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S.C. SUPREME COURT

THE STATE OF SOUTH CAROLINA
In The Supreme Court

APPEAL FROM
THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

Docket No. 2014-346-WS
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,

FINAL BRIEF OF RESPONDENT SOUTH CAROLINA OFFICE OF REGULATORY STAFF

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October 20, 2016

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STATEMENT OF THE CASE

This is an appeal of Public Service Commission of South Carolina ("Commission") Order Nos. 2015-846 and 2016-50 issued on December 8, 2015 and February 25, 2016, respectively, in Docket No. 2014-346-WS. In this case, Daufuskie Island Utility Company, Inc. ("DIUC"), a water and sewer company regulated by the Commission, filed an Application on June 9, 2015, with the Commission requesting a 108.9% revenue increase via a new schedule of rates and charges for water and sewer service to be collected by increasing the rates paid by its water and sewer customers. (Application and Application Schedule A-4.) (R. pp. 1416-1483 and 1439.) The 108.9% revenue increase equaled $1,182,301 in additional revenue, consisting of water revenue increases of $590,454 and sewer revenue increases of $591,847. (Application Schedule W-C and Schedule S-C.) (R. pp. 1445 and 1463.) After the Application was filed, the Commission was required to issue an Order "approving or disapproving the changes in full or in part within six months." S.C. Code Ann. Section 58-5-240(C) (2015).

ORS is automatically a party to all matters before the Commission pursuant to S.C. Code Ann. § 58-4-10(B) (2015). Petitions to Intervene were granted to Haig Point Club and Community Association, Inc. ("HPCCA"); Melrose Property Owner's Association, Inc. ("MPOA"); Bloody Point Property Owner's Association ("BPPOA") and Beach Field Properties, LLC ("Beach Field"). HPCCA, MPOA, BPPOA are collectively referred to as the Property Owners Associations ("POAs").

The Commission held a night hearing on September 15, 2015, at 6:00 pm on Daufuskie Island to provide residents an opportunity to testify about DIUC's application without having to travel to Columbia, South Carolina for the hearing scheduled for October 28, 2015.

Written testimony is required to be filed with the Commission and served on all parties on or before dates established by the Commission. S.C. Code Ann. § 58-3-140(D) (2015); 10 S.C. Code Ann. Regs. 103-845.C (2012). Pursuant to Commission Order No. 2015-57-H, DIUC filed its written direct testimony on September 18, 2015, and all other parties filed their written direct testimonies on October 2, 2015, with the exception of Beach Field which did not file testimony. DIUC filed written rebuttal testimony on October 9, 2015, and ORS and the POAs filed written surrebuttal testimony on October 16, 2015.

On October 27, 2015, the ORS and POAs (collectively the "Settling Parties") filed a Settlement Agreement with the Commission and served it on the parties. The Settlement Agreement was offered into evidence at the outset of the hearing on October 28, 2015. (Hearing Exhibit 3) (R. pp. 820-833.) Upon presentation of the Settlement Agreement, DIUC objected and asserted it was error for the Commission to accept the Settlement Agreement into the record. (Tr. p. 42 – p. 44, ll. 16) (R. p. 314-316, line 16.) The objection was overruled. (Tr. p. 48, ll. 2-14) (R. p. 320, lines 2-14.) Beach Field did not object to the Settlement Agreement.[1] After the Settlement Agreement was entered into the record, the Commission proceeded to hear testimony from the witnesses.

In the Settlement Agreement, the POAs agreed with all ORS adjustments recommended in ORS's pre-filed testimony, except for the adjustment for bad debt expenses. (Hearing Exhibit 3; Tr. p. 302, ll. 20-24; p. 304, ll. 11-14; Order Nos. 2015-846 p. 28-30 and No. 2016-50 p. 22) (R. pp. 820-833; p. 574, lines 20-24; p. 576, lines 11-14; pp. 57-59; and p. 27.) The Settling Parties agreed to adopt the methodology for calculating the bad debt expenses from DIUC's Application. Id. The Settlement Agreement resolved all issues among the Settling Parties and its terms reflected

[1] By letter dated July 12, 2016 to this Court, Beach Field stated that it does not have a position regarding the issues on appeal and does not intend to participate as a party Respondent.

acceptance of recommendations from pre-filed testimony along with the methodology for bad debt expenses from DIUC's application. (Hearing Exhibit 3) (R. p. 820-833.)

In Commission Order No. 2015-846, the Commission granted DIUC a 9.28% return on equity ("ROE") and a 16.18% operating margin which produced a revenue increase equaling $462,798 for the combined water and sewer operations. (Order No. 2015-846 p. 32-33) (R. pp. 61-62.) The granted revenue was 39.1% of the revenue requested by DIUC. (Order No. 2015-846 p. 29) (R. p. 58.) Commission Order No. 2015-846 also approved the Settlement Agreement. Id. The Commission's Order Nos. 2015-846 and 2016-50 (in response to DIUC's Petition for Reconsideration) included evidence and findings which concurred with the recommendations contained in pre-filed testimony and DIUC's Application. (R. pp. 30-65 and 6-27.)

DIUC contends the Commission committed errors related to the Settlement Agreement and in denying DIUC's requested revenue. DIUC filed a Notice of Appeal with this Court on March 22, 2016 after its Petition for Reconsideration was denied by the Commission in Order No. 2016-50 on February 25, 2016. The ORS and POAs support the Commission Orders.

STATEMENT OF FACTS

On June 9, 2015, DIUC filed an Application with the Commission pursuant to S.C. Code Ann. Section 58-5-240 and 10 S.C. Code Ann. Regs. 103-512.4.A and 103.712.4.A seeking approval of a new schedule of rates and charges for water and sewer service that DIUC provides to its customers within its authorized service area, Daufuskie Island, in Beaufort County, South Carolina. DIUC provides water supply/distribution services to 680 active residential and commercial service units and wastewater collection/treatment services to 493 active residential and commercial service units. (Tr. p. 507, ll. 9-12) (R. p. 779, lines 9-12.) In the Application, DIUC requested an increase in revenues of 108.9% for combined operations equaling the amount

of $1,182,301, consisting of water revenue increases of $590,454 and sewer revenue increases of $591,847. (Application Schedules A-4, W-C and S-C.) (R. pp. 1439, 1445, and 1463.) DIUC's requested revenue increase utilized an ROE of 10.5% based on the rate of return on rate base methodology and a 2014 historical test year ("test year"). (Application "Overview and Justification" and Schedule A-3.) (R. pp. 1418 and 1438.) In the Application, DIUC also requested to establish uniform rates between the Haig Point and Melrose communities. (Application "Overview and Justification.") (R. p. 1418.)

Before the instant case, DIUC's most recent rate case was in Commission Docket No. 2011-229-WS. (R. pp. 68-86.) In that case, Commission Order No. 2012-515 approved a settlement entered into by the POAs and DIUC that was not objected to by ORS whereby DIUC received a revenue increase of $291,485 based on a $5,000,000 rate base; an operating margin of 16.64%; and an ROE of 8.81%. (Order No. 2015-846 p. 2) (R. pp. 31, 75, and 77.) As part of that settlement, DIUC agreed not to seek another rate adjustment prior to July 1, 2014. (R. pp. 31 and 78.)

In this case, Petitions to Intervene were granted for the POAs and Beach Field who became the only other parties with DIUC and ORS. ORS is an automatic party in all matters before the Commission and its mandate is to "represent the public interest of South Carolina before the commission." S.C. Code Ann. § 58-4-10(B) (2015).

At the hearing before the Commission on October 28, 2015, and in support of its Application, DIUC presented the testimony of: John F. Guastella[2] (direct and rebuttal testimony), a member of the DIUC Board of Directors and President of Guastella Associates, LLC ("GA"), a

[2] Hearing Exhibit 7 consists of Guastella Direct Exhibits A and B. (R. pp. 846-891.) Hearing Exhibit 8 consists of Guastella Rebuttal Exhibits 1 through 5. (R. pp. 892-944.) Hearing Exhibit 9 is the GA Management Agreement. (R. pp. 945-953.) Hearing Exhibit 10 consists of the ORS and POAs responses to DIUC's discovery requests. (R. pp. 954-971.)

utility management, valuation and rate consulting firm headquartered in Boston, Massachusetts; Gary C. White (direct testimony), Vice President and Director of Accounting at GA; Eric Johanson (direct testimony), DIUC Chief Operator; and Maria Walls (rebuttal testimony), Beaufort County Treasurer. (Tr. p. 187, ll. 11-12; p. 188, ll. 1-2; p. 227, ll. 13-17; p. 123, ll. 11-14; p. 114, ll. 11-12; p. 81, ll. 15-18) (R. p. 459, lines 11-12; p. 460, lines 1-2; p. 499, lines 13-17; p. 395, lines 11-14; p. 386, lines 11-12; p. 353, lines 15-18.) Mr. Guastella and Mr. White testified as a panel about GA's management of DIUC and the finances of DIUC. Mr. Johanson's testimony addressed the operations of DIUC. Mr. Johanson was excused from the hearing without appearing before the Commission after his testimony was accepted into the record without objection from the other parties. Ms. Walls provided testimony on property taxes.

