 251) This testimony was not challenged or in any way disputed by ORS or Intervenors. The Commission erred in refusing to consider this reliable, probative, and substantial evidence, and instead allowed *nothing* for the undeniable work that has been performed in order to make improvements essential to provide adequate service to the customers and complying with environmental regulations. The requested management fees should be allowed.

3. The Commission erred in finding Guastella Associates is an affiliate of DIUC and in failing to apply the proper standard to analyze the Utility's actual costs for management fees. Because DIUC and Guastella Associates are not affiliated, DIUC's expenditures for management fees are presumed reasonable and incurred in good faith.

In defending its original Order, the Commission ruled on reconsideration that, "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." (Order 2016-50 at 12-13) Therefore, continued the Commission, "although expenses of a public utility are presumed to be reasonable when incurred in good faith, the presumption does not apply to affiliate payments." (Order 2016-50 at 12)

A utility in a ratemaking proceeding is "entitled to a presumption that its expenditures were reasonable and incurred in good faith." Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff, 392 S.C. 96, 109, 708 S.E.2d 755, 762 (2011). "This presumption does not shift the burden of *persuasion* but shifts the burden of *production* on to the Commission or other contesting party to demonstrate a tenable basis for raising the specter of imprudence." Id. (emphasis added.) DIUC is entitled to this presumption with regard to the GA fees totaling $171,364, as submitted. The record contains nothing to suggest the GA-DIUC agreement is not proper.

Mr. Guastella testified at length about the management agreement and how it was negotiated:

> Our management fee was an arm's length negotiation ... when the CK Materials people were thinking about acquiring the utility from International Paper, they came to me and asked if I would help them with that acquisition. They came to me because International Paper recommended that I help them acquire the utility system. In order for me to do – once I helped them with the acquisition, I was asked whether or not I would then manage the utility, because they really didn't know how to do that. So I entered into an arm's length agreement with what was then the Haig Point Utility, which we had to change the name to Daufuskie Island Utility at the request of the homeowners and the owners of Haig Point Utility, and I worked up a management agreement that includes all the duties and functions that Guastella would perform on a day-to-day basis.

(Tr. at 170-171) There is nothing in the record to dispute this testimony or to provide even an arguably tenable basis for raising the specter of imprudence. See Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff, 392 S.C. 96, 109, 708 S.E.2d 755, 762 (2011).

As such, DIUC is entitled to (and the Commission erred in failing to apply) the presumption that the GA fees totaling $171,364 as submitted expenses are reasonable and incurred in good faith as required by law.

4. Even if Guastella Associates were an affiliate of DIUC, which it is not, the record demonstrates the significant management efforts of Guastella Associates during the test year.

With regard to its request to reduce the amount recoverable for GA's management fees, ORS simply asserted:

> ORS proposes to adjust outside services for management fees to reflect the previously Commission approved amount of $132,211. During the review, ORS did not find that the management services provided by Guastella and Associates ("GA") increased and did not find the requested increase justifiable.

(Tr. at 493). The Order Approving Settlement then repeats "ORS testified that it found no apparent increases in the management services provided by GA and did not find the requested increase justified." (Order 2015-846 at 24)

ORS did not provide and the record does not include any narrative or quantitative analysis that justifies the downward adjustment to management fees actually incurred. First, there was no proof that the services supplied by GA in the years in question were identical. Second, the record on the whole establishes GA's increasing efforts. Specifically, DIUC provided proof of GA's new projects and efforts in its May 2015 Report of Capital Improvements. (Tr. Ex 7) The Report includes information regarding the very unusual problems faced by the Company and how those problems were addressed by GA pursuant to its management agreement. (Tr. Ex 7) DIUC provided a comprehensive description of GA's services and accomplishments and the resulting significant benefits to the customers, as follows:

- GA directed the transition for the HPUC acquisition as well as the merger of MUC, improving records, billing and operations, despite the many problems that arose during this merger of books and records. (Tr. at Exhibit 7)

- GA managed the operations despite an immediate 25% annual shortfall of revenues because of MUC's failure to pay its share of the jointly owned wastewater treatment plant. (Tr. at Exhibit 7)

- When the owners of MUC simply abandoned the utility operations and filed for bankruptcy, GA directed DIUC's effort to protect the MUC's customers from interruption of water and sewer service; DIUC was not compensated for this effort, despite DIUC's cash shortage. (Tr. p. 214)

- GA undertook an extensive effort over about a three year period trying to obtain financing, including about 15 months *after* the 2012 rate increase, without which it would have been nearly impossible to continue to provide adequate service. GA's expertise in preparing qualified appraisals and rate setting were critical in obtaining approval of financing. (Tr. p. 220).

