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STATE OF SOUTH CAROLINA
In the Supreme Court

APPEAL FROM THE PUBLIC SERVICE COMMISSION

S.C. SUPREME COURT

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.

RECORD ON APPEAL

VOLUME I of III

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BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2014-346-WS - ORDER NO. 2016-156

MARCH 1, 2016

IN RE: Application of Daufuskie Island Utility	)	ORDER APPROVING
Company, Incorporated for Approval of an	)	APPEALS BOND
Increase for Water and Sewer Rates, Terms	)	
and Conditions	)	

INTRODUCTION

This matter comes before the Public Service Commission of South Carolina (“Commission”) on the Petition for Approval of Bond Pursuant to S.C. Code Ann. Section 58-5-240 (“the Petition”) filed by Daufuskie Island Utility Company, Inc. (“Daufuskie Island”, “the Company” or “the utility”). Having examined the utility’s Petition and supporting materials, as well as the filings submitted by the other parties, and having determined that the surety selected by the utility and that a proposed amount of the bond to be discussed *infra* are in accordance with the requirements of the applicable statute, the Commission is required to approve the bond.. Under South Carolina law, the utility may, notwithstanding this Commission’s order partially rejecting its petition for rate relief, implement the proposed rate increases during the pendency of its appeal if it posts sufficient bond in accordance with S.C. Code Ann. § 58-5-240(D). Pursuant to this subsection, if our order denying in part the proposed rate relief is upheld on appeal, the utility will be required to refund the additional funds collected during the pendency of appeal with interest accrued at the rate of twelve percent per annum.

SUMMARY OF THE UNDERLYING RATE CASE

On June 11, 2015, Daufuskie Island filed an Application seeking approval of a new schedule of rates and charges for water and sewer services. The Application sought an increase in annual service revenues of \$1,182,301 for combined operations. The Commission held an evening public hearing on September 15, 2015, and an evidentiary hearing on October 28, 2015. A joint proposed order was filed by the Haig Point Club and Community Association, Inc., Melrose Property Owner's Association, Inc., Bloody Point Property Owner's Association (collectively, the POAs) and the Office of Regulatory Staff ("ORS"). The utility also filed a proposed order. On December 8, 2015, in Order No. 2015-846, the Commission approved additional operating revenues of \$462,798. Daufuskie Island filed a Petition for Reconsideration and/or Rehearing with this Commission. Various parties filed responses to this Petition. On January 13, 2016, this Commission entered a Directive denying the utility's Petition. On February 25, 2016, this Commission issued Order No. 2016-50, which implemented the terms of the January 13, 2016 Directive.

TERMS AND CONDITIONS OF THE PROPOSED BOND

Daufuskie Island requests that the Commission approve a bond pursuant to S.C. Code Ann. Section 58-5-240(D) in the amount of \$700,000, pending any subsequent appeal. According to the utility, the \$700,000 figure represents the additional annual revenue which Daufuskie Island would be entitled to earn if the Commission had approved the Application in full. Daufuskie Island submits that, based upon the additional amount of revenues which would be generated had the Commission approved the requested

increase, a surety bond in the amount proposed is sufficient.

Subsequent to the filing of the utility's Petition, other parties in the case filed responses, proposing varying amounts for the bond. The Property Owners Associations of Haig Point, Melrose, and Bloody Point jointly assert that a bond in the amount of two years collections, plus 12% interest amounting to \$1,568,000 constitutes a more reasonable amount for the bond. The ORS proposes one and one-half years' worth of collections and interest, for a total bond amount of \$1,218,141.27. The utility filed replies to both parties' submissions, noting, *inter alia*, that the increase under bond to proposed utility rates would not begin until the second quarter of 2016, i.e. April 1, 2016, with bills mailed after July 1, 2016. Daufuskie Island noted that it would take until May 2017 for customers to have paid a full year of the Company-requested increased revenue.

Daufuskie Island later modified its Petition somewhat to propose that the ORS calculation for one year of collections plus interest should be used for the bond figure. Although the utility states that ORS calculated this amount to be \$731,346, the actual ORS calculation for a year's collection plus interest was \$787,867. In addition, the Company noted that if the Commission wanted to place additional conditions on the bond, that it would consent to either increase the bond prior to the July 1, 2017 billing, or otherwise reduce rates to the level approved by the Commission's original rate order of December 8, 2015, also to be done prior to the July 1, 2017 billings.

THE APPLICABLE STATUTE

In Section 1 of Act No. 138 of 1983, the South Carolina General Assembly substantially rewrote Section 58-5-240 of the South Carolina Code. The amendment to

Section 58-5-240 provided in part that if the Commission rejects a utility's application for rate relief, the utility may nevertheless choose to impose a rate increase while the utility seeks reconsideration by the Commission of the matter and/or appeal of the Commission's denial of rate relief before the Supreme Court of South Carolina, so long as the utility provides an appropriate surety bond in an amount sufficient to ensure repayment of any overcollection, with interest to be assessed at twelve percent per annum. The Commission is without discretion to prohibit the utility from imposing its proposed rates under an appropriate bond. The statute, as amended by the General Assembly in 1983, allows the utility to impose its proposed rates under bond as a matter of right where the utility demonstrates that the surety and the bond are sufficient to ensure that the ratepayers will be reimbursed with interest for overcharges in the event the utility's appeal is ultimately unsuccessful.

ORDER

Based on the information presented to us, the proposed surety and the bond in the amount of \$787,867, effective July 1, 2016, for a period of one year are appropriate and are approved. With the additional condition approved by us, *infra*, we believe that the public is being properly protected while this matter is on appeal.

As an additional condition of the bond, the Company shall file a status report on or before May 1, 2017, to advise this Commission as to the status of the Company's appeal of this Commission's Orders. If the utility expects the appeals process to extend beyond July 1, 2017 at the time of the status report, the utility shall also file a proposal as to how it believes the bonding period should be extended. Daufuskie Island shall serve the status

report, and, if necessary, the proposal for bond continuation on the parties, who will have until May 15, 2017, to file comments with this Commission on the status report and/or proposal for bond continuation.

Should the original rates proposed by the Company be deemed excessive by the Court, then refunds plus interest must be made to the Company's customers in a manner consistent with the provisions of S.C. Code Ann. Section 58-5-240, and in a manner approved by this Commission. If the Company's appeal is unsuccessful, it shall submit a plan for refunds to the Commission, with copies to the parties within ten (10) days of receipt of the Court Order notifying them of loss of the appeal. The other parties shall then have ten (10) days from receipt of the Company's proposed methodology to comment.

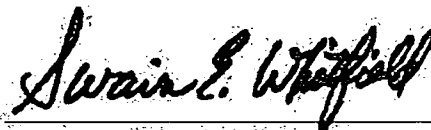
This Order shall remain in full force and effect until further order of the Commission.

BY ORDER OF THE COMMISSION:



Nikiya Hall, Chairman

ATTEST:



Swain E. Whitfield, Vice Chairman

(SEAL)

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA

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

FEBRUARY 25, 2016

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

I. INTRODUCTION

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

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

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

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

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

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

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

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

II. SPECIFIC COMPANY ARGUMENTS

A. DEFAULT AND LOAN COMPLIANCE

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

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

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

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

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

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

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

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

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

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

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

B. ADJUSTMENTS FOR RECONSIDERATION

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

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

i. **Property Taxes**

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

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

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

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

ii. **Management Fees**

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

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

See Hearing Exhibit 9.

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

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

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

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

Utility Company, Inc. and its management company Guastella Associates, LLC are affiliates, as per the Agreement between the two dated June 18, 2015. See Hearing Exhibit 9. (An “affiliate” is defined by Black’s Law Dictionary Free Online Legal Dictionary 2nd edition as “Companies that have a shared resources, interests, or business dealings.”) In addition, further evidence of affiliation between GA and DIUC is shown in the Utility’s 2014 Annual Report to the Commission and ORS. John Guastella, the Managing Member of Guastella Associates, LLC, has been a member of the Board of Directors of DIUC since July 9, 2008.¹ Further evidence of Mr. Guastella’s membership on the DIUC Board of Directors is found at page 227 of the Transcript of Record, wherein Mr. Guastella admitted that he was still a DIUC Board of Directors member at the time of his testimony in this case.

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

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

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

iii. Rate Case Expenses

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

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

iv. **Bad Debt**

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

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

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

a. References to the Previous Rate Case

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

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

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

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

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

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

v. Rate Base Issues

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

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

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

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

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

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

III. RATE OF RETURN

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

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

IV. CONCLUSION

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

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

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

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

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

BY ORDER OF THE COMMISSION:



Nikiya Hall, Chairman

ATTEST:



Swain E. Whitfield, Vice Chairman

(SEAL)

**PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA
COMMISSION DIRECTIVE**

ADMINISTRATIVE MATTER	☐	DATE	<u>February 03, 2016</u>
MOTOR CARRIER MATTER	☐	DOCKET NO.	<u>2014-346-WS</u>
UTILITIES MATTER	☒	ORDER NO.	<u>2016-90</u>

THIS DIRECTIVE SHALL SERVE AS THE COMMISSION'S ORDER ON THIS ISSUE.

SUBJECT:

DOCKET NO. 2014-346-WS - Application of Daufuskie Island Utility Company, Incorporated for Approval of an Increase for Water and Sewer Rates, Terms and Conditions – Staff Presents for Commission Consideration the Petition for Approval of Bond Pursuant to S.C. Code Ann. §58-5-240 Filed on Behalf of Daufuskie Island Utility Company, Incorporated.

COMMISSION ACTION:

The provisions of S.C. Code Ann. Section 58-5-240(D) set out bonding provisions for appeals by utilities of Commission rate orders. These bonding provisions are meant to protect the public in situations where refunds to the ratepayers may ultimately be determined to be appropriate by a Court. In the present case, we have a Petition for approval of a bond from Daufuskie Island Utility Company, and we have also received a response to the Petition from the three Daufuskie Island Property Owners Associations as well as a Reply to that Response. The filings express vastly different opinions as to what bond amount would properly protect the public during the course of the proposed appeal by the Utility. I move that we request the input of the Office of Regulatory Staff on this question, since ORS represents the public interest before the Commission. ORS input would certainly be helpful in our determination of an appropriate bond amount to protect the public. Because we are asking for ORS input, I also move that we carry this agenda item over until a future Commission meeting.