The POAs presented two panels of witnesses. The first panel consisted of Paul Vogel[3] (direct testimony), HPPCA resident; Doug Egly[4] (direct testimony), Chief Executive Officer of the Haig Point Association; and Tony Simonelli (direct testimony), real estate broker on Daufuskie Island. (Tr. p. 315, ll. 8-15; p. 327, ll. 3-5; p. 334, ll. 2-5) (R. p. 587, lines 8-15; p. 599, lines 3-5; p. 606, lines 2-5.) POA witnesses Vogel, Egly, and Simonelli presented testimony illustrating the points of view of their respective organizations, and each providing testimony opposing DIUC's request. The second panel consisted of Lynn M. Lanier[5] (direct testimony) and Charles Loy[6] (direct and surrebuttal testimony), principals of GDS Associates, Inc., a utility consulting and engineering firm with its principal offices in Marietta, Georgia; and Harry Jue[7] (direct testimony), water and sewer consultant with Hussey Gay Bell Engineering. (Tr. p. 417, ll. 2-5; p. 367, ll. 2-5;

[3] Hearing Exhibit 11 is Vogel Exhibit 1. (R. pp. 972-973.)
[4] Hearing Exhibit 12 is Egly Exhibit 1. (R. pp. 974-975.)
[5] Hearing Exhibit 14 consists of Lanier Exhibits 1 through 5. (R. pp. 979-1057.) Exhibit 3 was revised at the hearing.
[6] Hearing Exhibit 15 is Loy Surrebuttal Exhibit 1. (R. pp. 1058-1265.) Hearing Exhibit 16 is Loy Direct Appendix A. (R. pp. 1266-1278.)
[7] Hearing Exhibit 13 is Jue Exhibit 1. (R. pp. 976-978.)

p. 359, ll. 3-5) (R. p. 689, lines 2-5; p. 639, lines 2-5; p. 631, lines 3-5.) Mr. Lanier and/or GDS Associates, Inc. represents and performs utility rate services for almost all of the twenty electric cooperatives in South Carolina. (Tr. p. 420, ll. 5-6) (R. p. 692, lines 5-6.) POA witness Loy provided testimony regarding accounting and rate base issues. POA witness Lanier provided testimony on the overall Application and incorporated Mr. Loy's recommended adjustments. Beach Field did not pre-file or present testimony at the Commission hearing.

ORS presented testimony via one panel consisting of Dr. Douglas H. Carlisle[8] (direct testimony), ORS Economist; Ivana C. Gearheart[9] (direct testimony), ORS Audit Manager; and Willie J. Morgan[10] (direct and surrebuttal testimony), ORS Deputy Director for the Water and Wastewater Department. (Tr. p. 470, ll. 10-12; p. 488, ll. 12-14; p. 505, ll. 10-13) (R. p. 742, lines 10-12; p. 760, lines 12-14; p. 777, lines 10-13.) Dr. Carlisle has a Ph.D. in Government and International Relations from the University of Virginia and is a Certified Rate of Return Analyst. (Tr. p. 470, ll. 15-17, 23) (R. p. 742, lines 15-17, 23.) His testimony included an analysis and recommendation for an ROE of 9.31% based on the calculated average from the range 8.91% to 9.71%. (Tr. p. 471, ll. 7-9) (R. p. 743; lines 7-9.) To develop the ROE recommendation for DIUC, Dr. Carlisle evaluated the return requirements of investors on the common stock of two groups: publicly held water and sewerage service companies and a Comparable Earnings Model group. (Tr. p. 474, ll. 16-20) (R. p. 746; lines 16-20.) Dr. Carlisle then applied to the first group, two known and generally accepted methods for determining a recommended ROE, the Discounted Cash Flow Model and Capital Asset Pricing Methods. (Tr. p. 474, ll. 20-23) (R. p. 746, lines 20-23.)

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[8] Hearing Exhibit 17 is Carlisle Direct Exhibits 1 through 10. (R. pp. 1279-1307.)
[9] Hearing Exhibit 18 is Gearheart Direct Exhibits 1 through 8. (R. pp. 1308-1323.)
[10] Hearing Exhibit 19 is Morgan Direct Exhibits 1 through 8. (R. pp. 1324-1344.) Hearing Exhibit 20 is Morgan Surrebuttal Exhibits 1 and 2. (R. pp. 1345-1349.)

ORS witness Gearheart has a Master's Degree in Business Administration with an emphasis in Accounting and her testimony detailed ORS's examination of the Application and DIUC's books and records as well as the subsequent accounting and pro forma adjustments recommended by ORS. (Tr. p. 488, ll. 15-17; p. 489, ll. 1-17) (R. p. 760, lines 15-17; p. 761, lines 1-17.) Ms. Gearheart testified that ORS's examination of DIUC's Application consisted of three steps. (Tr. p. 489, ll. 5-8) (R. p. 761, lines 5-8.) In step one, ORS verified that the operations and rate base numbers reported by DIUC in its Application were supported by DIUC's accounting books and records for the twelve months ended December 31, 2014, the test year chosen by DIUC. (Tr. p. 489, ll. 8-11) (R. p. 761, lines 8-11.) Second, ORS tested the underlying transactions in the books and records for the test year to ensure that the transactions were adequately supported, had a stated business purpose, were allowable for ratemaking purposes, and were properly recorded. (Tr. p. 489, ll. 11-14; *see also* p. 527, ll. 5 - p. 528, ll. 8 (regarding verifying transactions)) (R. p. 761, lines ll-14; *see also* p. 799, line 5–p. 800, line 8.) Third, ORS's examination consisted of adjusting, as necessary, the revenues, expenditures, and capital investments to normalize the Company's operations and rate base numbers, in accordance with generally accepted regulatory principles and prior Commission orders. (Tr. p. 489, ll. 14-17) (R. p. 761, lines 14-17.)

ORS witness Morgan is a licensed Professional Engineer registered in South Carolina with over twenty-nine years of combined regulatory compliance experience with DHEC and ORS providing assistance and oversight for water and wastewater facilities and services. (Tr. p. 505, ll. 17 - p. 506, ll. 5) (R. p. 777, lines 17–p. 778, line 5.) Mr. Morgan's direct testimony focused on DIUC's compliance with Commission rules and regulations, ORS's business office compliance review, inspections of DIUC's water and wastewater systems, test-year and proposed revenue, and performance bond requirements. (Tr. p. 506, ll. 6-12) (R. p. 778, lines 6-12.) Mr. Morgan's

surrebuttal testimony responded to DIUC's rebuttal testimony on the ownership of property identified as the Elevated Storage Tank Site. (Tr. pp. 515-517) (R. pp. 787-789.)

After ORS completed its examination, but before it filed testimony, ORS shared the results of its audit with DIUC. After sharing its audit results, ORS held an exit audit conference call with DIUC for DIUC to ask questions about ORS's adjustments. (Tr. p. 202, ll. 21-23) (R. p. 474, lines 21-23.) DIUC was also provided ORS's work papers about the plant items represented by the adjustments. Id.

Pursuant to its statutory duties, ORS initiated settlement discussions with the parties and shared revenue, operating margin, and ROE amounts resulting from its recommended adjustments. S.C. Code Ann. § 58-4-50(A)(9). The POAs and ORS entered into a Settlement Agreement, and while Beach Field declined to sign as a party to the Settlement Agreement, Beach Field did not object to it. The Settlement Agreement reflects agreement with all of ORS's adjustments set forth in ORS's pre-filed testimony, except for the bad debt expense adjustment. (Tr. p. 302, ll. 20-24; p. 304, ll. 11-14; Order Nos. 2015-846 p. 28-30 and 2016-50 p. 22) (R. p. 574, lines 20-24; p. 576, lines 11-14; pp. 57–59; and p. 27.) The Settlement Agreement calculated bad debt expense using the methodology proposed by DIUC in its Application. (Tr. p. 502, ll. 24 – p. 503, ll. 2) (R. p. 774, line 24–p. 775, line 2.) The ORS and POAs did not set forth any adjustments in the Settlement Agreement that were not already recommended in ORS's pre-filed testimony or DIUC's Application. Id. The Settlement Agreement revenue, ROE, and operating margin were calculated using ORS's adjustments and DIUC's methodology for bad debt expense. Based on those calculations, the Settlement Agreement set forth a $462,798 revenue increase, an ROE of 9.28%, and an operating margin of 16.18% for DIUC's combined operations. (Hearing Exhibit 3, Tr. p. 503, ll. 3-5) (R. pp. 820-833; p. 775, lines 3-5.) DIUC declined to settle the case; therefore, the

settlement document was not shared with DIUC prior to its filing with the Commission. The Settlement Agreement was filed with the Commission and served on the parties on October 27, 2015.