- When there were insufficient funds to pay for temporary repairs to the failed wastewater lagoon liner, GA worked with the president of DIUC to use his contracting firm to make the emergency repairs (Tr. at Exhibit 7)

- GA's expertise in appraisals, valuation and condemnations were beneficial in dealing with the condemnation of the land at the storage tank site, assisting DIUC in prevailing at summary judgment. (Tr.p.220)

- GA **saved DIUC and its customers over $350,000 in property taxes and another $100,000 in present value savings** related to the 8 year payment agreement. (Tr. p. 213 and Exhibit 7)

- GA's administration and supervision of the capital improvements **saved DIUC and its customers as much as $400,000 in construction costs,** as well as significant savings for the Fire Department for the construction of a helipad. (Tr. p. 173)

- Because cash flow is always first used to operate the water and sewer systems, **the owners of DIUC have never been paid a dividend** and

> **GA is owed thousands of dollars in accrued payments.** Mr. Guastella explained that the past due accounts payable to GA will eventually be paid by the owners and not the customers. (Tr. pp. 141 and 247)

With regard to quality of GA's services, the record establishes GA's high level of performance and includes DHEC's praise of GA's efforts in emails to Mr. Guastella, which state:

> We would like to thank Guastella Associates for your attention, cooperation and assistance ... . The upgrades you have made, and continue to make, will serve both the utility and its customers well. We wish you success in your proposed rate increase, as that will assist the utility in remaining viable and effective in its mission to serve its customers and protect South Carolina's environment. We look forward to continuing to work with you.

(Tr. Exhibit 8, Email from H. Michael Longshore, MPH, Compliance and Enforcement Section, Water Pollution Control Division, Bureau of Water to John Guastella)

Finally, comparing the amount requested for management fees demonstrates they are reasonable. Mr. Guastella provided a schedule comparing the costs per customer of DIUC with other municipal water and sewer utilities in South Carolina. (Tr. Exhibit 8) After adjusting for taxes and cost of capital in order to compare the cost of operations on an equal basis, *DIUC's cost per customer is lower than four of the eight utilities*, even though the cost per customer should be considerably higher because DIUC has a much lower number of customers. (Id.) Also, DIUC is on an island accessible only by boat, which drastically increases costs of doing business on the Island. (Tr. p. 216)

Again, the Commission' Order includes no mention of this evidence, let alone proper consideration of the same which is required by law.

The reliable, probative, and substantial evidence on the whole record demonstrates DIUC's expenses for management services totaling $171,364 were properly

incurred, were earned, are reasonable in amount, and are recoverable. The Commission erred in adopting the unsubstantiated adjustment downward to $132,211 included in the Settlement Agreement. The ruling is contrary to the reliable, probative, and substantial evidence on the whole record and should be modified to allow the requested and earned management fees of $171,364.

C. The reliable, probative, and substantial evidence on the whole record demonstrates DIUC should be allowed to recover its Rate Case Expenses of $191,200.

In adopting the unsupported request of ORS that DIUC be denied recovery of expenses associated with pursuing the instant rate case, the Commission erred again by refusing to allow presumptively reasonable expenses.

The Order states the following prior to adopting the referenced ORS recommendation:

> 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).

(Order 2015-846 at 25) However, Ms. Gearheart on behalf of ORS did not provide any analysis that establishes the basis for ORS's proposed $75,000 cap on rate case expenses, and no testimony that the work included in the Company's proposed expense was not performed or was unnecessary. (Tr. at 484-500) This is insufficient to support the unexplained and arbitrary adjustment generally and in light of the presumed reasonableness of the expense.