PRESIDING: Hall

SESSION: Regular

TIME: 2:00 p.m.

	MOTION	YES	NO	OTHER
ELAM	☐	☒	☐	
FLEMING	☐	☒	☐	
HALL	☐	☒	☐	
HAMILTON	☐	☒	☐	
HOWARD	☒	☒	☐	
RANDALL	☐	☒	☐	
WHITFIELD	☐	☒	☐	

(SEAL)

RECORDED BY: J. Schmieding



BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2014-346-WS - ORDER NO. 2015-846
DECEMBER 8, 2015

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

I. Introduction

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

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

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

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

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

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

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

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

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

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

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

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

At the hearing on October 28, a Settlement² between the POAs and ORS was entered into the record after an objection to it by DIUC was overruled. DIUC, the POAs and ORS presented testimony and exhibits after one public witness, Mr. Reid Delaney,³ testified. Mr. Delaney testified that he owns property on which assets are located and utilized by DIUC for its regulated water and sewer business.

DIUC presented the testimony of: John F. Guastella⁴ (direct and rebuttal testimony), President of Guastella Associates, LLC (“GA”), a utility management, valuation and rate consulting firm headquartered in Boston, Massachusetts; Gary C. White (direct), Vice President and Director of Accounting at GA; Eric Johanson (direct), DIUC Chief Operator; and the Honorable Maria Walls⁵ (rebuttal), Beaufort County Treasurer. Mr. Guastella and Mr. White testified as a panel about the management and finances of DIUC. Mr. Johanson’s testimony addressed the operations of DIUC. Mr. Johanson was excused from the hearing without appearing before the Commission after

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

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

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

⁵ Hearing Exhibit 5 consists of Walls Rebuttal Exhibit A.

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

The POAs presented two panels of witnesses. The first panel consisted of Paul Vogel⁶ (direct), Haig Point Club and Community Association resident; Doug Egly⁷ (direct), Chief Operating Officer of the Haig Point Association; and Tony Simonelli (direct), real estate broker on Daufuskie Island. The second panel consisted of Lynn M. Lanier⁸ (direct) and Charles Loy⁹ (direct and surrebuttal), Principals of GDS Associates, Inc., a utility consulting and engineering firm with its principal offices in Marietta, Georgia; and Harry Jue¹⁰ (direct), water and sewer consultant with Hussey Gay Bell Engineering. POA witnesses Vogel, Egly, and Simonelli presented testimony illustrating the points of view of their respective organizations, and each providing testimony opposing DIUC's request. POA witness Loy provided expert testimony regarding accounting and rate base issues. POA witness Lanier provided expert testimony on the overall Application and incorporated Mr. Loy's recommended adjustments. Beach Field did not pre-file or present testimony at the Commission hearing.

ORS presented the testimony of Douglas H. Carlisle¹¹ (direct), ORS Economist; Ivana C. Gearheart¹² (direct), ORS Audit Manager; and Willie J. Morgan¹³ (direct and surrebuttal), ORS Deputy Director for the Water and Wastewater Department, in a panel.

⁶ Hearing Exhibit 11 is Vogel Exhibit 1.

⁷ Hearing Exhibit 12 is Egly Exhibit 1.

⁸ Hearing Exhibit 14 consists of Lanier Exhibits 1 through 5. Exhibit 3 was revised at the hearing.

⁹ Hearing Exhibit 15 is Loy Surrebuttal Exhibit 1. Hearing Exhibit 16 is Loy Direct Appendix A.

¹⁰ Hearing Exhibit 13 is Jue Exhibit 1.

¹¹ Hearing Exhibit 17 is Carlisle Direct Exhibits 1 through 10.

¹² Hearing Exhibit 18 is Gearheart Direct Exhibits 1 through 8.

¹³ Hearing Exhibit 19 is Morgan Direct Exhibits 1 through 8. Hearing Exhibit 20 is Morgan Surrebuttal Exhibits 1 and 2.

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

II. REVIEW OF THE EVIDENCE AND EVIDENTIARY CONCLUSIONS

Standards and Required Findings

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

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

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

Test Year

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

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

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

Rate of Return on Rate Base

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

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

Capital Structure and Cost of Debt

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

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

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

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

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

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

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

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

Cost of Equity/Return on Equity

DIUC witness Guastella testified that the requested 10.5% ROE is based on his experience and judgment. (Guastella Direct, R. p. 193). The POAs' witness Lanier testified, "This is the same rate the Company requested in its 2012 rate case¹⁴, which was a specified rate, rather than a rate developed through justification of the ROE required to meet its needs for profit margin and to attract the needed debt capital." (Lanier Direct, R. p. 437, ll. 1-4).

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

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

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

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

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

Connecticut DPUC Formula:

Average Large Company	9.69%
Small Company Adder	0.50%
Performance Adder	<u>0.50%</u>
	<u>10.69%</u>

Florida PSC Leverage Graph Formula:

$5.6\% + (2.279 / \text{Equity Ratio})$	= ROE
Range	100% = 7.88%
	40% = 11.30%
Equity Ratio	58.8% = <u>9.47%</u>

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

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

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

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

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

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

Rate Base

The rate base proposed by DIUC for combined operations was \$7,085,475.¹⁵ In support of its rate base, DIUC included several plant assets, particularly a 125,000 gallon elevated water storage tank, well and facilities (the "facilities") which are located on real property not owned by DIUC. Specifically, the facilities are located on real property (the "Site") that, as described below, was sold at a delinquent tax sale. DIUC does not dispute that it is not the owner of the Site.¹⁶ However, DIUC offered testimony and evidence that it owns these facilities, and asserts that 1) the tax sale did not include the storage tank, well and facilities, only the Site; 2) DIUC pays property taxes to Beaufort County for the facilities; 3) DIUC has the right to operate those facilities on any parcel of land in the

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

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

Haig Point development¹⁷; and 4) these facilities are “used and useful” in providing water service. (Guastella Direct, R. p. 195, Walls Rebuttal, R. pp. 82-83). DIUC offered the testimony of the Beaufort County Treasurer Maria Walls who stated the Company is paying a utility tax on water system infrastructure. (Walls Rebuttal, R. p. 83).

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

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

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

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

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

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

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

By contrast, ORS used the carryforward rate base from the last rate case in Docket No. 2011-229-WS, \$4,615,755, and made adjustments through December 31, 2014¹⁸. (R. p. 524.) Using DIUC's utilization factor method with ORS's adjustments, ORS recommended that \$1,932,858 be deducted from the Company's December 31, 2014, Application rate base. Of the amount deducted, \$1,624,696 is gross plant in service representing non-allowable plant, adjustments from the previous case not carried forward by DIUC in this Application, and retirements. (Gearheart Direct, R. p. 496.)

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

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

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

The Facilities

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

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

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

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

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

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

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

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

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

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

Property Taxes

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

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

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

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

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

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

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

Management Fees, Rate Case Expenses, and Other Expenses

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

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

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

ORS excluded from operating and maintenance expenses the incentive fee¹⁹ included in the test year and \$25,439²⁰ representing GA's management fee, legal expenses related to the property tax appeal and tax sale of the water tower, and other expenses not allowable for rate making purposes. (Gearheart, Direct R. p. 493). DIUC witness Guastella disputed all exclusions noting "[GA's] efforts reflect an unequivocal commitment to provide adequate service to the customers, some of which were achieved because of GA's rate setting expertise that is not typical of other managers." (Guastella Rebuttal, R. p. 198). "Having consulted for some 600 developer-related water and sewer utilities, I am not aware of any that had managers with the regulatory, utility accounting, valuation, or rate setting experience that GA applied in meeting the challenges of

¹⁹ See ORS Adjustment 4(m).

²⁰ See ORS Adjustment 4(g).

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

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

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

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

Bad Debt Expense

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

Other Adjustments

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

Performance Bond

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

Settlement

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

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

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

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

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

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

III. FINDINGS OF FACT

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

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

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

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

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

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

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

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

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

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

IV. CONCLUSIONS OF LAW

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

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

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

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

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

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

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

V. ORDERING PROVISIONS

IT IS THEREFORE ORDERED THAT:

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

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

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

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

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

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

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

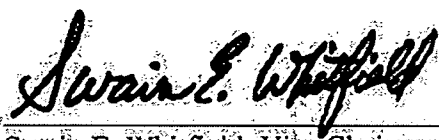
8. This Order shall remain in full force and effect until further order of the Commission.

BY ORDER OF THE COMMISSION:



Nikiya Hall, Chairman

ATTEST:



Swain E. Whitfield, Vice Chairman

(SEAL)

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

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

III. Availability Rates (Quarterly)

A. <u>Water</u>	\$40.40	\$99.38
B. <u>Sewer</u>	\$71.83	\$110.72

III. Special Conditions

A. Tapping Fees:

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

*This applies to lots purchased prior to date of this order, but not to lots sold after the date of this order. (See Commission Order No. 93-761 in Docket No. 87-333-WS)

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

- B. Backflow Prevention: All irrigation systems and pipes running from potable water lines must have approved backflow prevention devices installed.
- C. System Development Charge: Should new customers or their agent(s) petition to connect to the systems where there are no existing lines, pumps, hydrants, etc.; and should such petitions be approved, the following requirements shall apply:

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

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

- a. System Original Cost - Accumulated Depreciation = Net Cost
- b. Net Cost - Outstanding Debt = Total Equity*

Total Equity Investment
System Water or Sewer

- c. Flow (Total design gallons per day) = \$/gallons

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

**PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA
COMMISSION DIRECTIVE**

ADMINISTRATIVE MATTER	☐	DATE	<u>August 12, 2015</u>
MOTOR CARRIER MATTER	☐	DOCKET NO.	<u>2014-346-WS</u>
UTILITIES MATTER	☒	ORDER NO.	<u>2015-585</u>

THIS DIRECTIVE SHALL SERVE AS THE COMMISSION'S ORDER ON THIS ISSUE.