At the outset of the hearing on October 28, 2015, the Settlement Agreement was entered into the record. [11] (Tr. p. 48, ll. 2-14) (R. p. 320, lines 2-14.) DIUC's objection to it being introduced into the record was overruled. Id. On December 8, 2015, the Commission issued Order No. 2015-846 with evidentiary findings that matched the terms of the Settlement Agreement and concluded with approving the Settlement Agreement. (R. pp. 30-65.) On December 21, 2015, DIUC filed a Petition for Reconsideration and/or Rehearing which was denied by the Commission in Order No. 2016-50. (R. pp. 6-27.)

The contested matters in this case are related to the following:

- Whether DIUC owns certain plant assets; (Order Nos. 2015-846 p. 14-21 and 2016-50 p. 18-20) (R. pp. 43–50 and pp. 23-25.)
- The appropriate dollar amount on which to value DIUC's overall rate base (also called plant in service); Id.
- The relationship between Mr. Guastella as a board member of DIUC and his position as president of GA, DIUC's management company; (Tr. p. 187, ll. 11-12; p. 188, ll. 1-2; p. 227, ll. 13-17; Order No. 2016-50 pgs. 12-13) (R. p. 459, lines 11-12; p. 460, lines 1-2; p. 499, lines 13-17; pp. 17-22.)
- The Management Contract drafted by Mr. Guastella and executed between Mr. Guastella, on behalf of GA, and DIUC which requires DIUC to pay GA the

[11] The "Settlement Agreement" containing five exhibits was entered into the record as Hearing Exhibit 3. (R. p. 820.)

following: (Tr. p. 171, ll. 3-19 and Hearing Exhibit 9.) (R. p. 443, lines 3-19; pp. 945-953.)

1. a management fee of $13,596.85 a month with an annual 3.5% increase and an additional increase for customer growth; (Tr. p. 228, ll. 3-13, 23-25; p. 229, ll. 1-14; Hearing Exhibit 9; Order Nos. 2015-846 p. 24 and 2016-50 p. 11) (R. p. 500, lines 3-13, 23-25 p. 501, lines 1-14; pp. 945-953; p. 53; p. 16.)
2. a finance fee of 2% of the principal amount of any loan or GA's actual total hourly rates for handling the loan, whichever is greater; (Tr. p. 229, ll. 15 - p. 231, ll. 18; Hearing Exhibit 9; Order Nos. 2016-50 p. 11 and 2015-846 p. 24) (R. p. 501, lines 15-p. 503, line 18; pp. 945-953; p. 16; p. 53.)
3. a capital fee of 10% for the first $50,000 of construction and 8% for construction costs over $50,000; (Tr. p. 232, ll. 19 - p. 234, ll. 10; Hearing Exhibit 9; and Order Nos. 2016-50 p. 11 and 2015-846 p. 24) (R. p. 504, line 19-p. 506, line 10; pp. 945-953; p. 16, p. 53.)
4. an incentive fee of 20% of the total net utility operating income; (Tr. p. 171, ll. 10-19, p. 293, ll. 18-25; Hearing Exhibit 9; and Order Nos. 2016-50 p. 11 and 2015-846 p. 24) (R. p. 443, lines 10-19; p. 565, lines 18-25; pp. 945-953, p. 16, p. 53.)
5. an incentive fee if DIUC is sold; and, (Tr. p. 235, ll. 14 - p. 236, ll. 17; Hearing Exhibit 9; and Order Nos. 2016-50 p. 11 and 2015-846 p. 24) (R. p. 507, line 14-p. 508, line 17; pp. 945-953; p. 16; p. 53.)

6. separate payments for: travel expenses; expenses for the preparation and filing of general rate increases for DIUC; and for work done on any formal proceedings that would require work that is not anticipated for day-to-day management or the other provisions of the agreement; (Tr. p. 242, ll. 1-12; Hearing Exhibit 9; and Order Nos. 2016-50 p. 11 and 2015-846 p. 24) (R. p. 514, lines 1-12; pp. 945-953; p. 16; p. 53.)

- The amount to be recovered annually from ratepayers for management expenses, rate case expenses and taxes; and, (Order Nos. 2015-846 p. 22-27 and 2016-50 p. 9-15) (R. pp. 51-56; pp. 14-20.)
- Whether the Commission's approval of the Settlement Agreement was in error and whether it will cause financial harm to DIUC. (Order Nos. 2015-846 p. 29-33 and 2016-50 p. 4-8) (R. p. 58-62; p.9-13.)

The ORS and POAs support the Commission's Orders.

STANDARD OF REVIEW

The standard of review applicable to decisions of the Commission is set forth in the South Carolina Administrative Procedures Act, S.C. Code Ann. § 1-23-310 *et seq.* (Supp. 2015), as interpreted in numerous decisions of South Carolina Appellate Courts. "This Court employs a deferential standard of review when reviewing a decision from the Commission and will affirm the Commission's decision if it is supported by substantial evidence." S.C. Energy Users Comm. v. S.C. Elec. & Gas, 410 S.C. 348, 353, 764 S.E.2d 913, 915 (2014) (citing S.C. Energy Users Comm. v. Pub. Serv. Comm'n of S.C., 388 S.C. 486, 490, 697 S.E.2d 587, 589-90 (2010)). "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." Friends of

the Earth v. PSC of S.C., 387 S.C. 360, 366, 692 S.E.2d 910, 913 (2010). "The possibility of drawing two inconsistent conclusions from the evidence does not prevent the Commission's finding from being supported by substantial evidence." Sharpe v. Case Produce, Inc., 336 S.C. 154, 160, 519 S.E.2d 102, 105 (1999). In addition, "the Court may not substitute its judgment for the Commission's on questions about which there is room for a difference of intelligent opinion." Friends of the Earth v. PSC of S.C., 387 S.C. 360, 366, 692 S.E.2d 910, 913 (2010). Lastly, "The Commission is considered the expert designated by the legislature to make policy determinations regarding utility rates." S.C. Energy Users Comm. v. S.C. Elec. & Gas, 410 S.C. 348, 353, 764 S.E.2d 913, 915 (2014) (citing S.C. Energy Users Comm. v. Pub. Serv. Comm'n of S.C., 388 S.C. 486, 490, 697 S.E.2d 587, 590 (2010)). "Thus, [b]ecause the Commission's findings are presumptively correct, the party challenging the Commission's 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 of the record as a whole." S.C. Energy Users Comm. v. S.C. Elec. & Gas, 410 S.C. 348, 354, 764 S.E.2d 913, 915-16 (2014) (citing S.C. Energy Users Comm. v. Pub. Serv. Comm'n of S.C., 388 S.C. 486, 491, 697 S.E.2d 587, 590 (2010)).

ARGUMENT

I. THE COMMISSION'S DECISIONS TO REDUCE DIUC'S REQUESTED MANAGEMENT EXPENSES, RATE CASE EXPENSES, RATE BASE, PROPERTY TAXES, AND BAD DEBT EXPENSES ARE SUPPORTED BY SUBSTANTIAL EVIDENCE ON THE WHOLE RECORD.

DIUC argues the Commission erred in Order Nos. 2015-846 and 2016-50 by rejecting DIUC's requested management fees, rate case expenses, plant in service and property taxes. (DIUC Initial Brief p. 27.) DIUC also challenges the Commission's acceptance of DIUC's bad debt expense methodology. (DIUC Initial Brief p. 52.) DIUC's argument is that the Commission

should at a minimum grant DIUC's Application as filed and ignore or give less weight to the evidence submitted by ORS and the POAs, except for ORS's bad debt expense adjustment. ORS respectfully submits that the Commission's decisions are supported by substantial evidence and asks the Court to affirm the Commission's Orders.

DIUC utilizes the case of Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff, 392 S.C. 96, 708 S.E.2d 755 (2011) in its Brief stating the Commission committed error. However, DIUC misapplies Utils. Servs. of S.C. Id. DIUC appears to read Utils. Servs. of S.C. as stating that a presumption of reasonableness for expenses is dispositive and that incurred expenses must be found reasonable no matter their amount and despite overwhelming evidence otherwise. (DIUC Initial Brief p. 42.) This is not correct. As stated by the Court in Utils. Servs. of S.C., "the PSC may determine that some portion of an expense actually incurred by a utility should not be passed on to consumers." Utils. Servs. of S.C. 392 S.C. at 105, 708 S.E.2d at 760. Here, the Commission did just that. In Utils. Servs. of S.C., the Court stated the following with respect to the presumption and burden to be applied to a utility's expenditures:

> Utility is correct that it was entitled to a presumption that its expenditures were reasonable and incurred in good faith, and therefore, a showing that its expenses had increased since its last rate case could satisfy its burden of proof. Nevertheless, the presumption in a utility's favor clearly does not foreclose scrutiny and a challenge. In those circumstances, the burden remains on the utility to demonstrate the reasonableness of its costs. It seems to us that Utility wants the presumption of reasonableness to be dispositive. In Hamm, 309 S.C. at 286-87, 422 S.E.2d at 112-13, we stated: Although the burden of proof of the reasonableness of all costs incurred which enter into a rate increase request rests with the utility, the utility's expenses are presumed to be reasonable and incurred in good faith. 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. This evidence may be provided . . . through the Commission's broad investigatory powers. The ultimate burden of

> showing every reasonable effort to minimize . . . costs remains on the utility.

Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff, 392 S.C. 96, 109-10, 708 S.E.2d 755, 762-63 (2011) (citing Hamm v. S.C. Pub. Serv. Comm'n, 309 S.C. 282, 286-287, 422 S.E.2d 110, 112-113 (1992)).

A presumption of reasonableness therefore only applies to utility expenses until they are challenged by the Commission or another party. Id. At that time, the burden remains with the utility to overcome the challenge. Id. Here, ORS and the POAs challenged DIUC's property taxes, management fees, rate case expenses, rate of return and plant in service. Through its direct testimony, ORS and the POAs demonstrated a tenable basis for "raising the specter of imprudence." Utils. Servs. of S.C., 392 S.C. at 110, 708 S.E.2d at 763. "If an investigation initiated by ORS or by the PSC yields evidence that overcomes the presumption of reasonableness, a utility must further substantiate its claimed expenditures." Id. In considering the evidence, the Commission did not find that DIUC overcame the challenges to the reasonableness of its expenses. "The evidence presented by ORS in the present case was competent and credible, and we reasonably accepted it on its own merits." (Order No. 2016-50 p. 22) (R. p. 27.)

DIUC also states that the Commission erroneously relied on DIUC's previous rate case in Docket No. 2011-229-WS to justify the denial of DIUC's expenses. (DIUC Initial Brief p. 33-34, 42-43, and 51-52.) This is incorrect and was addressed by the Commission in Order No. 2016-50 in response to DIUC's Petition for Reconsideration. The Commission stated:

> [T]his Commission did not "rely on" Order No. 2012-515 [in Docket No. 2011-229-WS] in approving ORS's adjustments, but rather used the adjustments approved by Order No. 2012-515 as a baseline for determination, and then relied on the evidence provided by ORS and the POAs to arrive at a final decision.
>
> While Utilities does stand for the proposition that it is erroneous to use a previous rate increase as justification for denying a rate

> increase, Utilities, 392 S.C. 115, 708 S.E.2d 765, that case also recognizes that "a previous rate increase may provide a baseline for the PSC to use in determining whether a utility has incurred additional expenses requiring additional revenue." Id. This Commission used the information from Docket No. 2011-229-WS as a baseline for consideration of DIUC's proposal, but used the evidence in this Docket to justify the decisions in Order No. 2015-846.
>
> In other words, a previous rate increase is typically a "starting point" in a new rate case. Accordingly, the only way for DIUC to attempt to justify an increase in expenses (or for the ORS or the POAs to attempt to rebut a proposed increase) is to "compar[e] the expense from the test year used in the previous rate case with those from the test year in this case...." Heater of Seabrook, Inc. v. Public Service Comm'n of S.C., 324 S.C. 56, 61, 478 S.E.2d 826, 828 (1996).[12]

(Order No. 2016-50 p. 16-17) (R. p. 21-22.)

The Commission's analysis is correct. It did not rely on a previous case as justification for its decisions as fact finder. ORS typically uses the previous case as its baseline or starting point for examining rate cases filed at the Commission. This process is recognized by Utils. Servs. of S.C. Utils. Servs. of S.C., 392 S.C. at 114, 708 S.E.2d at 765. As an example, ORS witness Gearheart testified that in order to calculate plant-in-service, ORS's "standard procedures are to roll forward the plant ORS calculated in the last rate case." (Tr. p. 524, ll. 15 - p. 525, ll. 1) (R. p. 796, line 15-p. 797, line 1.) Using the previous case as a baseline or starting point is intuitive, practical and allows consistency and continuity for ORS in carrying out its statutory duty to provide recommendations to the Commission with respect to proposed rates. S.C. Code Ann. § 58-4-50(A)(1) (2015).

ORS also uses the prior case as a benchmark for expenditures and makes recommendations based on its knowledge of the prior case. For the Commission to accept ORS's recommendations

[12] The Utilities case referenced by the Commission in Order No. 2016-50 is Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff, 392 S.C. 96, 708 S.E.2d 755 (2011). ORS refers to this case as Utils. Servs. of S.C.

where ORS's recommendation involves a prior case is not the same as the Commission *relying* on the previous case to justify its decision.

A. The Commission's decision to disallow a portion of DIUC's requested management expenses is supported by substantial evidence.

DIUC asserts that the Commission should have approved recovery of the $171,364 in management fees requested for GA and that the Commission erroneously relied on a prior rate case for its decision. (Application Schedule A-4. DIUC Initial Brief p. 34-37.) (R. p. 1439.) ORS disagrees. GA is the management company for DIUC. (Tr. p. 188, ll. 1-2) (R. p. 460, lines 1-2.) John Guastella is GA's president, also acts as the manager of DIUC, and serves on the DIUC Board of Directors. (Tr. P. 187, ll. 9-12, p. 188, ll. 1-2, p. 227, ll. 13-17 and Order No. 2016-50 p. 12-14) (R. p. 459, lines 9-12 p. 460, lines 1-2; p. 499, lines 13-17; p. 17-19.)

The Management Contract drafted by Mr. Guastella and executed between DIUC and Mr. Guastella, on behalf of GA, has an initial term through December 31, 2018 with automatic renewal provisions. (Hearing Exhibit 9; Tr. p. 171, ll. 3-19 (R. pp. 945-953; p. 443, lines 3-19.) The compensation GA receives from DIUC per the Management Contract is set forth in the Statement of Facts to this brief. GA is receiving a substantial financial benefit from its relationship with DIUC. ORS recommended that GA's management fees be limited to the previous Commission-approved amount of $132,211 a year because the GA management services had not increased and the requested amount was not justified. (Tr. p. 493, ll. 1-5 and Order Nos. 2016-50 p. 12 and 2015-846 p. 24) (R. p. 765, lines 1-5; p. 17; p. 53.) It is undisputed that under GA's tenure, DIUC property taxes went unpaid, causing a 2011 delinquent tax sale of DIUC property. (Tr. p. 75, ll. 11-15; p. 82, ll. 17-19; p. 271-272; p. 442, ll. 20 – p. 443, ll. 20; and Order Nos. 2015-846 p. 22 and No. 2016-50 p. 9) (R. p. 347, lines 11-15; p. 354, lines 17-19; p. 543-544; p. 714, line 20-p.

715, line 20; p. 51; p. 14.) Mr. Guastella testified that DIUC's South Carolina regulatory gross receipts payment was paid late. (Tr. p. 244, ll. 6-12 and Order No. 2015-846 p. 26) (R. p. 516, lines 6-12 and p. 55.) ORS was aware of these matters when it made its recommendation. ORS counsel presented ORS's position during opening statements for the hearing, "We believe the utility is paying a premium for the management services. We think management services have a value. We think the ratepayers should pay it. But ORS doesn't think the ratepayers should pay the premium." (Tr. p. 56, ll. 15-19) (R. p. 328, lines 15-19.) The POAs testified that GA was an absentee manager and opposed DIUC's management fees. (Tr. p. 319, ll. 5-17, p. 432, ll. 13-p. 433, ll. 6 and Order No. 2015-846 p. 26) (R. p. 591, lines 5-17; p. 704, line 13-p. 705, line 6; p. 55.)

Here, the ORS and the POAs presented evidence that challenged DIUC's management expenses. DIUC did not overcome that challenge, and the Commission accepted ORS's recommendation. In agreeing with ORS's adjustment, the Commission stated, "we agree that GA provides services to the ratepayers, but disagree that the services are at a level that warrant the amount set forth in the management services contract. We think it is appropriate for DIUC stockholders to have responsibility for the difference." (Order No. 2015-846 p. 26) (R. p. 55.)

In addition, the Commission correctly concluded that GA and DIUC are affiliates and applied case law holding that the presumption of reasonableness does not apply to payments made by a regulated entity to an affiliate. (Order No. 2016-50 p. 12-13) (R. pp. 17-18.) Utils Servs. of S.C., 392 S.C. at 110-111, 708 S.E.2d at 763. (citing Hilton Head Plantation Utilities, Inc. v. Public Service Comm'n of S.C., 312 S.C. 448, 449-51, 441 S.E.2d 321, 322-23 (1994). In showing that GA and DIUC are affiliates, the Commission utilized the definition of "affiliate" provided by Black's Law Dictionary Free Online Legal Dictionary 2nd Edition. It defines an "affiliate" as,

"Companies that have a shared resources, interests, or business dealings."[13] Here, all three criteria are met as Mr. Guastella is a board member of DIUC, a manager of DIUC, and the president of GA. (Tr. p. 187, ll. 9-12, p. 188, ll. 1-2, p. 227, ll. 13-17 and Order No. 2016-50 p. 12-14) (R. p. 459, lines 9-12; p. 460, lines 1-2; p. 499, lines 13-17; p. 17-19.) Even if GA and DIUC could be viewed as unaffiliated, DIUC failed to overcome its burden to demonstrate the reasonableness of its management expenses to the Commission once challenged by ORS and the POAs.