As discussed previously herein, DIUC is entitled to a presumption that its expenditures were reasonable and incurred in good faith. See also Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff, 392 S.C. 96, 109, 708 S.E.2d 755, 762 (2011). There was no evidence supporting any conclusion that these accurately reported rate case expenses were in any way improper.

Even without this presumption, in his rebuttal testimony Mr. Guastella outlined the extensive work involved in this rate case proceeding and explained that the amount of information and paperwork required of DIUC was equal to that required of large utilities in rate cases. (Tr. p. 181) In other words, the time, expense, and effort necessary to pursue a rate application is not lessened because the utility has fewer customers of a smaller service area. This is particularly true in this case where ORS required DIUC to respond to a tremendous amount of discovery. (Tr. p. 218) Additionally, to defend the ultimate agreement by ORS and the Intervenors to simultaneously support denial of rates sufficient to operate the Utility, DIUC prepared extensive prefiled testimony, reviewed the direct testimonies of nine ORS and Intervenor witnesses, prepared rebuttal testimony and surrebuttal testimony, the prepared for the all-day hearing on the Application. (Tr. p. 218)

As it did when adopting the management fee adjustment of ORS, the Commission erred in again relying on a previous order to justify without support the denial of DIUC's rate case expenses. See Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff, 392 S.C. 96, 708 S.E.2d 755 (2011). Mr. Guastella testified that in the last rate case the Company requested $181,200 but that DIUC's actual expense totaled $370,000; and in this case, the actual expenses are reported at $380,000, yet DIUC is only requested the Commission

allow $191,200. (Tr. p. 181) That means DIUC voluntarily proposed to bear approximately one-half of the rate case expenses and only included half of actual expenses incurred in the rate request.

The record further demonstrates that DIUC's requested rate case expense of $191,200 is similar in amount with the rate case expenses that the Commission allowed in another 2012 contested rate decision. Specifically, Order No. 2012-98 in PSC Docket No. 2011-317-WS, approved rate case expenses of $190,905. (Order No. 2012-98 and Pet. for Recon. p. 17)

There is simply no evidence to support allowing DIUC only $75,000 for rate case expenses in the current case. The past Order of the Commission allowing an almost dollar-for-dollar identical amount of $190,095 and the record as a whole support and justify the submitted rate case expenses of $191,200. This portion of the Order must be modified.

D. The reliable, probative, and substantial evidence on the whole record demonstrates the Elevated Water Tank is part of the DIUC Water Plant and should be included for calculation of DIUC's Plant In Service.

South Carolina has long allowed utilities to earn "a fair return on the value of its property used and useful in the service of its customers." De Pass v. Broad River Power Co., 173 S.C. 387, 389, 176 S.E. 325, 326 (1934). The reasoning is sound – when a utility invests in equipment and real property for use in providing service, the utility is allowed to charge rates sufficient to allow it to operate and maintain that plant in service. The more equipment and facilities that are part of plant in service, the higher the allowable rate.

South Carolina Code of Laws, Regulation 103-702.16, entitled "Water Plant," defines the plant in service for a water utility like DIUC to include "all facilities owned by the utility for the collection, production, purification, storage, transmission, metering, and distribution of potable water."

The Commission's Order does not allow DIUC to include all of the items the Application reported as comprising DIUC's water plant facilities that are used and useful to the Utility. (Order 2015-846 at 18-21) The primary item of value excluded by the Order is DIUC's 125,000 gallon elevated storage tank and related facilities ("Elevated Storage Tank") which should have been included at a value of $1,303,083.97. (Tr. at 201)

The history of the Elevated Tanks Site is unique, so a brief summary is in order.

The parcel of land upon which the Elevated Tank Site is located was involved in a tax sale to Mr. Mamdouh Sabry Abdelrahman ("Sabry"). (Tr. at 76) As explained by the Honorable Maria Walls, Beaufort County Treasurer:

> The Tax Deed to Mr. Sabry did not include the elevated water tank, the well, the water pump, system pipes, or other DIUC property located on the Elevated Tanks Site. All of those items remain part of the DIUC water system infrastructure. That utility property remains part of the system owned and operated by DIUC.