SUBJECT:

DOCKET NO. 2014-346-WS - Application of Daufuskie Island Utility Company, Incorporated for Approval of an Increase for Water and Sewer Rates, Terms and Conditions - Staff Presents for Commission Consideration the Petition to Intervene Filed on Behalf of Beach Field Properties, LLC.

COMMISSION ACTION:

Grant the Petition to intervene in Docket No. 2014-346-WS filed by Beach Field Properties, LLC.

PRESIDING: HallSESSION: RegularTIME: 2:00 p.m.

	MOTION	YES	NO	OTHER
ELAM	☐	☒	☐	
FLEMING	☐	☒	☐	
HALL	☐	☒	☐	
HAMILTON	☒	☒	☐	
HOWARD	☐	☐	☐	<u>Absent</u> Sick Leave
RANDALL	☐	☒	☐	
WHITFIELD	☐	☒	☐	

(SEAL)

RECORDED BY: J. Schmieding

**PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA
COMMISSION DIRECTIVE**

ADMINISTRATIVE MATTER	☐	DATE	<u>August 12, 2015</u>
MOTOR CARRIER MATTER	☐	DOCKET NO.	<u>2014-346-WS</u>
UTILITIES MATTER	☒	ORDER NO.	<u>2015-584</u>

THIS DIRECTIVE SHALL SERVE AS THE COMMISSION'S ORDER ON THIS ISSUE.

SUBJECT:

DOCKET NO. 2014-346-WS - Application of Daufuskie Island Utility Company, Incorporated for Approval of an Increase for Water and Sewer Rates, Terms and Conditions – Staff Presents for Commission Consideration the Petition to Intervene Filed on Behalf of Haig Point Club and Community Association, Incorporated, Melrose Property Owners Association, Incorporated, and Bloody Point Property Owners' Association.

COMMISSION ACTION:

Grant the Petition to Intervene in Docket No. 2014-346-WS filed by the Haig Point Club and Community Association, Inc.; Melrose Property Owners Association, Inc.; and Bloody Point Property Owners' Association.

PRESIDING: HallSESSION: Regular

TIME: 2:00 p.m.

	MOTION	YES	NO	OTHER
ELAM	☐	☒	☐	
FLEMING	☐	☒	☐	
HALL	☐	☒	☐	
HAMILTON	☒	☒	☐	
HOWARD	☐	☐	☐	<u>Absent</u> Sick Leave
RANDALL	☐	☒	☐	
WHITFIELD	☐	☒	☐	

(SEAL)

RECORDED BY: J. Schmieding

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2011-229-WS - ORDER NO. 2012-515

JULY 10, 2012

IN	Application of Daufuskie Island Utility	)	ORDER APPROVING
RE:	Company, Inc. for Approval of Water and	)	AND ADOPTING
	Sewer Rates, Terms and Conditions	)	SETTLEMENT
		)	AGREEMENT

The above-captioned matter is before the Public Service Commission of South Carolina ("Commission") on the proposed Settlement Agreement ("the Settlement Agreement") filed on June 25, 2012, by Haig Point Club and Community Association, Inc. ("HPCCA"), Bloody Point Property Owners Association, Inc. ("BPPOA"), Melrose Property Owners Association, Inc. ("MPOA"), and Daufuskie Island Utility Company, Inc. ("DIUC") (hereinafter collectively referred to as the "signatory agreeing Parties" or sometimes individually as a "Party"). As explained more fully below, the South Carolina Office of Regulatory Staff ("ORS") does not object to the Settlement Agreement and was identified as one of the signing "Parties to this Settlement Agreement." Intervenor Patrick M. Connolly, Esquire, did not submit prefiled testimony or appear at the hearing on May 30, 2012. The proposed settlement was stated into the record at the hearing on May 30, 2012, after partial introduction of the evidence.¹

¹ After the hearing on May 30, 2012, the parties agreed to change the additional annual revenue permitted by their settlement from \$291,448 to \$291,485.

This matter was initiated on June 6, 2011, when DIUC filed a letter of intent with the Commission and on January 10, 2012, DIUC filed an Application for approval of an adjustment in its rates and charges for water and sewer services with the Commission pursuant to S.C. Code Ann. § 58-5-240 and 26 S.C. Code Ann. Regs. 103-712.4.A and 103.512.4.A.

By letter dated January 24, 2012, the Commission's Clerk's Office instructed DIUC to publish a prepared Notice of Filing, one time, in newspapers of general circulation in the area affected by DIUC's Application. The Notice of Filing described the nature of the Application and advised all interested persons desiring to participate in the scheduled proceedings of the manner and time in which to file appropriate pleadings for inclusion in the proceedings as a party of record. The Commission also instructed DIUC to notify directly, by U.S. Mail, each customer affected by the Application by mailing each customer a copy of the Notice of Filing. On February 20, 2012, DIUC filed Affidavits of Publication demonstrating that the Notice of Filing had been duly published and provided a letter certifying that it had complied with the instructions of the Commission's Clerk's Office and mailed a copy of the Notice of Filing to all customers.

In response to a request for a local hearing, by Order No. 2012-196 (March 7, 2012), the Commission ordered a public night hearing.²

On March 13, 2012, DIUC revised its application. By letter dated March 20, 2012, the Commission's Clerk's Office instructed DIUC to publish a prepared

² The purpose of the night hearing was to provide a forum, at a convenient time and location, for customers of DIUC to present their comments regarding the service and rates of DIUC.

Public Notice of Night Hearing and Revised Notice of Filing, one time, in newspapers of general circulation in the area affected by DIUC's Revised Application. The Public Notice of Night Hearing and Revised Notice of Filing described the night hearing to be conducted on April 30, 2012, and the nature of the Revised Application and advised all interested persons desiring to participate in the amended schedule of the proceedings of the manner and time in which to file appropriate pleadings for inclusion in the proceedings as a party of record. The Commission also instructed DIUC to notify directly, by U.S. Mail, each customer affected by the Application by mailing each customer a copy of the Public Notice of Night Hearing and Revised Notice of Filing. On April 5, 2012, DIUC filed Affidavits of Publication demonstrating that the Public Notice of Night Hearing and Revised Notice of Filing had been duly published and provided a letter certifying that it had complied with the instructions of the Commission's Clerk's Office and mailed a copy of the Notice of Filing to all customers.

On April 30, 2012, the Commission held a night hearing at Haig Point Club and Community Association, 10 Haig Point Circle, Daufuskie Island, South Carolina to hear comments from members of the public.

The Commission, with Chairman Howard presiding, heard the expert witnesses testify on DIUC's Application beginning at 10:30 am on May 30, 2012, at the Commission Hearing Room located at 101 Executive Center Drive in Columbia, South Carolina. DIUC was represented by G. Trenholm Walker, Esquire. ORS was represented by Nanette S. Edwards, Esquire, and Courtney D. Edwards,

Esquire. Intervenors HPCCA, BPPOA, and MPOA were collectively represented by John F. Beach, Esquire. Intervenor Patrick M. Connolly, Esquire, did not appear at the merits hearing.

Negotiations between the signatory agreeing Parties in this proceeding, with ORS participating, resulted in a proposed settlement during the course of the merits hearing on May 30, 2012, and ultimately in the Settlement Agreement signed by the Parties on June 25, 2012. In the Settlement Agreement, the Applicant, the three property owner's groups and the Office of Regulatory Staff are collectively defined as the "Parties." The Settlement Agreement also identifies these same entities as "Parties to this Settlement Agreement." However, the first paragraph explains that the Settlement Agreement is "made . . . without objection from the South Carolina Office of Regulatory Staff ("ORS")." Further, the Settlement Agreement signature page "representing and binding" the ORS, states: "We do not object to and acknowledge the effect of this settlement."

The signatory agreeing Parties have all determined that their interests, as well as the public interest, are best served by settling the dispute in this matter under the terms and conditions in the Settlement Agreement and set forth below.

By signing the Settlement Agreement, the signatory agreeing Parties' counsel acknowledged their respective clients' consent to its terms. The Settlement Agreement provides that the signatory agreeing Parties all viewed the terms of the agreement to be fair and reasonable.

The Commission considered and evaluated the Settlement Agreement at its meeting on June 27, 2012. The Commission is fully familiar with this matter based on the evidence and arguments that were presented at the merits hearing on May 30, 2012, and determined that no additional testimony or other proof is necessary.

All signatory agreeing Parties have agreed in the Settlement Agreement that a resolution of this matter on the terms therein allows DIUC to continue to provide water and wastewater services to its customers, and would provide a fair and reasonable operating margin and return on equity to DIUC.

The rates for residential and commercial water, sewer, and irrigation, as well as the charges for availability fees, are specified in Settlement Agreement Exhibit 1, which is attached to and incorporated as a part of this Order as Order Attachment No. 1.

We find that the rates and charges agreed to by the signatory agreeing Parties and not objected to by ORS are fair and reasonable and will allow DIUC to continue to provide its customers with adequate water and wastewater service. We specify an allowable operating margin of 16.64% and find that a rate of return on equity of 8.81% is fair and reasonable under the circumstances based on the proof admitted into evidence at the hearing.

The signatory agreeing Parties all agreed, and this Commission finds, that an increase in rates and charges (including availability fees) for water and sewer rates, fees, and charges is necessary. DIUC (through its predecessors) has not obtained an increase in its rates and charges since 2005. Since that time, DIUC's costs of

providing service have increased so that it can no longer earn a fair return on its investment. Significant facilities operated by DIUC are in need of maintenance and repair.

The signatory agreeing Parties therefore agreed and stipulated to certain rates and charges, which we hereby approve, that are specified in Settlement Agreement Exhibit 1 and included in Order Attachment No. 1. We agree with the signatory agreeing Parties that the rates and charges contained in the Settlement Agreement are fair and reasonable, and will allow DIUC to continue to provide its customers with adequate water and wastewater services.

The Commission further finds that the additional conditions imposed under the Settlement Agreement with respect to annual reporting to the Commission and ORS on the intended loan are also fair, reasonable, and necessary.

The Commission finds the terms and conditions set forth in the Settlement Agreement and Exhibits thereto are fair and reasonable to the Parties and ORS as well as to the DIUC customers affected by the rates and fees approved by this Order.