Last, ORS disputes DIUC's statement that the management fees of $132,211, recommended by ORS and adopted by the Commission, were not approved in DIUC's last rate case in Docket No. 2011-229-WS. [14] (DIUC Initial Brief p. 33.) The testimony filed in Docket No. 2011-229-WS by ORS audit witness Christina Stutz shows on page 6, and in her attached Audit Exhibit CAS-1, an adjustment to the requested outside management services to recommend the amount of $132,212[15]. The Commission's Order in that case, Order No. 2012-515, approved a settlement agreement entered into by DIUC and the POAs. (Order No. 2015-846 p. 2) (R. pp. 31 and 68-86.) ORS did not object to the settlement agreement. Id. Commission Order No. 2012-515 attached and incorporated the settlement agreement in that case as Order Attachment No. 1. (R. pp. 68-86.) On page 2, paragraph 4 the following is stated in Order Attachment No. 1/the settlement agreement:

> The Parties agree to and stipulate that DIUC shall be entitled to an adjustment in rates and charges sufficient to generate additional revenues for the test year of $291,485 based on the test year revenues *after adjustments proposed by ORS in its pre-filed testimony and exhibits*. (Emphasis added.) (R. p. 77.)

[13] http://thelawdictionary.org/affiliate/

[14] ORS includes this discussion about DIUC's management fees from the prior rate case because DIUC raises it in its Initial Brief.

[15] The amount in the 2011 Docket differs by $1.

The settlement agreement in the prior case specifically agreed to calculate the revenue based on ORS's adjustments. The Commission's approval of the settlement agreement in DIUC's last rate case approved ORS's adjustment for management fees. (*See also* Tr. p. 434, ll. 1-8 referencing the prior settlement agreement and ORS adjustments) (R. p. 706, lines 1-8.)

Also for clarity's sake, using the above discussion on the last rate case as an example, the utility may pay any amount which it desires for management expenses, or any expenses, even if it is above the Commission-approved amount. If the Commission approves an adjustment limiting expenses, it only applies to what the utility can recover from ratepayers. The difference may be made up by stockholders or other sources.

In conclusion, the Commission's adoption of ORS's recommendation for management expenses is based on substantial evidence in the whole record.

B. The Commission's decision to disallow a portion of DIUC's requested rate case expenses is supported by substantial evidence.

Rate case expenses are expenses incurred to prepare the rate case and generally include administrative fees in the case preparation, attorney fees, and expert witness fees. DIUC asserts that ORS did not provide any analysis for its rate case expenses recommendation and that the Commission's acceptance of ORS's recommendation was error. (DIUC Initial Brief p. 41.) ORS disagrees. "It is the duty and responsibility of the regulatory staff to when considered necessary by the Executive Director of the Office of Regulatory Staff and in the public interest, review, investigate, and *make appropriate recommendations* to the commission with respect to the rates charged or proposed to be charged by any public utility." (Emphasis added.) S.C. Code Ann. § 58-4-50(A)(1)(2015). ORS provided recommendations in this case. ORS recommended that DIUC's current rate case expenses be limited to $75,000 and amortized over five years. (Tr. p.

494, ll. 22 - p. 495, ll. 5 and Order Nos. 2015-846 p. 25-27 and 2016-50, p. 14-15) (R. p. 766; line 22-p. 767, line 5; pp. 54-56; pp. 19-20.) ORS also recommended that the unamortized rate case expense from DIUC's last rate case, $22,500, be included with the same amortization period totaling $97,500 in overall rate case expenses to be amortized over five years. Id. S.C. Code Ann. § 58-4-50(A)(1) requires nothing further than a recommendation. Inherent in ORS's recommendation is its expertise and experience as the sole regulatory agency in South Carolina with the duty of examining utilities along with its knowledge of the case. In this case, ORS was aware that GA's relationship with DIUC was not at arm's length and that GA's Management Contract allowed GA to be paid separately for its work related to the Application. (Tr. p. 242, ll. 1-12; Hearing Exhibit 9; Order Nos. 2015-846 p. 24 and 2016-50 p. 11-13) (R. p. 514; lines 1-12; pp. 945-953; p. 53, pp. 16-18.) ORS recommended rate case expenses which it deemed reasonable and in the public interest. S.C. Code Ann. §§ 58-4-10(B) and 58-4-50(A)(1) (2015).

DIUC confuses the role of ORS with the role of the Commission. ORS makes recommendations to the Commission. S.C. Code Ann. § 58-4-50(A)(1). The Commission is the fact finder and must base its decision on reliable, probative, and substantial evidence in the whole record, which it did here. DIUC requested $191,200 for current and unamortized rate case expenses to be recovered over four years with this amount to be updated for actual rate case expenses at the hearing. (Tr. p. 218, ll. 9-11, 20-21 and Order Nos. 2016-50 p. 14 and 2015-846 p. 25) (R. p. 490, lines 9-11; 20-21; p. 19; p. 25.) ORS witness Gearheart provided her recollection that the total invoices submitted by DIUC for rate case expenses were $471,000 and of that amount, $120,000 were from GA with the remainder being legal fees. (Tr. p. 542, ll. 3-7) (R. p. 814, lines 3-7.) Granting excessive or unlimited rate case expenses eliminates any need for a utility to be conscientious of such costs.

POA witness Lanier described the scenario before the Commission by stating, "while the Commission may have some obligation to provide the Company the "opportunity" to earn specified return, it is not obligated to assure that the Company earn such returns, by granting any and all claimed expenses." (Tr. p. 434, ll. 10-13; *see also* p. 454, ll. 22 – p. 455, ll. 7 for additional testimony from the POAs regarding expenses.) (R. p. 706, lines 10-13; *see also* p. 726, line 22-p. 727, line 7.) Further, POA witness Lanier testified:

> The ORS staff typically conducts an exhaustive audit of an applicant's claimed expenses and carefully evaluates proposed expense adjustments. I and my colleagues and our clients in this matter did not have the resources to conduct such extensive investigations of specific expenses. However, I expect that the ORS staff will recommend reductions in some of the Company's requested expenses and, in view of the Company's unusually high growth in expense, I would support any reductions in expenses proposed by the ORS staff.

(Tr. p. 434, ll. 20 - p. 435, ll. 4) (R. p. 706, line 20-p. 707, line 4.)

As the trier of fact, the Commission is empowered with the authority to disallow certain expenditures a utility seeks. Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff, 392 S.C. 96, 112, 708 S.E.2d 755, 763 (2011). Here, the Commission did so based on substantial evidence in the whole record and its finding that DIUC payments to GA for rate case expenses are affiliate payments. (Order No. 2016-50, p. 14-15) (R. p. 19-20.) The Commission did not rely upon a prior rate case for its decision, but rather adopted ORS's recommendation that $75,000 in rate case expenses is a reasonable amount to pass to ratepayers. (Order Nos. 2015-846, p. 25-27 and 2016-50, p. 14-15) (R. p. 54-56 and p. 19-20.) DIUC failed to overcome this challenge to the reasonableness of its rate case expenses or substantiate to the Commission's satisfaction the prudency of over $450,000 in such costs. The Commission Order is thus without error.

C. The Commission's decision to adopt ORS's recommended rate base is supported by substantial evidence.

DIUC asserts it was error for the Commission to adopt ORS's recommended rate base ("plant in service" or "rate base"), because ORS's recommendation does not identify the specific plant items or their costs represented by the adjustments. (DIUC Initial Brief p. 49.) ORS used the list of plant in service categories in DIUC's Application to show adjustments. (Hearing Exhibit 18, ORS Audit Exhibit ICG-5; Application Schedules W-B.2, W-B.3, W-C.3, S-B.2, S-B.3 and S-C.3.) (R. p. 1320; pp. 1442-1443; p. 1451; pp. 1460-1461; p. 1469.) ORS disagrees with DIUC's assertion that the Commission committed error in adopting ORS's rate base.

ORS's process for determining plant in service is to roll forward plant in service from the last case. (Tr. p. 524 through p. 526, ll. 14) (R. pp. 796-798, line 14.) ORS witness Gearheart testified 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. p. 526, ll. 9-14) (R. p. 798, lines 9-14.) Specifically, she testified that the biggest part of the adjustment in this case was adding back adjustments ORS made from the last case that DIUC did not reflect in its books. (Tr. p. 524 through p. 526, ll. 14) (R. pp. 796-798, line 14.)