(Tr. at 83)

DIUC also put into evidence the Special Warranty Deed and Bill of Sale transferring the Elevated Tank Site to the Utility. (Tr. Exhibit 8). Treasurer Walls also testified unequivocally that the storage tank and facilities were not sold to Mr. Sabry because the tax deed and tax sale procedure used was for the sale of residential property; the County was not authorized to utilize that procedure to sell utility infrastructure.

Restating this conclusion, Ms. Walls testified, "what was conveyed [to Mr. Sabry] was based on the property we believed we were taxing at that time, which was a parcel of land." (Tr. at 76) She further testified:

> The tax deed, which would have been generated by the Treasurer's Office and filed with the Registrar of Deeds, was as it was listed by the Assessor's Office, who was valuing that property at that time. It did not include the elevated tank itself. The only structure indicated on that site was a utility shed, the contents of which would've been unknown at that time.

(Tr. at 76)

There was some further discussion at the hearing about an internet print-out that includes the code "UTLSHED" and whether that somehow identified the Elevated Tank as being taxed to Mr. Sabry. (Tr. at 103) The Order Denying the Petition for Reconsideration also refers to this abbreviation but then clearly states "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." (Order 2016-50 p.18) When asked if there was a building listed on the printout Treasurer Walls said "A residential shed or small utility, yes." (Tr. at 103) That residential shed, as noted on the residential tax record and consistent with Treasurer Walls' testimony, is **not** an elevated water tank or water system infrastructure.

ORS also admits in its Answer to the Petition for Reconsideration that Mr. Sabry is not paying taxes on the elevated storage tank. (Answer at 4) The record demonstrates that Mr. Sabry is paying residential taxes on a structure described as "Residential Shed – Small Util" with a value of $3,800 as of 2014. (Tr. at 103) The record does not support ORS's suggestion that the small residential utility shed on the property to the side of DIUC's Elevated Storage Tank and related facilities raises an uncertainty about DIUC's

ownership of the Elevated Storage Tank. It is undisputed that DIUC is paying property taxes on the Elevated Storage Tank, that the tank is used and useful, and that county's assessment for all the real property owned by Sabry does not include it. DIUC is entitled to include the $1,303,083.97 value of the Elevated Tank Site in its plant in service.

The record also shows that DIUC has other rights to the Elevated Tank Site that justify inclusion of the same in tis rate base. At the hearing, DIUC put into evidence the perpetual easement that allows DIUC to construct, operate and replace utility facilities. (Tr. Ex. 8). Pursuant to the Assignment of Rights, filed at Beaufort County Register of Deeds, Book 2298, Page 2080, Haig Point, Inc. assigned to Haig Point Utility Company, Inc. its rights pursuant to the covenants previously quoted. Pursuant to Order of the Public Service Commission dated March 6, 2009, Haig Point Utility Company, Inc. was approved to and did change its name to Daufuskie Island Utility Company, Inc. See S.C. Pub. Serv. Comm'n Order 2009-154. According to The Haig Point General Covenants, Article 3, §18, DIUC holds the following:

> **Certain Easements** The company reserves unto itself, its successors and assigns, a perpetual, alienable and releasable easement and right on, over, and under the ground of the Property to erect, maintain, and use...drainage ways, sewers, wells, pumping stations, tanks, water mains, and other suitable equipment for the conveyance and use of...sewer, water, drainage or other public conveniences or utilities on...the property as may be reasonably required ... .