After careful review and consideration of the Settlement Agreement, the evidence in the record in this proceeding, and the representations of counsel, the Commission concludes as a matter of law that (i) approval of the Settlement Agreement is in the public interest; (ii) the residential and commercial rates, fees, and charges (including availability fees) for both water and sewer agreed to by the signatory agreeing Parties and not objected to by ORS, and as set forth in Order

Attachment No. 1 attached hereto are reasonable and fair and should be put into effect after the notice required herein.

An examination of Settlement Agreement Exhibit 2, attached hereto as part of Order Attachment No. 1, reveals that, based on the operating revenues, income, and expenses agreed upon by the parties, the additional revenues produced by the new rates and charges will result in an operating margin for DIUC of 16.64% and return on equity of 8.81%. We find that the new rates and charges provide DIUC with the opportunity to earn a return on equity of 8.81% for this Company.

IT IS THEREFORE ORDERED THAT:

1. The Settlement Agreement, including its attached Exhibits, is attached hereto as Order Attachment No. 1, is accepted into the record without objection, and is incorporated into and made part of this Order by reference. Further, we find the Settlement Agreement is in the public interest and constitutes a reasonable resolution of this proceeding, and we therefore approve the settlement in its entirety.

2. The statement of proposed rates, fees, and charges attached to the Settlement Agreement (Order Attachment No. 1) is entered into the record of this case without objection. We find that the proposed rates, fees, and charges are both fair and reasonable and will allow DIUC to continue to provide its customers with adequate water and wastewater services. We further find that the additional terms and conditions set forth in the Settlement Agreement, including its reporting requirements if DIUC should obtain a bank loan, are reasonable and fair.

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

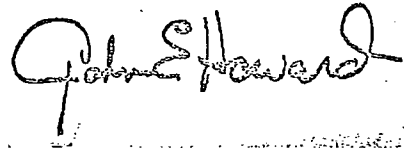
4. A return on equity of 8.81% based on the new rates, fees, and charges is approved for DIUC, as well as an operating margin of 16.64%

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

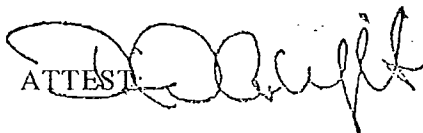
6. The Company's books and records shall be maintained according to the National Association of Regulatory Utility Commissioners ("NARUC") Uniform System of Accounts. The Company is directed to make any necessary adjustments to its accounting system to conform to the NARUC Uniform System of Accounts.

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

BY ORDER OF THE COMMISSION:



John E. Howard, Chairman



ATTEST

David A. Wright, Vice Chairman

(SEAL)

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA

DOCKET NO. 2011-229-WS

IN RE: Application of Daufuskie Island Utility,)	
Company, Inc. for Approval of Water)	
& Sewer Rates, Terms and Conditions)	SETTLEMENT AGREEMENT
_____)	

This Settlement Agreement is made by and among, Haig Point Club and Community Association, Inc. ("HPCCA"), Bloody Point Property Owners Association, Inc. ("BPPOA"), Melrose Property Owner's Association, Inc. ("MPOA") (all three, collectively, the "POA Intervenors"), and Daufuskie Island Utility Company, Inc. ("DIUC") and without objection from the South Carolina Office of Regulatory Staff ("ORS") (hereinafter collectively referred to as the "Parties" or sometimes individually as a "Party").

WHEREAS, on January 10, 2012, DIUC filed an Application for Approval of Water and Sewer Rates, Terms and Conditions ("Application") with the Public Service Commission of South Carolina ("Commission");

WHEREAS, the Parties to this Settlement Agreement are parties of record in the above-captioned docket;

WHEREAS, Intervenor Patrick M. Connolly, Esquire did not submit pre-filed testimony or appear at the hearing on May 30, 2012 and is not a signatory to this Settlement Agreement;

WHEREAS, the Parties commenced the merits hearing before the Commission on May 30, 2012, and during the course of the hearing engaged in discussions that resulted in a settlement of this proceeding after certain proof was admitted into the record;

WHEREAS, the Parties have each determined that their respective interests and the public interest would best be served by settling the above-captioned case and agreeing to a resolution of the various issues on the terms and conditions set forth below:

1. The Parties agree that an increase in water and sewer rates is necessary. DIUC (or its predecessor entities) has not applied for and received an increase in rates since 2005. The current rates do not enable DIUC to cover its costs of providing service and earn a fair return on its investment.
2. In the current proceeding, the Parties disputed the adjustment in rates, fees, and charges that would be necessary to provide DIUC a fair return on its investment as well as the rate of return and other matters.
3. The Parties agree and stipulate that DIUC shall be allowed to set rates and charges on a rate base of \$5,000,000. 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.
4. The Parties agree 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.

5. The Parties agree that this additional revenue would result in an operating margin of 16.64% and a return on equity of 8.81%.
6. The parties agree to the adjustment of the rates, fees, and charges to derive the additional revenue as set forth on the schedule of proposed rates, fees, and charges attached as Exhibit 1.
7. The Parties agree that the stipulated proposed rates, fees, and charges, and resulting additional revenues, allow DIUC the opportunity to earn a fair rate of return, as calculated on Exhibit 2. These stipulations 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.
8. DIUC agrees that it will not file an application for an increase in and/or adjustment to its rates and charges before July 1, 2014.
9. The Parties agree not to further litigate whether availability fees collected by DIUC or its predecessors that have been collected over the years were an approved rate or charge of the Commission.
10. DIUC intends to seek a loan from a financial institution. If DIUC obtains the loan, DIUC agrees to file a report annually (no later than the anniversary date of the loan) with ORS and the Commission (under this docket number), with copy mailed to the POA Intervenor at an address to be provided within 30 days of the Agreement, scheduling the use of the funds of the loan.
11. If the loan in the paragraph above is obtained, DIUC agrees to set up a capital reserve of no less than \$700,000 for capital repairs and improvements and shall file a report annually (no later than the anniversary date of the loan) with ORS and the

Commission (under this docket number), with copy mailed to the POA Intervenor at an address to be provided within 30 days of the Agreement, scheduling the use of the funds of the capital reserve account.

12. The Parties agree to cooperate in good faith with one another in recommending to the Commission that this Settlement Agreement be accepted and approved by the Commission as a fair, reasonable and full resolution of the above-captioned proceeding. The Parties agree to use reasonable efforts to defend and support any Commission Order issued approving this Settlement Agreement and the terms and conditions contained herein.
13. The Parties agree that this Settlement Agreement does not constrain, inhibit or impair in any way the arguments or positions they may choose to assert in future proceedings. If the Commission should decline to approve the Settlement Agreement in its entirety, then any Party desiring to do so may withdraw from the Settlement Agreement without penalty.
14. This Settlement Agreement shall be interpreted according to South Carolina law.
15. Each Party acknowledges its consent and agreement to this Settlement Agreement by authorizing its counsel to affix his or her signature to this document where indicated below. Counsel's signature represents his or her representation that his or her client has authorized the execution of this Settlement Agreement. Facsimile signatures and email signatures shall be as effective as original signatures to bind any party. This document may be signed in counterparts, with the various signature pages combined with the body of the document constituting an original and provable copy of this Settlement Agreement.

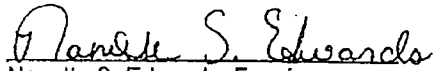
16. The Parties agree that no other evidence will be offered in the proceeding by the Parties other than what has already been admitted and this Settlement Agreement with Settlement Agreement Exhibits hereto attached.

17. The Parties agree that in the event any Party should fail to indicate its consent to this Settlement Agreement and the terms contained herein, then this Settlement Agreement shall be null and void and will not be binding on any Party.

[PARTY SIGNATURES TO FOLLOW ON SEPARATE PAGES]

WE DO NOT OBJECT TO AND ACKNOWLEDGE THE EFFECT OF THIS
SETTLEMENT:

Representing and binding the South Carolina Office of Regulatory Staff:

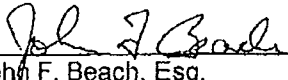


Nanette S. Edwards, Esquire
South Carolina Office of Regulatory Staff
1401 Main Street, Suite 900
Columbia, South Carolina 29201
Phone: (803) 737-0575
Fax: (803) 737-0895
Email: nsedwar@regstaff.sc.gov

Date: June 25, 2012

WE AGREE:

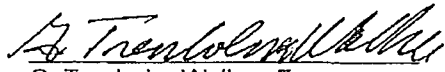
Representing and binding Haig Point Club and Community Association, Inc.
("HPCCA"), Melrose Property Owner's Association, Inc. ("MPOA"), and Bloody
Point Property Owners Association, Inc. ("BPPOA"):


John F. Beach, Esq.
Ellis, Lawhorne & Sims, P.A.
1501 Main Street
Columbia, SC 29201
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jbeach@ellislawhorne.com

Date: June 25, 2012

WE AGREE:

Representing and binding Daufuskie Island Utility Company, Inc.



G. Trenholm Walker, Esq.
Pratt-Thomas Walker, P.A.
16 Charlotte Street
Charleston, SC 29403
T: 843.727.2208
F: 843.727.2231
Email: gtw@p-tw.com

Date: June 25, 2012

SETTLEMENT AGREEMENT EXHIBIT 1

Daufuskie Island Utility Company, Inc.