ORS recommended that plant in service be reduced by $1,624,696. (Tr. p. 496, ll. 16-18; Hearing Exhibit 18, ORS Audit Exhibit ICG-5) (R. p. 768, lines 16-18; p. 1320.) This adjustment was net of additions and reductions to DIUC's rate base consisting of capital improvements, non-allowable plant, adjustments from the previous case not made by DIUC and retirements through July 31, 2015. (Tr. p. 496, ll. 16-18) (R. p. 768, lines 16-18.) Non-allowable plant includes plant that DIUC could not show it owned, such as the Elevated Storage Tank. (Tr. p. 529, ll. 14-20) (R. p. 801, lines 14-20.) For comparison, the POAs recommended that plant in service be reduced by $3,745,530. (Tr. p. 371, Table 1) (R. p. 643.)

Commission regulations list the required contents for water and sewer applications. 10 S.C. Code Ann. Regs. 103-512.4.A and 103-712.4.A (2012). For a sewer application, a "statement of total plant investment" is required and for a water application, "a statement of total plant investment by categories" is required. 10 S.C. Code Ann. Regs. 103-512.4.A.12 and 103-712.4.A.12 (2012). The regulations also require water and sewer applications to include a "depreciation schedule by categories of plant or average services lives." 10 S.C. Code Ann. Regs. 103-512.4.A.7 and 103-712.4.A.7 (2012). Based on the Commission's application requirements, it follows that any recommended plant adjustments would be made to the categories used by DIUC in its Application for its plant investment and depreciation schedule. This is what ORS did. (Hearing Exhibit 18, Audit Exhibit ICG-5; Application Schedules W-B.2, W-B.3, W-C.3, S-B.2, S-B.3, and S-C.3.) (R. p. 1320; pp. 1442-1443; p. 1451; pp. 1460-1461; p. 1469.)

The DIUC Application statement of plant investment listed general categories for both water and sewer. (Application Schedules W-B.2 and S-B.2.) (R. p. 1442 and 1460.) Those categories are in its depreciation schedule. (Application Schedules W-B.3, W-C.3, S-B.3, and S-C.3.) (R. p. 1443; p. 1451; p. 1461; p. 1469.) ORS's adjustments for plant in service correspond to those plant categories listed in DIUC's Application. (Hearing Exhibit 18, Audit Exhibit ICG-5) (R. p. 1320.) There is no error in the Commission agreeing to the use of the plant categories DIUC lists in its Application.

Further, in efforts to be collaborative, DIUC was informed of ORS's adjustments and given opportunities to provide support for its expenses to both ORS and the Commission. ORS held an exit audit conference call with DIUC for DIUC to ask questions about ORS's adjustments. (Tr. p. 202, ll. 21-23) (R. p. 474, lines 21-23.) DIUC was also provided ORS's work papers about ORS's adjustments and the plant items represented by the adjustments. (Tr. p. 202, ll. 21 – p. 203, ll. 3;

p. 151, ll. 1-3; p. 158, ll. 11-13, p. 202, ll. 21-p. 203, ll. 5) (R. p. 474, line 21-p. 475, line 3; p. 423, lines 1-3; p. 430, lines 11-13; p. 474, line 21-p.475, line 5.) ORS made itself available to DIUC on multiple occasions prior to filing ORS direct testimony in good faith efforts to share its audit status, provide details to DIUC, receive any information DIUC wished to provide, and answer questions. DIUC had the opportunity to present detailed evidence or testimony to rebut the challenges.

DIUC asserts the Commission relied upon prior Annual Reports to reduce the rate base and that doing so was in error. (DIUC Initial Brief p. 48.) While the Annual Reports were in the record, the Commission did not rely solely on the Annual Reports to justify its decision of accepting ORS's process and recommendation for determining rate base. [16] In its decision, the Commission held:

> The Commission cannot accept the rate base as proposed by DIUC, given the murky status of the equipment on the tax sale land. The ORS methodology is logical in its steps and sets forth sound methods for determining a proper rate base on which a return may be granted. Considering the number of rate cases and all that has occurred since International Paper owned the utility, the Commission declines to adopt the rate base proposed by the POAs.

(Order No. 2015-846 p. 18) (R. p. 47.)

ORS's process utilized the prior case's rate base as a starting point and then after examining the books and records, made adjustments to the list of plant assets from DIUC's Application. DIUC failed to present evidence to rebut the recommended plant in service adjustments made by

[16] The Commission stated the following on page 19 in Order No. 2016-50 about the Annual Reports: DIUC revised its Annual Reports to the Commission and ORS by lowering property values in apparent efforts to have its property taxes reduced. The values by which DIUC revised its Annual Reports appear to correspond to the value of the elevated storage tank and other property excluded for utility ratemaking purposes. ORS does not fault DIUC for revising its Annual Reports. Instead, it is ORS's position that DIUC cannot reap benefits of being the owner of the elevated storage tank for ratemaking purposes, but not the owner for property tax purposes. The Commission adopted this reasoning in Order No. 2015-846. See Walls Rebuttal, R. pp. 101-102; Morgan Direct, R. p. 511; Morgan Surrebuttal, R. pp. 515-517; R. p. 529 and Hearing Exhibit 20. (R. p. 24.)

ORS and therefore failed to carry its burden of proof. The Commission's adoption of ORS's recommendation for rate base is based on substantial evidence in the whole record. There was no error.

D. The Commission's decision to keep the Elevated Storage Tank out of rate base is supported by substantial evidence.

DIUC asserts that the Elevated Storage Tank should be included in its plant in service. (DIUC Initial Brief p. 43.) The Elevated Storage Tank is a 125,000 gallon elevated storage tank and well site located in Haig Point on Daufuskie Island. (Tr. p. 511, ll. 8-11) (R. p. 783, lines 8-11.) Pursuant to ORS's process for examining rate base discussed in the section above, ORS testified that the Elevated Storage tank was removed in the last rate case, and because ORS did not receive proof of ownership, the tank was not added back into plant in service. (Tr. p. 529, ll. 14-20) (R. p. 801, lines 14-20.)

The Commission's regulations define "water plant" as "all facilities *owned by the utility* for the collection, production, purification, storage, transmission, metering and distribution of potable water." (Emphasis added.) 10 S.C. Code Ann. Regs. 103-702.16 (2012). The regulation requires ownership. ORS counsel addressed the Elevated Storage Tank in her opening at the outset of the hearing:

> The utility will tell you it owns the water tower. It's not so clear. The Office of Regulatory Staff cannot determine whether the utility owns the water tower, or if the man who bought the property in the delinquent tax sale owns the water tower. Because the utility has not proven with certainty, and to ORS's satisfaction, that it owns the water tower, the Office of Regulatory Staff cannot, in good conscience, recommend that the ratepayers pay the company a return on a water tower that it may not own. It's that simple.
> (Tr. p. 56, ll. 3-14) (R. p. 328, lines 3-14.)

On pages 18 and 19 in Commission Order No. 2016-50, the Commission utilized passages from ORS's Answer to DIUC's Petition for Reconsideration to support its finding that the Elevated Storage Tank was properly removed from rate base. As reflected in that Order there is confusion over ownership of the Elevated Storage Tank. DIUC failed to provide convincing evidence of ownership of the Elevated Storage Tank, and the tank was therefore properly removed from rate base.

DIUC asserts it has a perpetual easement to the Elevated Storage Tank which allows its continued use; however, an easement does not equal ownership. (DIUC Initial Brief p. 46.) Access to and usage of a non-owned asset does not entitle a utility to have its ratepayers pay for the non-owned asset. The evidence supports the Commission's decision to not allow it in rate base. 10 S.C. Code Ann. Regs. 103-702.16. If at some future date DIUC can show it owns the Elevated Storage Tank and that it remains used and useful to the utility, then DIUC will be entitled in its next rate case to include the tank's value in plant in service and receive recovery through rates. (Tr. p. 529, ll. 14-23) (R. p. 801, lines 14-23.)

In conclusion, agreement on this issue with DIUC would establish precedent in South Carolina to permit utilities to sell their assets while simultaneously recovering the value of those assets through rates charged to their customers. It would also have the effect of expanding the definition in 10 S.C. Code Ann. Regs. 103-702.16 to include non-owned water plant. There is substantial evidence showing uncertainty over whether DIUC owns the Elevated Storage Tank and to support the Commission's decision.