(Tr. Ex. 8). As the rightful owner of the easements identified in Section 18 of the Haig Point General Covenants, DIUC's facilities are lawfully located on the Property. Also, contrary to the footnote in the Order, the easement is perpetual and DIUC does not have to re-record perpetual easements every time a parcel of land is sold; the rights granted

under the perpetual easement have and will remain in effect. (Tr. at 15; Hearing Exhibit 8)

There should be no uncertainty about ownership of DIUC's facilities. The storage tank and related utility facilities were not sold to Mr. Sabry. Further, late-filed Exhibit 6 indicates that the Beaufort County Assessor is valuing the property as residential property without reference to the tank and facilities on the property. See Exhibit 6 ("In fact, we have valued this property for several years, and the parcel is currently valued at $24,200 as of our 2013 [residential] Revaluation.") Clearly DIUC's storage facilities (some $1.3 million) are not included in that value. Moreover, Ms. Walls testified that DIUC's utility facilities at the site are being taxed as Utility Property of DIUC, and Mr. Guastella also testified that they are being assessed and taxed as Utility Property.

The reliable, probative, and substantial evidence on the whole record demonstrates the Elevated Water Tank is part of the DIUC Water Plant and its value of $1,303,083.97 should be included for calculation of DIUC's plant in service.

E. The Commission erred in adopting the reductions to Plant In Service proposed by the Settlement Agreement.

The Commission Order adopted the Settlement Agreement which recommended an adjustment to the value of the Elevated Storage Tank and related utility facilities on the land that was sold in a tax sale, because of what the Order describes as "reducing plant-in-service values for property tax purposes and uncertainty regarding what DIUC owns as a result of the delinquent tax sale." (Order 2015-846 at 21) However, the proposed ORS adjustment did not include a specific amount and it was not calculated based upon an analysis of the value of the Elevated Tank Site at the filed amount of $1,303,083.97; thus, as a result, the Commission's adoption of the total downward

adjustment of $1,624,696 was likewise not specific or supported by facts in the record. This Court must modify the Order's $1,624,696 reduction in value for plant in service. Or, stated differently, the Order's allowance for DIUC's plant in service should be increased to include $1,303,083.97 for the Elevated Tank Site as well as increased by $321,612.03 to reverse the additional downward adjustment improperly applied in the Order.

Every utility, even small ones like DIUC, are by law entitled to "a fair return on the value of its property used and useful in the service of its customers; and, as is its duty, the rate-making body named by the Legislature for that purpose fixes such rates . . . as will insure such a return... ." De Pass v. Broad River Power Co., 173 S.C. 387, 389, 176 S.E. 325, 326 (1934). The Order's adjustment to plant in service substantially prejudices DIUC by denying it a lawful return and the Order's basis for the adjustment in plant in service lacks a sufficient foundation in fact. S.C. Code Ann. § 1-23-380 requires this Court reverse the Order's adjustment to plant in service. Additionally, the Commission's inferences and reliance upon certain documents constitute clear error, as explained below.

1. It was error for the Commission to rely upon DIUC's Revised Water Annual Reports for 2012 and 2013 to reduce DIUC's Plant In Service for ratemaking purposes.

The only actual evidence provided to support the Settlement Agreement's $1,624,696 reduction in value for plant in service were DIUC's Revised Water Annual Reports for 2012 and 2013. In those Revised Reports, DIUC explained to the DOR that in order to resolve challenges to its previous rate case DIUC agreed to a settlement that utilized a rate base of $5,000,000 for calculation of rates. See Order 2012-515. To reflect that percentage reduction, DIUC reduced all entries on the Report to reflect a

percentage change. (Hearing Exhibit 20, p. 2 stating clearly that the revised filing was merely "Adjusted to reflect the rate base allowed in Docket No. 2011-229-WS.")

The Commission then concluded in error that "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." (Order 2015-846 p. 21) So, the Commission did not have and did not require ORS or the Intervenors to provide any evidence to support the reduction. By the Order's clear language, the Commission issued applied the adjustment without any specific grounds to support it.

However, the evidence demonstrates that DIUC did not revise its annual reports to DOR by lowering property values and eliminating the value of the Elevated Storage Tank. DIUC's amended returns reflected a prorated adjustment to **all** primary plant accounts to reflect the $5,000,000 rate base that was part of the settlement in the last rate case. (Hearing Exhibit 20) In turn, DOR lowered its total assessed value and DIUC's customers benefited by a reduction of the annual property taxes. DIUC's original cost of utility plant in service and net investment were not revised for book or rate setting purposes.