Settlement Rates

		Haig Pt. Rates	Melrose Rates
I. Residential Rates			
A. Water:			
1) Tapping Fees & 3/4" Meter Box		\$500.00	\$500.00
2) Base Quarterly Charge		\$62.09	\$80.72
3) Consumption Charge (per 1,000 gallons)	0 to 22,500 gallons per quarter	\$2.76	\$0.00
	Over 22,500 gallons	\$2.76	\$2.44
B. Sewer:			
1) Tapping Fees & Service Lateral		\$500.00	\$500.00
2) Base Quarterly Charge		\$110.38	\$80.72
3) Volumetric Charge (per 1,000 gallons)	0 to 22,500 gallons per quarter	\$1.32	\$0.00
	Over 22,500 gallons	\$1.32	\$1.77
C. Irrigation:			
1) Tapping Fees & 3/4" Meter Box		\$500.00	\$500.00
2) Consumption Charge (per 1,000 gallons)	0 to 18,000 gallons per quarter	\$2.76	\$1.66
	18,001 to 60,000 gallons	\$3.09	\$1.66
	Over 60,000 gallons	\$3.50	\$1.66
II. Commercial Rates			
A. Water:			
1) Tapping Fees per Hotel or Inn Room		\$250.00	\$250.00
2) Tapping Fees up to 1-1/2" Meter		\$500.00	\$500.00
3) Tapping Fees 2" or 3" Meter		\$1,500.00	\$1,500.00
4) Tapping Fees for 6" Meter		\$3,500.00	\$3,500.00
Note: Larger meters on a case by case basis.			
5) Base Quarterly Charge		\$86.93	\$136.60
6) Consumption Charge (per 1,000 gallons)	0 to 22,500 gallons per quarter	\$2.76	\$0.00
	Over 22,500 gallons	\$2.76	\$2.44
B. Sewer:			
1) Tapping Fees per Hotel or Inn Room		\$250.00	\$250.00
2) Tapping Fees 4" - 8" Sewer Pipe		\$500.00	\$500.00
2) Base Quarterly Charge		\$178.21	\$136.60
3) Volumetric Charge (per 1,000 gallons)	0 to 22,500 gallons per quarter	\$1.32	\$0.00
	Over 22,500 gallons	\$1.32	\$1.77
C. Irrigation:			
1) Tapping Fees & 3/4" Meter Box		\$500.00	\$500.00
2) Consumption Charge (per 1,000 gallons)	0 to 18,000 gallons per quarter	\$2.76	\$1.66
	18,001 to 60,000 gallons	\$3.09	\$1.66
	Over 60,000 gallons	\$3.50	\$1.66

III. Availability Rates (Quarterly)

A. <u>Water:</u>	\$31.04	\$76.36
B. <u>Sewer</u>	\$55.19	\$85.08

IV. Special Conditions

A. Tapping Fees:

Remain as in original tariff.

B. Backflow Prevention:

Remain as in original tariff.

C. System Development Charge:

Remain as in original tariff.

SETTLEMENT AGREEMENT EXHIBIT 2

Daufuskie Island Utility Company, Inc.
Docket No. 2011-229-WS

Determination of Revenue Increases and Rates of Return and Operating Margin
per Settlement Agreement

Description (a)	(b)	Taxes and Rates (c) (d) (e)			Combined (f)
3 Revenue at Present Rates (Per ORS)					\$714,996
4 Additional Service Availability Revenue (Per ORS)					\$52,422
5 Subtotal Present Revenue					\$767,418
6 SETTLEMENT AGREEMENT ADDITIONAL REVENUE					\$291,485
7 Total Revenue - Proposed Rates per Settlement Agreement					\$1,058,903
8 (Percent Increase)					37.98%
9 O&M Expense					\$493,574
10 Bad Debts Adjustment				0.01339	\$4,604.91
11 Depreciation					\$56,177
12 Amortization					\$15,000
13 Revenue Taxes	0.95100%				\$10,070
14 Property Taxes					\$172
15 Payroll Taxes					\$9,128
16 Interest Expense					\$195,000
17 Total Expenses and Deductions					\$783,726
18 Net Income Before Taxes					\$275,177
19 State Tax		5.0%			\$13,759
20 Fed Taxable Income					\$261,418
21 Fed Income Tax					\$85,203
22 1st \$50,000 @ 15%	50000		7500	15%	
23 Next \$25,000 @ 25%	25000	75000	13750	25%	
24 Next \$25,000 @ 34%	25000	100000	22250	34%	
25 Next \$235,000 @ 39%	235000	335000	113900	39%	
26 Over \$335,000 @ 34%				34%	
27 Composite Rate - average					32.6%
28 Net Income (after taxes) - Equity Return					\$176,215
29 Common Equity					\$2,000,000
30 Return on Equity					8.81%
31 Return on Rate Base					7.42%
32 Operating Margin					16.64%
SETTLEMENT CAPITAL STRUCTURE					
33 Interest Rate					6.5%
34 Long-term Debt				60%	\$3,000,000
35 (debt portion)					60%
36 Common Equity					\$2,000,000
37 (equity portion)					40%
38 Total Rate Base					\$5,000,000
39 (total)					

STATE OF SOUTH CAROLINA
In the Supreme Court

RECEIVED

APPEAL FROM THE PUBLIC SERVICE COMMISSION

MAR 25 2016

Docket No. 2014-346-WS

S.C. SUPREME COURT

Daufuskie Island Utility Company, Inc.,

Appellant,

v.

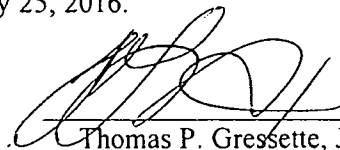
South Carolina Office of Regulatory Staff,
Haig Point Club and Community Association, Inc.,
Melrose Property Owner's Association, Inc.,
Bloody Point Property Owner's Association, and
Beach Field Properties, LLC,

Respondents.

NOTICE OF APPEAL

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

March 22, 2016



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BEACH FIELD PROPERTIES, LLC

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2014-346-WS - ORDER NO. 2015-846

DECEMBER 8, 2015

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

I. Introduction

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

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

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

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

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

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

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

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

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

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

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

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

At the hearing on October 28, a Settlement² between the POAs and ORS was entered into the record after an objection to it by DIUC was overruled. DIUC, the POAs and ORS presented testimony and exhibits after one public witness, Mr. Reid Delaney,³ testified. Mr. Delaney testified that he owns property on which assets are located and utilized by DIUC for its regulated water and sewer business.

DIUC presented the testimony of: John F. Guastella⁴ (direct and rebuttal testimony), President of Guastella Associates, LLC (“GA”), a utility management, valuation and rate consulting firm headquartered in Boston, Massachusetts; Gary C. White (direct), Vice President and Director of Accounting at GA; Eric Johanson (direct), DIUC Chief Operator; and the Honorable Maria Walls⁵ (rebuttal), Beaufort County Treasurer. Mr. Guastella and Mr. White testified as a panel about the management and finances of DIUC. Mr. Johanson’s testimony addressed the operations of DIUC. Mr. Johanson was excused from the hearing without appearing before the Commission after

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

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

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

⁵ Hearing Exhibit 5 consists of Walls Rebuttal Exhibit A.

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

The POAs presented two panels of witnesses. The first panel consisted of Paul Vogel⁶ (direct), Haig Point Club and Community Association resident; Doug Egly⁷ (direct), Chief Operating Officer of the Haig Point Association; and Tony Simonelli (direct), real estate broker on Daufuskie Island. The second panel consisted of Lynn M. Lanier⁸ (direct) and Charles Loy⁹ (direct and surrebuttal), Principals of GDS Associates, Inc., a utility consulting and engineering firm with its principal offices in Marietta, Georgia; and Harry Jue¹⁰ (direct), water and sewer consultant with Hussey Gay Bell Engineering. POA witnesses Vogel, Egly, and Simonelli presented testimony illustrating the points of view of their respective organizations, and each providing testimony opposing DIUC's request. POA witness Loy provided expert testimony regarding accounting and rate base issues. POA witness Lanier provided expert testimony on the overall Application and incorporated Mr. Loy's recommended adjustments. Beach Field did not pre-file or present testimony at the Commission hearing.

ORS presented the testimony of Douglas H. Carlisle¹¹ (direct), ORS Economist; Ivana C. Gearheart¹² (direct), ORS Audit Manager; and Willie J. Morgan¹³ (direct and surrebuttal), ORS Deputy Director for the Water and Wastewater Department, in a panel.

⁶ Hearing Exhibit 11 is Vogel Exhibit 1.

⁷ Hearing Exhibit 12 is Egly Exhibit 1.

⁸ Hearing Exhibit 14 consists of Lanier Exhibits 1 through 5. Exhibit 3 was revised at the hearing.

⁹ Hearing Exhibit 15 is Loy Surrebuttal Exhibit 1. Hearing Exhibit 16 is Loy Direct Appendix A.

¹⁰ Hearing Exhibit 13 is Jue Exhibit 1.

¹¹ Hearing Exhibit 17 is Carlisle Direct Exhibits 1 through 10.

¹² Hearing Exhibit 18 is Gearheart Direct Exhibits 1 through 8.

¹³ Hearing Exhibit 19 is Morgan Direct Exhibits 1 through 8. Hearing Exhibit 20 is Morgan Surrebuttal Exhibits 1 and 2.

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

II. REVIEW OF THE EVIDENCE AND EVIDENTIARY CONCLUSIONS

Standards and Required Findings

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

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

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

Test Year

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

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

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

Rate of Return on Rate Base

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

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

Capital Structure and Cost of Debt

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

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

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

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

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

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

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

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

Cost of Equity/Return on Equity

DIUC witness Guastella testified that the requested 10.5% ROE is based on his experience and judgment. (Guastella Direct, R. p. 193). The POAs' witness Lanier testified, "This is the same rate the Company requested in its 2012 rate case¹⁴, which was a specified rate, rather than a rate developed through justification of the ROE required to meet its needs for profit margin and to attract the needed debt capital." (Lanier Direct, R. p. 437, ll. 1-4).

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

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

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

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

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

Connecticut DPUC Formula:

Average Large Company	9.69%
Small Company Adder	0.50%
Performance Adder	<u>0.50%</u>
	<u>10.69%</u>

Florida PSC Leverage Graph Formula:

$5.6\% + (2.279 / \text{Equity Ratio})$	= ROE
Range	100% = 7.88%
	40% = 11.30%
Equity Ratio	58.8% = <u>9.47%</u>

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

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

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

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

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

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

Rate Base

The rate base proposed by DIUC for combined operations was \$7,085,475.¹⁵ In support of its rate base, DIUC included several plant assets, particularly a 125,000 gallon elevated water storage tank, well and facilities (the "facilities") which are located on real property not owned by DIUC. Specifically, the facilities are located on real property (the "Site") that, as described below, was sold at a delinquent tax sale. DIUC does not dispute that it is not the owner of the Site.¹⁶ However, DIUC offered testimony and evidence that it owns these facilities, and asserts that 1) the tax sale did not include the storage tank, well and facilities, only the Site; 2) DIUC pays property taxes to Beaufort County for the facilities; 3) DIUC has the right to operate those facilities on any parcel of land in the

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

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

Haig Point development¹⁷; and 4) these facilities are “used and useful” in providing water service. (Guastella Direct, R. p. 195, Walls Rebuttal, R. pp. 82-83). DIUC offered the testimony of the Beaufort County Treasurer Maria Walls who stated the Company is paying a utility tax on water system infrastructure. (Walls Rebuttal, R. p. 83).