E. <u>The Commission's decision to adopt ORS's recommended property tax expense is supported by substantial evidence.</u>

For property tax expense, ORS recommended inclusion of $171,492 annually to cover taxes using: 1) DIUC's per book amount, 2) the 2012 tax amounts, 3) the 2013 tax amounts, and 4) the 2014 test year amount. (Tr. p. 495, ll. 6-15; p. 496, ll. 1-4; p. 518. ll. 14 – p. 519, ll. 16) (R. p. 767, lines 6-15; p. 768, lines 1-4; p. 790 line 14-p.791, line 16.) DIUC requested $258,227.40 annually for property tax expenses. (DIUC Initial Brief p. 33.) It is undisputed that DIUC did not pay Beaufort County taxes for certain years. (Tr. p. 212 ll. 18-23) (R. p. 484, lines 18-23.) As a result, Beaufort County and DIUC entered into a Property Tax Settlement Agreement, amended once, for the payment of taxes for years 2012, 2013, 2014, and 2015. (Hearing Exhibit 5, Walls Exhibit A.) (R. pp. 835-840.) ORS recommended that DIUC receive $244,899 for the 2012 and 2013 taxes with that amount amortized over 8 years. (Tr. p. 495, ll. 6-15) (R. p. 767, lines 6-15.) With the 8-year amortization, DIUC would receive $30,612 annually for the 2012 and 2013 taxes. Id. In addition ORS recommended that DIUC receive $140,880 for the 2014 taxes with no amortization. (Tr. p. 496, ll. 1-4; p. 518. ll. 14 – p. 519, ll. 16 (R. p. 768, lines 1-4; p. 790, lines 14-p. 791, line 16.) The sum of ORS's recommendations equal $171,492 annually for taxes. Id. For comparison, the POAs recommended lower amounts. (Tr. p. 427, ll. 12-18) (R. p. 699, lines 12-18.)

ORS uses known and measurable amounts in calculating adjustments. (Tr. p. 473, ll. 3) (R. p. 745, line 3.) ORS recommended including the 2012 and 2013 taxes, because DIUC did not have an opportunity to request a rate increase to recover taxes for these years after agreeing to a moratorium through July 1, 2014 in the settlement in Docket No. 2011-229-WS. (Tr. p. 518. ll. 14 – p. 519, ll. 16) (R. p. 790, line 14-p. 791, line 16.) ORS included the 2014 taxes because 2014 was DIUC's test year. Id. ORS declined to support recovery of the 2015 taxes. Id. DIUC witness Beaufort County Assessor Maria Walls testified that annual tax notices are mailed in November

and are due the following January. (Tr. p. 84 ll. 2-9) (R. p. 356, lines 2-9.) Accordingly, the taxes billed November 1, 2015, would be due January 15, 2016. Id. Specifically, 2015 taxes were not recommended by ORS because 2014 was the test year chosen by the DIUC and DIUC had not been billed for the 2015 taxes. (Tr. p. 518. ll. 14 – p. 519, ll. 16) (R. p. 790, line 14-p. 791, line 16.)

DIUC maintains that the 2015 amount should have been included because the amount was set forth as a known amount in the Beaufort County Property Tax Settlement. (DIUC Initial Brief p. 29.) DIUC chose 2014 as its test year, and ORS declined to recommend amounts from a future test year even though the amount was part of a settlement agreement with Beaufort County. (Tr. p. 518. ll. 14 – p. 519, ll. 16) (R. p. 790, line 14-p. 791, line 16.) The Commission agreed and stated that delinquent taxes are not the fault of the customers while also acknowledging DIUC's settlement with Beaufort County had already been amended once and could be amended in the future. (Order Nos. 2015-846 p. 23 and 2016-50, p. 10; Hearing Exhibit 5, Walls Exhibit A) (R. p. 52; p. 15; pp. 835-840.)

With respect to the Annual Reports that DIUC states were wrongly relied upon by the Commission, those showed that DIUC does not pay taxes on all of its utility plant in service it claims to be part of its rate base in this docket and that DIUC reduced its plant in service by a value greater than the Elevated Storage Tank. (Order No. 2016-50, p. 10) (R. p. 15.) The Commission did not rely solely upon the Annual Reports for its decision, but used them to show the tax situation is still in "disarray." (Order Nos. 2015-846, p. 19-21 and 2016-50, p. 10) (R. pp. 48-50; p. 15.) The Commission's ruling for property taxes was based upon substantial evidence, and ORS respectfully requests that the Court affirm the Commission's decision.

F. There is no error in the Commission accepting DIUC's methodology for bad debt expenses that DIUC set forth in its Application

DIUC asserts the use of its own methodology is error. (DIUC Initial Brief p. 52.) Specifically, DIUC asserts it is error for the Commission to adopt the methodology set forth in DIUC's Application for calculating bad debt expense. Id. DIUC asserts the bad debt adjustment set forth in ORS's pre-filed direct testimony is appropriate, because ORS recommended more money for DIUC. (Tr. p. 136, ll. 19 - p. 137. ll. 10) (R. p. 408, line 19-p. 409, line 10.) Prior to the Settlement Agreement, ORS recommended $105,384 for bad debt expenses by applying 0.5% to the pro forma revenues. (Tr. p. 493, ll. 11-13) (R. p. 765, lines 11-13.) The POAs recommended $23,554 for bad debt expense. (Hearing Exhibit 14, Amended Lanier Exhibit 3, C-4) (R. p. 1002.)

In the Settlement Agreement, the methodology used by the Company in its Application was accepted by the ORS and POAs and the result was a lower number than the one put forth in ORS's direct testimony. (Tr. p. 57, ll. 3-8, p. 502, ll. 24 - p. 503, ll. 2, Hearing Exhibit 3, Settlement Agreement) (R. p. 329, lines 3-8; p. 774, line 24-p. 775, line 2; p. 820-833.) The Commission reasoned "this bad debt expense methodology is just and reasonable, particularly because it encourages DIUC to collect those debts it is owed." (Commission Order No. 2015-846, p. 27) (R. p. 56.) There is no error in the Commission agreeing to the same methodology utilized and proffered by the Company in its Application.

II. THE COMMISSION COMMITTED NO ERROR IN GRANTING 39.1% OF DIUC'S REQUESTED REVENUE INCREASE AND IN APPROVING THE SETTLEMENT AGREEMENT.

DIUC asserts the Commission committed errors in admitting the Settlement Agreement between the POAs and ORS. (DIUC Initial Brief p. 13-23.) ORS disagrees. The Commission could have reached the same ruling in this case if the Settlement Agreement had never existed,

because the Commission substantiated each of its findings from evidence in the record. The Commission agreed with ORS's recommendations from ORS's pre-filed testimony except for the bad debt expense.

Nevertheless, ORS addresses each of DIUC's assertions. DIUC states the Commission violated its own Settlement Policies and Procedures and that admission of the Settlement Agreement was:

- Irrelevant and immaterial;
- Evidence of collusion between ORS and the Intervenors in an effort to unduly influence the Commission;[17]
- A vessel to usurp the fact finding of the Commission, cause the Commission not to weigh the evidence, and to suggest that DIUC was unreasonable and not acting in the public's interest; and
- Prejudicial.

In addition and with respect to the Settlement Agreement, DIUC asserts the Commission violated S.C. Rules of Evidence 401, 402, 403 and 408; violated 10 S.C. Code Ann. Regs. 103-846 (2012); erred in admitting the Settlement Agreement into evidence; and erred in allowing testimony after the Settlement Agreement was entered into evidence. The Commission committed no errors with respect to the Settlement Agreement.

First, ORS has the statutory duty and responsibility "to serve as a facilitator or otherwise act directly or indirectly to resolve disputes and issues involving matters within the jurisdiction of the commission." S.C. Code Ann. § 58-4-50(A)(9 (2015). In S.C. Code Ann. § 58-4-50(A)(9) (2015), the General Assembly recognizes the benefit of resolving matters among parties on matters before the Commission. DIUC asserts there was error in admitting this Settlement Agreement because DIUC was not a signatory. However, the General Assembly did not require that

[17] ORS shared its work papers and the resulting revenue, ROE and operating margin from its adjustments with DIUC and the POAs. ORS communicates and shares information with parties in proceedings. There was nothing improper about ORS's conduct with the POAs.

resolutions on matters before the Commission have agreement among *all* parties or with the applicant. The General Assembly's endorsement of resolutions shows that settlement agreements are relevant to matters before the Commission.

Second, the Settlement Agreement at issue here contained terms based on ORS's recommendations in its pre-filed testimony and the bad debt expense methodology set forth in DIUC's Application. It contained relevant information already pre-filed with the Commission. It was not unfairly prejudicial, misleading or confusing. The Commission stated, "The evidence presented by ORS in the present case was competent and credible, and we reasonably accepted it on its own merits. The only adjustment accepted by us as part of the Settlement Agreement that was not an ORS adjustment was the Company's original bad debt adjustment." (Order No. 2016-50 p. 22) (R. p. 27.) In other words, the Commission could have reached its same findings without the Settlement Agreement. The revenue, ROE, and operating margin calculated and presented in the Settlement Agreement utilized ORS's adjustments and DIUC's methodology for bad debt expense. It was not error for the Commission to hear all testimony from the settling parties to fulfill its role as fact finder and in pursuit of its statutory duties. The Commission did not act contrary to or in violation of S.C. Rules of Evidence 401, 402, and 403 and 10 S.C. Code Ann. Regs. 103-846 (2012).