2. There is nothing in the record provided by ORS or the Intervenors to identify the specific plant items or their costs represented by the adjustments for "capital improvements" or "non-allowable plant" or "adjustments from previous cases" or "retirements". As such, the Commission erred in adopting them into its Order.

ORS presented testimony of ORS Audit Manager Ivana Gearheart who stated ORS proposed its adjustment reducing the DIUC plant in service "to reflect capital improvements, non-allowable plant, adjustments from the previous case not made by

DIUC and retirements through July 31, 2015" and to account for "undocumented expenses." (Tr. at 496 and Hearing Exhibit 18 and Audit Exhibit ICG-4, Page 5, ORS Adj. 10, respectively) However, there is nothing in the record provided by ORS or the Intervenors to identify the specific plant items or their costs represented by the adjustments for "capital improvements" or "non-allowable plant" or "adjustments from previous cases" or "retirements".

Even without factual support, the Order adopted these adjustments from the Settlement Agreement stating that "ORS Audit Exhibit ICG-5 (Hearing Exhibit 18) shows the specific items composing the $1,624,696." However, that statement is simply incorrect. While Audit Exhibit ICG-5 does include a column entitled "ORS Adjustment," that column lists the amounts reflected for primary plant accounts, not items of plant. (Tr. Ex. 18) The adjustments in that column, by plant account, cannot be identified with specific items of plant, cannot be correlated to the specific cost of the items being adjusted, and there is no way to identify ORS's stated reasons for the adjustments. (Tr. Ex. 18)

For example, it cannot be determined from Audit Exhibit ICG-5 what items of plant were adjusted for "non-allowable plant" or what costs were adjusted for "non-allowable plant." Moreover, merely stating that an item of plant is non-allowable is not justification as to why it is not allowable and it is not sufficient evidence to support the Order. Audit Exhibit ICG-5 also fails to identify the adjustment being made to the elevated storage tank, well and facilities, or the amount of the adjustment. The Commission erred in relying on the exhibit for this adjustment. Because the exhibit is not

reliable or probative, S.C. Code Ann. § 58-5-240(H) and S.C. Code Ann. § 1-23-380 require remand or modification of the Order by this Court.

With respect to "undocumented expenses" Mr. Guastella explained in rebuttal that an absence of some invoices should not constitute a lack of documentation for rate setting purposes, and that DIUC provided ORS with ample documentation, including itemized assets by primary plant account, description, original costs as booked, year of installation and in service dates. (Tr. at 150–153) Mr. Guastella also testified that it is consistent with the NARUC Uniform System of Accounts to estimate the cost of utility plant in the absence of documentation. (Tr. 204) ORS witness Ms. Gearheart testified she was not familiar with the NARUC provisions that address inclusion of estimated costs in the absence of documentation. (Tr. 530) However, Intervenors' witness Charles Loy testified that "The NARUC USoA requires an 'estimate' of plant values when there is no supporting documentation available." (Tr. 385) ORS should have estimated the reasonableness of the costs recorded and booked rather than excluding an unspecified amount for alleged "undocumented expenses," which implies some inappropriate action by DIUC.

With respect to adjustments from the previous case, ORS did not identify any of the specific items or their cost. As testified by Ms. Gearheart, "Those adjustments were simply carried over from the last rate case, and we do not retest or retry anything that was approved in the last rate case." (Tr. at 526) The Order also includes reference to a "carryforward amount" of $4,615,755 from the previous rate case but that specific number is not in the record for this proceeding. It only appears in ORS's proposed order. Again, the Commission cannot rely on a previous order as justification for this type of

analysis in a current case. See Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff, 392 S.C. 96, 708 S.E.2d 755 (2011). Furthermore, DIUC's previous rate case was settled by agreement that specifically stated, "This stipulated rate base shall not be binding in future proceedings; instead, those proceedings will be determined based on the evidence presented in each docket and the applicable law." (Tr. at 525 and Order 2012-515) This intermingling of matters within and outside the record along with using calculations specifically excluded by the last case's settlement must be addressed by the Court.

The $1,624,696 reduction in value for plant in service is not supported by the reliable, probative, and substantial evidence on the whole record. As such, the Order should be modified to include an additional $1,624,696 for plant in service.