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

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

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

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

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

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

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

By contrast, ORS used the carryforward rate base from the last rate case in Docket No. 2011-229-WS, \$4,615,755, and made adjustments through December 31, 2014¹⁸. (R. p. 524.) Using DIUC's utilization factor method with ORS's adjustments, ORS recommended that \$1,932,858 be deducted from the Company's December 31, 2014, Application rate base. Of the amount deducted, \$1,624,696 is gross plant in service representing non-allowable plant, adjustments from the previous case not carried forward by DIUC in this Application, and retirements. (Gearheart Direct, R. p. 496.)

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

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

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

The Facilities

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

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

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

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

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

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

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

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

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

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

Property Taxes

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

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

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

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

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

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

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

Management Fees, Rate Case Expenses, and Other Expenses

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

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

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

ORS excluded from operating and maintenance expenses the incentive fee¹⁹ included in the test year and \$25,439²⁰ representing GA's management fee, legal expenses related to the property tax appeal and tax sale of the water tower, and other expenses not allowable for rate making purposes. (Gearheart, Direct R. p. 493). DIUC witness Guastella disputed all exclusions noting "[GA's] efforts reflect an unequivocal commitment to provide adequate service to the customers, some of which were achieved because of GA's rate setting expertise that is not typical of other managers." (Guastella Rebuttal, R. p. 198). "Having consulted for some 600 developer-related water and sewer utilities, I am not aware of any that had managers with the regulatory, utility accounting, valuation, or rate setting experience that GA applied in meeting the challenges of

¹⁹ See ORS Adjustment 4(m).

²⁰ See ORS Adjustment 4(g).

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

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

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

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

Bad Debt Expense

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

Other Adjustments

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

Performance Bond

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

Settlement

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

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

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

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

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

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

III. FINDINGS OF FACT

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

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

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

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

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

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

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

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

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

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

IV. CONCLUSIONS OF LAW

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

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

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

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

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

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

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

V. ORDERING PROVISIONS

IT IS THEREFORE ORDERED THAT:

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

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

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

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

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

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

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

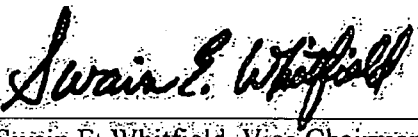
8. This Order shall remain in full force and effect until further order of the Commission.

BY ORDER OF THE COMMISSION:



Nikiya Hall, Chairman

ATTEST:



Swain E. Whitfield, Vice Chairman

(SEAL)

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

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

III. Availability Rates (Quarterly)

A. <u>Water</u>	\$40.40	\$99.38
B. <u>Sewer</u>	\$71.83	\$110.72

III. Special Conditions

A. Tapping Fees:

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

*This applies to lots purchased prior to date of this order, but not to lots sold after the date of this order. (See Commission Order No. 93-761 in Docket No. 87-333-WS)

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

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

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

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

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

a. System Original Cost	-	Accumulated Depreciation	=	Net Cost
b. Net Cost	-	Outstanding Debt	=	Total Equity*

Total Equity Investment
System Water or Sewer

c. Flow (Total design gallons per day)	=	\$/gallons

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

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2014-346-WS - ORDER NO. 2016-50

FEBRUARY 25, 2016

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

I. INTRODUCTION

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

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

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

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

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

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

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

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

II. SPECIFIC COMPANY ARGUMENTS

A. DEFAULT AND LOAN COMPLIANCE

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

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

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

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

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

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

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

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

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

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

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

B. ADJUSTMENTS FOR RECONSIDERATION

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

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

i. Property Taxes

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

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

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

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

ii. Management Fees

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

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

See Hearing Exhibit 9.

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

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

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

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

Utility Company, Inc. and its management company Guastella Associates, LLC are affiliates, as per the Agreement between the two dated June 18, 2015. See Hearing Exhibit 9. (An “affiliate” is defined by Black’s Law Dictionary Free Online Legal Dictionary 2nd edition as “Companies that have a shared resources, interests, or business dealings.”) In addition, further evidence of affiliation between GA and DIUC is shown in the Utility’s 2014 Annual Report to the Commission and ORS. John Guastella, the Managing Member of Guastella Associates, LLC, has been a member of the Board of Directors of DIUC since July 9, 2008.¹ Further evidence of Mr. Guastella’s membership on the DIUC Board of Directors is found at page 227 of the Transcript of Record, wherein Mr. Guastella admitted that he was still a DIUC Board of Directors member at the time of his testimony in this case.

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

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

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

iii. Rate Case Expenses

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

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

iv. **Bad Debt**

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

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

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

a. References to the Previous Rate Case

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

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

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

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

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

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

v. Rate Base Issues

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

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

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

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

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

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

III. RATE OF RETURN

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

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

IV. CONCLUSION

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

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

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

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

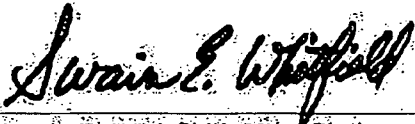
This Order shall remain in full force and effect until further order of the Commission.

BY ORDER OF THE COMMISSION:



Nikiya Hall, Chairman

ATTEST



Swain E. Whitfield, Vice Chairman

(SEAL)

**PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA
COMMISSION DIRECTIVE**

ADMINISTRATIVE MATTER	☐	DATE	<u>February 24, 2016</u>
MOTOR CARRIER MATTER	☐	DOCKET NO.	<u>2014-346-WS</u>
UTILITIES MATTER	☒	ORDER NO.	<u></u>

SUBJECT:

DOCKET NO. 2014-346-WS - Application of Daufuskie Island Utility Company, Incorporated for Approval of an Increase for Water and Sewer Rates, Terms and Conditions – Staff Presents for Commission Consideration the Petition for Approval of Bond Pursuant to S.C. Code Ann. § 58-5-240 Filed on Behalf of Daufuskie Island Utility Company, Incorporated.

COMMISSION ACTION:

Daufuskie Island Utility Company, Incorporated seeks approval of an appeal bond, pursuant to the provisions of S.C. Code Section 58-5-240 (D). This statute requires that such an appeal bond be a "reasonable amount approved by the Commission, with sureties approved by the Commission." During the pendency of any appeal, if such a bond is posted, the statute allows the Company to collect its originally requested rates, subject to refunds with 12% interest should the Company be unsuccessful in its appeal.

In this case, we have received several proposals for specific amounts for the bond by the utility and the parties, which is for the protection of the public during the pendency of the appeal. The latest proposal by the utility is that we approve a bond in the amount of one year of collections, with interest. ORS calculates this amount to be approximately \$787,867. I would note, after the posting of any appeals bond, the Company states that it would not bill its requested rates until July 1, 2016. In addition, the utility notes that it would consent to a condition of the bond requiring DIUC to either increase the amount of the bond prior to its July 1, 2017 billing or to otherwise reduce its rates to the level approved by the Commission in its Order Approving Settlement Among Certain Parties and Ruling on Application for Adjustments in Rates dated December 8, 2015.

With these matters in mind, I move that we approve and find reasonable the bond amount of \$787,867, effective July 1, 2016 for a period of one year. The Company shall then file a status report on or before May 1, 2017, to advise this Commission as to the status of the Company's appeal of the Commission's Orders. If the Company expects the appeals process to extend beyond July 1, 2017 at the time of the status report, the Company shall file a proposal as to how it believes that the bonding period should be extended. DIUC shall serve the status report and its proposal for continuation of the bond on the parties, who shall have until May 15, 2017 to file comments with this Commission on the Company's proposal. I also move that we approve the proposed surety. Should the original rates proposed by the Company be deemed excessive by the Court, then refunds plus interest must be made to the Company's customers in a manner consistent with the provisions of S.C. Code Section 58-5-240 and in a manner approved by this Commission.

PRESIDING: HallSESSION: RegularTIME: 2:00 p.m.

	MOTION	YES	NO	OTHER
ELAM	☐	☒	☐	
FLEMING	☐	☒	☐	
HALL	☐	☒	☐	

HAMILTON	☐	☒	☐
HOWARD	☒	☒	☐
RANDALL	☐	☒	☐
WHITFIELD	☐	☒	☐

(SEAL)



RECORDED BY: J. Schmieding

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2014-346-WS

IN RE:)
)
Application of Daufuskie Island Utility Company, Inc.)
For Approval of a New Schedule of Rates and)
Charges for Water and Sewer Service)

**DIUC REPLY TO ORS POSITION LETTER
RE: PETITION FOR APPROVAL OF BOND**

As explained in DIUC's Petition for Approval of Bond and Affidavit of John F. Guastella filed January 20, 2016, pursuant to S.C. Code Ann. 58-5-240 DIUC seeks the Commission's approval of a one-year renewable bond in the amount of \$700,000.

Intervenors filed a response to DIUC's petition asserting the Commission should impose a bond amount of \$1,568,000. On February 2, 2016, DIUC explained in its Reply to Intervenors' Response to Petition for Approval of Bond that the timeframes established by statutory noticing requirements prevent DIUC from immediately collecting increased rates; therefore, it will take until May of 2017 for DIUC customers to have paid a full year of the new DIUC rates.

ORS originally did not take a position on the bond matter. After noting the disparity between DIUC's proposed bond amount of \$700,000 and the astronomical amount of \$1,568,000 sought by Intervenors, the Commission asked for ORS input. *See* Order 2016-90.

By letter dated February 11, 2016, ORS calculated the one-year difference in rates as \$731,346, but suggested a bond in the amount of \$1,218,141.27 should be imposed to cover collections over an 18-month period.