DIUC argues that the Settlement Agreement is prejudicial because it suggests "DIUC was unreasonable and not acting in the public's interest since it was not a party to it." (DIUC Initial Brief p. 19.) The mere introduction of a settlement in no way suggests unreasonableness on the part of a party. Conversely, the Commission was entitled to determine that the Settlement Agreement was unreasonable. The Settlement Agreement was also not evidence of conduct or statements made in compromise negotiations. Instead, the Settlement Agreement was the product

of negotiations. There was no violation of S.C. Rule of Evidence 408. Last, DIUC does not have a duty to act in the public's interest.

DIUC asserts that the Commission violated its own Settlement Policies and Procedures.[18] (R. p. 1484.) DIUC did not raise a violation of the Settlement Policies and Procedures prior to this appeal. Therefore, the allegation that the Commission violated its Settlement Policies and Procedures is not preserved for appeal. In addition, the Settlement Policies and Procedures are not included in DIUC's Designation of Matter. Nevertheless, among the five sections in the Settlement Policies and Procedures, DIUC focuses on Section V. (R. p. 1485.) However, Section V sets forth procedures for when *all* parties to a proceeding reach an agreement. Id. The Settlement Policies and Procedures contain the following statements from Sections I through IV which discuss settlements in general:

- "The Commission encourages the resolution of matters brought before it through the use of stipulations and settlements." (Section I.)
- "Settlements must be supported by probative evidence." (Section I.)
- "Proponents of a proposed settlement carry the burden of showing that the settlement is reasonable, in the public interest, or otherwise in accordance with law or regulatory policy." (Section III.)
- "The Commission is not bound by settlements." (Section IV.)
- "[The Commission] will independently review any settlement proposed to it to determine whether the settlement is just, fair and reasonable, in the public interest, or otherwise in accordance with law or regulatory policy." (Section IV.)

[18] DIUC refers to Settlement Procedures revised 6/13/2005. The Settlement Procedures on the Commission's website state they were revised 6/13/2006. (R. p. 1484.)

(R. p. 1484.)

The above statements from the Commission's Settlement Policies and Procedures further support the Commission's decision to hear the testimony of ORS and the POAs after the Settlement Agreement was entered into evidence.

Section V of the Settlement Policies and Procedures begins, "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 representatives, the following procedures shall be followed: [remainder not replicated]." (Emphasis added.) (R. p. 1485.) Section V, which DIUC focuses on in its brief, does not apply to this case since the Settlement Agreement did not contain signatures from all parties. The Commission did not violate its Settlement Policies and Procedures with respect to the Settlement Agreement.

In conclusion, the Commission heard all testimony and considered the evidence and could have reached the very same conclusions in its Orders without the Settlement Agreement. There was no error in the Settlement Agreement's admission or approval.

III. THE COMMISSION COMMITTED NO ERROR IN REFUSING TO CONSIDER LOAN SPECIFICS THAT WERE NOT RAISED DURING THE HEARING.

DIUC asserts the Commission's Orders will cause "inevitable loan default." (DIUC Initial Brief p. 23.) The Commission correctly ruled that it cannot address these issues. "While Company witness Guastella made a bare assertion at the hearing, which is referenced in the Petition [for Reconsideration], regarding the effect of adoption of the rates approved in the Settlement Agreement, the specific issues and characterizations of the [loan] Covenants, DIUC's operation under the Covenants, and SunTrust's putative actions pursuant to the Covenants raised in the Petition [for Reconsideration] and discussed in [Petition for Reconsideration] Attachment A were

not raised during the hearing." (Order No. 2016-50 p. 5) (R. p. 10.) The referenced loan documents were not offered as evidence and are not in the record of this case. (Order No. 2016-50 p. 4) (R. p. 9.)

DIUC's assertion about default is unsupported by the record. Mr. Guastella's pre-filed direct testimony addressed the main reasons for DIUC's proposed revenue:

> The increase is primarily due to property taxes that went from less than $10,000 to nearly $270,000, including the amortization of previously unbilled taxes; an increase in rate base from the settlement amount in the last rate case of $5.0 to nearly $7.1 million; an increase operation and maintenance expenses of about $237,000; and the "fallout" impact on income taxes.

(Tr. p. 189, ll. 4-10) (R. p. 461, lines 4-10.)

Potential loan default is not discussed. If the loan conditions were so tenuous, it would follow that DIUC would have included the conditions in its justification for its rate increase.[19] DIUC did not.

The Commission noted on page 4 of Order No. 2016-50 that "there is very little testimony in the case about the present loan." The foundation in support of DIUC's argument is Mr. Guastella's testimony at the hearing where 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, ll. 12-21) (R. p. 458; lines 12-21.)

[19] The Application must contain cost justifications and a statement justifying DIUC's need for the new rates. S.C. Code Ann. § 58-5-240 (2015) and 10 S.C. Code Ann. Regs. 103-512.4.A.(1) and (9) and 103-712.4.A.(1) and (9) (2012).

This testimony was puffery. There was also testimony from Mr. Guastella that he had made a management decision to refinance the loan in the near future. (Tr. p. 183, ll. 3-5, p. 192, ll. 11-17, p. 193, ll. 1-4, *see also* p. 244-246 wherein Commissioner Fleming asks about the financing fee GA will earn as a result of the refinancing.) (R. p. 455; lines 3-5; p. 464, lines 11-17; p. 465, lines 1-4; *see also* p. 516-518.) If the loan was going to be refinanced, then the existing debt service would also change. The Commission opined that "even if the materials had been submitted into evidence, it is questionable if the outcome would have changed." (Order No. 2016-50 p. 21) (R. p. 26.)

DIUC testimony that the Settlement Agreement will allow for no return on equity is not supported in the record. ORS rate of return expert Dr. Carlisle testified to a recommended ROE of 9.31% based on the calculated average from the range 8.91% to 9.71% derived from his analyses. (Tr. p. 471, ll. 3-9) (R. p. 743, lines 3-9.) The Commission-approved Settlement Agreement included an ROE of 9.28%, which is within the range recommended by Dr. Carlisle and close to his specific recommendation. (Id.; and, Hearing Exhibit 3) (Id.; and R. p. 61 and pp. 820-833.)[20]

Further, ORS witness Morgan testified to ORS's statutory duty to protect the public interest. (Tr. p. 519, ll. 17-23) (R. p. 791, lines 17-23.) The definition of "public interest" which ORS is obligated to represent specifically includes the "preservation of the financial integrity of the state's public utilities and continued investment in and maintenance of utility facilities so as to provide reliable and high quality utility services." S.C. Code Ann. § 58-4-10(B)(3) (2015). ORS

[20] For comparison purposes, the POAs recommended in its pre-filed testimony an ROE in the range of 8.5% to 9%. (Tr. p. 441, ll. 8-18) (R. p. 713, lines 8-18.) The POAs calculated a revenue increase of $429,442 or 39.9% for the combined operations. Id.

witness Morgan confirmed in his testimony that ORS would not make a recommendation that would cause financial instability to any public utility. (Tr. p. 519, ll. 17-23) (R. p. 791, lines 17-23.) In addition, POA witness Lanier testified that he believed DIUC could improve its cash position by making changes in its operations and management practices. (Tr. p. 422, ll. 11-13) (R. p. 694, lines 11-13.) The GA Management Contract payments and rate case expenses suggest opportunities for lower costs.

In its Initial Brief, DIUC attempts to shift responsibility to ORS for not cross-examining DIUC about the loan terms, and states because of this, the "inevitable default" went unchallenged. Appellant's argument is without merit. First, the loan documents were not in evidence. Second, it is not ORS's responsibility to build the record for DIUC. The burden of proof rests with DIUC. There was substantial evidence in the record supporting an ROE in the range of 8.91% to 9.71% along with the revenue increase it produces. (Tr. p. 471, ll. 3-9) (R. p. 743, lines 3-9.) There was no evidence in the record supporting DIUC's assertion of a 0% ROE. Whether or not ORS chose to cross examine Mr. Guastella is irrelevant. The Commission's approval of the Settlement Agreement will not cause DIUC to default on its loan and the Commission was correct to exclude consideration of specific loan-related matters and documents not in evidence.

CONCLUSION

The Commission's Orders were based on reliable, probative, and substantial evidence on the whole record. ORS respectfully requests that the Court affirm Commission Order Nos. 2015-846 and 2016-50.

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Respectfully submitted,

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THE STATE OF SOUTH CAROLINA
In The Supreme Court

APPEAL FROM
THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

Docket No. 2014-346-WS
Case Tracking Number 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.

CERTIFICATE OF COUNSEL

The undersigned hereby certifies that this Final Brief of Respondent Office of Regulatory Staff complies with Rule 211(b), SCACR.

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October 20, 2016
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CERTIFICATE OF SERVICE

This is to certify that I have caused to be served this day one (1) copy of **the Office of Regulatory Staff's Final Brief** by placing same in the care and custody of the United States Postal Service with first class postage affixed thereto and addressed as follows:

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