F. The Commission erred in adopting the Settlement Agreement proposal for Bad Debts.

The Order also accepts the Settlement Agreement's recommendation for bad debts. The Order reverses ORS's original adjustment up to $108,349 of bad debts and, instead, allows only the $30,852[5] DIUC included in its Application. In response to the Application, ORS first proposed the Commission increase DIUC's bad debt allowance to $108,349; this was one of twenty adjustments accepted by DIUC as reflected in Mr. Guastella's rebuttal testimony. (Tr. at 199) ORS maintained its position until the day before the evidentiary hearing when the Settlement Agreement was first disclosed to DIUC. The Order's acceptance of the Settlement Agreement and its bad debt expense methodology is contrary to the record, as testified by Mr. Guastella:

> Q. One of the adjustments proposed by ORS, and included within that list, I believe, is number 14. Is that bad debt?

[5] The total of $16,090 stated in the Order is incorrect. DIUC's adjustment was $16,090 but the total *pro forma* amount was $30,852.

A. Yes.

Q. Can you explain why the utility was willing to accept that adjustment?

A Yes. Our bad-debt expense per books, which went to 2014, was over $100,000. When we prepared our filing, we took a conservative approach and allowed only $30-$40,000, I believe. When I saw ORS's testimony, they used a percentage applied to revenues, and they came up with $100,000, which was consistent with our 2014 level. I then looked at our latest 12 months of revenues, compared to a previous similar period of 12 months of revenue, and I found that our bad debts' expense were still up over the $100,000. So I accept their adjustments. It favors the company, but it's the reality of what we've been facing. Our bad debts were at a level of $100,000, before we filed the case and subsequent to filing the case, and ORS's adjustment was reasonable and I accepted it.

(Tr. at 136 – 137)

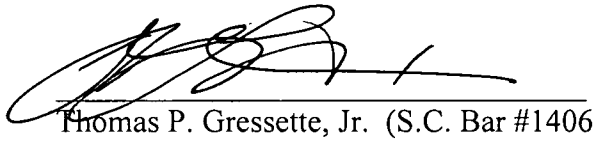
No ORS witness provided any cost justification for the change in ORS's position as to the bad debt other than a capitulation to the request of the Intervenors. The two matters in the record as to the proper level of bad debts are ORS's original position of $108,349 and DIUC's testimony that the actual bad debts expenses for the test year and the most current 12 month period is over $100,000. (Tr. at 136) The Commission's decision to disallow almost $70,000 of the actual bad debt expense suffered by DIUC is not supported by the reliable, probative, and substantial evidence on the whole record demonstrates There is no proof that $30,852 is realistic or anywhere close to the actual amount. The Order should be modified to reflect ORS's original position of $108,349 and DIUC's testimony that the actual bad debts expenses for the test year and the most current 12 month period is over $100,000.

CONCLUSION

In the proceedings below, the Commission blindly adopted an improperly presented and admitted Settlement Agreement then entered an Order Approving Settlement that fails, in violation of S.C. Code Ann. § 58-5-240(H), to rely exclusively on reliable, probative, and substantial evidence on the whole record. Pursuant to S.C. Code § 1-23-380, this Court should reverse and vacate Orders 2015-846 and 2016-50 then remand this matter for determination of rates in accordance with the Applicant's requests herein regarding property taxes, management fees, rate case expenses, plant in service, and bad debts.

Respectfully Submitted,

PRATT-THOMAS WALKER, PA



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Charleston, South Carolina

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SC SUPREME COURT

STATE OF SOUTH CAROLINA
In the Supreme Court

APPEAL FROM THE PUBLIC SERVICE COMMISSION

Appellate Case No. 2016-000652

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 SERVCE

The undersigned hereby certifies that on this 13th day of June, 2016, a copy of Appellant's INITIAL BRIEF, DESIGNATION OF MATTER, and MOTION FOR PERMISSION TO EXTEND PAGE LIMITATION was served on counsel of record, by placing same in the United States Mail, first class postage prepaid to the following:

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