As previously explained in DIUC's Reply to Intervenor's Response to Petition for Approval of Bond, a one-year bond is sufficient:

It is likely that [the new rate] increase will take effect no sooner than the beginning of the second quarter, which is April 1, 2016. Second quarter bills, however, will not be mailed until after July 1, 2016 and will be due within 30 days. The next three quarterly billings would be on October 1, 2016, January 1, 2017 and April 1, 2017. Thus, it will take until May of 2017 for DIUC customers to have paid a full year of the DIUC rates.

Return at p. 2. A full year of collections at the higher rates plus interest calculated by ORS totals \$731,346. *See* ORS Bond Calculation for DIUC Using 18 Months, attached to ORS Letter dated February 11, 2016. Again, DIUC's requested rates will not be billed until July 1, 2016, which is over 4 months from now. That means DIUC customers will not have paid a full year of the increased rates until after the July 1, 2017 billing. *See* DIUC Reply to Intervenor's Response to Petition for Approval of Bond (explaining schedule established by statutory noticing requirements as well as billing and collection timetables).

The only requirement for a bond under S.C. Code Ann. § 58-5-240 is that it be a "reasonable amount approved by the Commission, with sureties approved by the Commission." To require double the amount of bond (as suggested by Intervenor and ORS) is simply unnecessary and therefore unreasonable. DIUC should not be required to expend additional funds for the increased bond when the matter can be revisited, if necessary, in one year's time.

Alternatively, should the Commission wish to impose some additional condition to address matters raised by Intervenor and ORS, DIUC would consent to a condition of the bond requiring DIUC to either increase the amount of the bond prior to its July 1, 2017 billing or to

otherwise reduce its rates to the level approved by the Commission in its Order Approving Settlement Among Certain Parties and Ruling on Application for Adjustments in Rates dated December 8, 2015. Such a provision would fully protect the customers from any excessive charges and enable DIUC to avoid the unnecessary cost of securing additional bond coverage.

DIUC respectfully requests the Commission enter an order approving the proposed bond in response to DIUC's request pursuant to S.C. Code Ann. § 58-5-240.

Respectfully submitted,

By: s/Thomas P. Gressette, Jr.
Thomas P. Gressette, Jr.
(843) 727-2249 direct
tpg@p-tw.com
G. Trenholm Walker
(843) 727-2208 direct
gtw@p-tw.com

PRATT-THOMAS WALKER, P.A.
16 Charlotte Street
Charleston, SC 29403

ATTORNEYS FOR DAUFUSKIE ISLAND
UTILITY COMPANY, INC.

February 12, 2016
Charleston, South Carolina

C. DUKES SCOTT
EXECUTIVE DIRECTOR

1401 Main Street, Suite 900
Columbia, SC 29201



NANETTE S. EDWARDS
DEPUTY EXECUTIVE DIRECTOR

Phone: (803) 737-0800
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shudson@regstaff.sc.gov

*Shannon Bowyer Hudson
Deputy Chief Counsel for ORS*

February 11, 2016

VIA ELECTRONIC FILING

Jocelyn G. Boyd, Esquire
Chief Clerk & Administrator
Public Service Commission of South Carolina
101 Executive Center Drive, Suite 100
Columbia, South Carolina 29210

Re: Application of Daufuskie Island Utility Company, Incorporated for Approval of an Increase for Water and Sewer Rates, Terms and Conditions
Docket No. 2014-346-WS

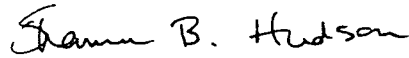
Dear Ms. Boyd:

Order No. 2016-90 requested the South Carolina Office of Regulatory Staff ("ORS") to provide input on a bond amount to be secured by Daufuskie Island Utility Company, Inc. ("DIUC").

ORS recommends \$1,218,141.27 for the bond amount. This recommendation is premised on DIUC opting to place into effect the full revenue request from its Application for 18 months. Specifically, ORS derived this number by taking the difference between the approved revenue amount from Order No. 2015-846 and DIUC's requested revenue amount applied to 18 months and with 12% interest. ORS utilized 18 months because if an appeal ensues, it proceeds directly to the South Carolina Supreme Court and will likely take less than two years but may take longer than one year for completion.

In addition, if an appeal proceeds and DIUC is unsuccessful, the 12% interest on refunds to customers is required per S.C. Code Ann. § 58-5-240(D). The enclosure shows details of ORS's calculation.

Sincerely,



Shannon Bowyer Hudson

Enclosure

cc: G. Trenholm Walker, PA, Esquire (via E-mail)
Thomas P. Gressette, Jr., Esquire (via E-mail)
John F. Beach, Esquire (via E-mail)
John J. Pringle, Jr., Esquire (via E-mail)
Lyndey Ritz Zwing, Esquire (via E-mail)
M. John Bowen, Jr., Esquire (via E-mail)
Margaret M. Fox, Esquire (via E-mail)
John F. Guastella (via E-mail)
F. David Butler, Esquire (via E-mail)
Joseph Melchers, Esquire (via E-mail)

ORS BOND CALCULATION FOR DIUC USING 18 MONTHS

I. DIUC's Application revenue:

\$2,267,721	Total Annual Revenue Requested - Application for the Approval of an Adjustment in Rates and Charges, Schedule A-4
(\$11,025)	Application for the Approval of an Adjustment in Rates and Charges, Schedule A-4 includes \$63,229 in miscellaneous revenues, of which, \$11,025 for tap fees and a returned check fee are not impacted by a change in quarterly rates.
(A) <u>\$2,256,696</u>	Application annual revenue generated from requested rate structure and amount from which to deduct Commission Order No. 2015-846 revenue.

II. Commission Order No. 2015-846 allowed revenue:

\$1,536,375	Total Annual Revenue Allowed
(\$11,025)	The same tap fees and returned check fee are removed from miscellaneous revenue of \$37,508 since these amounts are not impacted by a change in quarterly billing rates. The remaining miscellaneous revenue amounts: \$9,416 in late fees and \$17,067 in availability fees are impacted by a change in the quarterly billing rates and remain for the bond calculation.
(B) <u>\$1,525,350</u>	Amount to be deducted from DIUC Application Revenue

III. 18 Month Revenue Calculation:

(A) \$2,256,696	
(B) <u>(\$1,525,350)</u>	
\$731,346	
x 1.5	Convert Annual to 18 Mos.
<u>\$1,097,019</u>	Bond Amount for 18 Mos. without Interest

IV. 18 Month Revenue with 12% Interest:

Quarter	Qtrly Revenue Collected	Current Liability	Current Interest	Total Bond Amount
1	\$ 182,836.50	\$ 182,836.50	\$ 5,485.10	\$ 188,321.60
2	\$ 365,673.00	\$ 371,158.10	\$ 11,134.74	\$ 382,292.84
3	\$ 548,509.50	\$ 565,129.34	\$ 16,953.88	\$ 582,083.22
4	\$ 731,346.00	\$ 764,919.72	\$ 22,947.59	\$ 787,867.31
5	\$ 914,182.50	\$ 970,703.81	\$ 29,121.11	\$ 999,824.92
6	\$ 1,097,019.00	\$ 1,182,661.42	\$ 35,479.84	~~\$1,218,141.27~~

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2014-346-WS

IN RE:)
)
Application of Daufuskie Island Utility Company, Inc.)
For Approval of a New Schedule of Rates and)
Charges for Water and Sewer Service)

**DIUC REPLY TO INTERVENORS' RESPONSE
TO PETITION FOR APPROVAL OF BOND**

Pursuant to S.C. Code Ann. 58-5-240, DIUC intends to put the rates requested in its Application into effect during the pendency of its further appeals and seeks an Order from the Commission approving its proposed bond and surety. Intervenor filed a Response asserting the bond should "be based on *two* years of additional revenue (\$1,400,000), and include 12% annual interest (\$84,000) for two years (total interest of \$168,000), resulting in a bond amount of \$1,568,000." Once again, the Intervenor asks this Commission to endorse an extreme position unsupported by law or fact.

In support of their request that the Commission require a bond for the exaggerated period of two years, Intervenor cites Orders of the Commission from 2010 and 2005. However, the Intervenor fails to inform the Commission that neither of those appeals took two years.

In the 2010 case, the Supreme Court remanded the matter to the Commission within 18 months. See *Exhibit One*, Order 2010-543 Approving Surety Bond dated August 12, 2010 and Order 2012-158 Scheduling Hearing After Remand dated February 22, 2012. In the other matter

cited by Intervenor, the appeal was remanded to the Commission within five months. See *Exhibit Two*, Order 2005-450 Granting Motion to Set Bond dated August 25, 2005 and Order 2006-89 dated February 8, 2006 (referencing Commission hearing held after remand on January 24, 2006). It is likewise not likely that the appeal in this matter will take two years. The proposed bond amount is sufficient as to time.

In requesting the bond amount be more than doubled to \$1,580,000, Intervenor's Response also ignores the manner in which new rates will be noticed, billed, and collected on a quarterly basis.

Once a reasonable bond is approved allowing DIUC to implement its originally requested rates, DIUC will mail its customers a 30-day notice of implementation of the Application's 108.9% increase. It is likely that increase will take effect no sooner than the beginning of the second quarter, which is April 1, 2016. Second quarter bills, however, will not be mailed until after July 1, 2016 and will be due within 30 days. The next three quarterly billings would be on October 1, 2016, January 1, 2017 and April 1, 2017. Thus, it will take until May of 2017 for DIUC customers to have paid a full year of the DIUC rates. That is 16 months from now. The one-year \$700,000 bond amount is more than enough to assure refunds, with interest properly calculated.

The pending appeal of the *Sabry* matter as well as cost of the bond must also be considered. The Commission's Order states that, "Should the Court rule in favor of the Company, then the issue of ownership of this property and possible inclusion in rate base may be clearer for further examination in a future rate case." A decision from the Court of Appeals clarifying this issue could come within the next three to six months. The impact of adding the cost of those facilities to DIUC's revenue base is estimated at approximately \$200,000, which

would be a direct reduction of the level of refunds potentially due. Additionally, the one-year \$700,000 bond is expected to cost in excess of \$10,000. Requiring DIUC to double the bond amount and double the time period, as requested by Intervenor, will likewise increase the cost of the bond and subject the Utility to unreasonable burden. If DIUC obtains the one-year bond, the Commission can certainly revisit the matter at the end of the first year to determine what additional requirements, if any, should be imposed or if the bond even needs to be renewed. There is simply no need to require DIUC to purchase an unnecessary year of bond coverage.

The bond and surety proposed by DIUC in its Petition for Approval of Bond complies with all statutory requirements. The additional time and increased bond amount requested by Intervenor is totally unnecessary and unduly burdensome. Therefore, DIUC respectfully requests the Commission enter an order approving the proposed bond in response to DIUC's request pursuant to S.C. Code Ann. § 58-5-240.

Respectfully submitted,

By: s/ Thomas P. Gressette, Jr.

Thomas P. Gressette, Jr.

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16 Charlotte Street

Charleston, SC 29403

ATTORNEYS FOR DAUFUSKIE ISLAND
UTILITY COMPANY, INC.

February 2, 2016

Charleston, South Carolina

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2014-346-WS

IN RE:	)	
	)	
Application of Daufuskie Island Utility	)	
Company, Inc. for Approval of an	)	RESPONSE TO PETITION FOR
Adjustment for Water and Sewer	)	APPROVAL OF BOND
Rates, Terms, and Conditions	)	

Haig Point Club and Community Association, Inc. ("HPCCA"), Melrose Property Owner's Association, Inc. ("MPOA"), and Bloody Point Property Owner's Association ("BPPOA") (together "POAs") hereby respond briefly to the Petition for Approval of Bond ("Petition") filed by Daufuskie Island Utility Company, Inc. ("DIUC") on January 20th.

DIUC's calculation of a \$700,000 bond does not include the interest required by S.C.

Code Ann. § 58-5-240 (D):

All increases in rates put into effect under the provisions of this section which are not approved and for which a refund is required shall bear interest at a rate of twelve percent per annum. The interest shall commence on the date the disallowed increase is paid and continue until the date the refund is made.

Accordingly, \$700,000 would bear annual interest of \$84,000.

In addition, DIUC's calculation presumes a timeframe during which this matter will be on appeal- one year- that is inconsistent with past Commission practice using *two* years to calculate an appropriate bond. DIUC's calculation of additional revenue presumes that the rates would be in effect while this matter is on appeal for only one year (\$175,000 per quarter x 4 quarters= \$700,000). However, this Commission has approved bonds that calculate

“additional annual revenue” based upon a two-year appeal period.¹ Accordingly, in order to ensure that DIUC customers are fully protected in the event a refund is appropriate following an unsuccessful appeal, a “reasonable amount” would be based on *two* years of additional revenue (\$1,400,000), and include 12% annual interest (\$84,000) for two years (total interest of \$168,000), resulting in a bond amount of \$1,568,000.

For the foregoing reasons, the POAs request that the Commission consider the above in setting any bond, and grant such other relief as is just and proper.

Respectfully submitted,

ADAMS AND REESE, LLP

BY: s/ John J. Pringle, Jr.
John J. Pringle, Jr.
1501 Main Street, 5th Floor
Columbia, SC 29201
Telephone: (803) 254-4190
Facsimile: (803) 799-8479
jack.pringle@arlaw.com

Attorneys for Haig Point Club and
Community Association, Inc., Melrose
Property Owner’s Association, Inc. and
Bloody Point Property Owner’s Association

January 8, 2016
Columbia, South Carolina

¹ See *In Re: Application of United Utility Companies, Incorporation for Adjustment of Rates and Charges and Modification to Certain Terms and Conditions for the Provision of Water and Sewer Service*, “Order Approving Surety Bond,” Docket No. 2009-479-WS, Order No. 2010-543 issued August 12, 2010 (approving proposed bond “based on the additional amount of revenues which would be generated had the Commission approved the requested increase with the agreed upon adjustments *over a period of two years*”); See also *In Re: Application of Total Environmental Solutions, Incorporated (TESI) for Approval of an Adjustment of Rates and Charges for Water and Sewer Services*, “Order Granting Motion to Set Bond,” Docket No. 2004-90-W/S, Order No. 2005-450 issued August 25, 2005 (calculating the bond assuming “that the appeal will take two years”

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2014-346-WS

IN RE:)
Application of Daufuskie Island Utility Company, Inc.) AFFIDAVIT OF
For Approval of a New Schedule of Rates and) JOHN F. GUASTELLA
Charges for Water and Sewer Service)

Personally appeared before me John F. Guastella, who being duly sworn, testifies as follows:

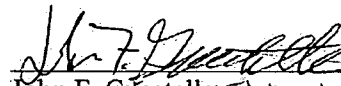
1. My name is John F. Guastella.
2. I offer this Affidavit as testimony, under oath and under penalty of perjury, stating and affirming that I have personal knowledge of the facts set forth herein, that I am competent to testify to the matters set forth herein, and that all statements included herein are truthful and accurate.
3. I am President of Guastella Associates, LLC ("Guastella").
4. Guastella is the manager of Daufuskie Island Utility Company, Inc. ("DIUC").
5. Guastella has been the manager of DIUC since July 9, 2008. I have served as the President of Guastella throughout this period and I have been personally involved the day-to-day operations as well as the management activities and decisions of DIUC.
6. As President of Guastella, the manager of DIUC, I am responsible for the day-to-day management of DIUC which includes maintaining its books, records, and subscriber account information.
7. On June 6, 2015, DIUC filed an Application for the Approval of an Adjustment in Rates and Charges for Water and Sewer Service ("the Application"). The Application seeks this Commission's approval of a new schedule of rates and charges for water and sewer service.
8. On December 8, 2015, the Commission entered its Order Approving Settlement Among Certain Parties and Ruling on Application for Adjustments in Rates ("Order"). The Order does not authorize the increased rates as requested by DIUC.

9. The Order's rates do not provide sufficient income for DIUC to accumulate funds for payment of its 2016 taxes due in January 2017, as well as other expenses necessary for the adequate operation of the water and sewer systems. The lack of income allowed to DIUC by the Order will put DIUC in default on its \$2,500,000 term loan and will preclude DIUC's ability to repay its \$500,000 line of credit.
10. On December 21, 2015, DIUC appealed the Order by filing with the Commission a Petition for Reconsideration and/or Rehearing.
11. On January 13, 2016, the Commission entered a Directive denying the Petition for Reconsideration and/or Rehearing.
12. DIUC intends to pursue additional appeal(s) of the Order.
13. DIUC intends to put the rates requested in its Application into effect though conclusion of all appeals and/or proceedings on remand, if any.
14. DIUC is in the process of securing a bond in the amount of \$700,000 from Hanover Insurance Company. The application process involves submission of personal financial statements from the individuals who own the stockholder of DIUC. Hanover Insurance Company also serves as surety for the water and the sewer performance bonds DIUC maintains in compliance with state requirements.
15. The new rates would be reflected in the April 1, 2016, billing and the bond would be submitted to the Commission prior to that billing.
16. After DIUC implements its proposed rates, it should collect approximately \$175,000 per quarter in addition to the rates recently authorized by the Commission, except for the first quarter which would be prorated between the different rates. Therefore, the proposed bond provides ample coverage to secure any repayment subsequently ordered by the Commission.
17. I understand and agree on behalf of DIUC that if DIUC implements the increased rates requested by its June 9, 2015, Application for the Approval of an Adjustment in Rates and Charges for Water and Sewer Service ("the Application") and included schedule, DIUC does so conditioned upon the refund, in a manner to be prescribed by order of the Commission, to the persons, corporations, or municipalities, respectively, entitled to the amount of the excess, if the rate or rates put into effect are finally determined to be excessive.
18. I further understand and agree on behalf of DIUC that during any period in which DIUC charges these increased rates under bond, it should maintain records or other evidence of

payments made by its subscribers or patrons under the rate or rates which the utility has put into operation in excess of the rate or rates in effect immediately prior to the filing of the Application and included schedule.

19. DIUC is able to account for and properly manage the records necessary to document payments made by its subscribers or patrons under the rates which the utility has put into operation in excess of the rates in effect immediately prior to the filing of the Application and included schedule.
20. I further understand and agree on behalf of DIUC that all increases in rates which are not approved and for which a refund is required shall bear interest at a rate of twelve percent per annum. The interest shall commence on the date the disallowed increase is paid and continue until the date the refund is made.

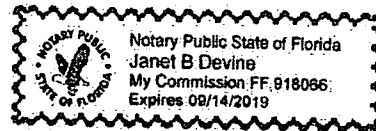
FURTHER AFFIANT SAYETH NOT.


John F. Guastella F.D.L. #6234-116-40-221-0
01-2018

SWORN to before me this 20 day of January, 2016.


Notary Public for the State of Florida

My Commission Expires: 9/14/2019



BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2014-346-WS

IN RE:)
)
Application of Daufuskie Island Utility Company, Inc.)
For Approval of a New Schedule of Rates and)
Charges for Water and Sewer Service)

PETITION FOR APPROVAL OF BOND PURSUANT TO S.C. CODE ANN. § 58-5-240

On June 9, 2015, pursuant to S.C. Code Sections 58-5-210 *et seq.*, and S.C. Code Ann. Regs. 103-514.4, Regs. 103-712.4, and Regs. 103-834 of the Commission's Rules of Practice and Procedure, Daufuskie Island Utility Company, Inc. ("DIUC" or "the Company") filed an Application for the Approval of an Adjustment in Rates and Charges for Water and Sewer Service ("the Application"). The Application seeks this Commission's approval of a new schedule of rates and charges for water and sewer service.

On December 8, 2015, the Commission entered its Order Approving Settlement Among Certain Parties and Ruling on Application for Adjustments in Rates ("Order"). The Order does not authorize the increased rates as requested by DIUC; instead, the Order incorporates every adjustment, without exception, proposed by ORS. DIUC maintains these adjustments and therefore the Order are without factual foundation and ignore known and measurable expenses resulting in a stated rate of return and operating margin that are entirely illusory.

On December 21, 2015, DIUC appealed the Order by filing with the Commission a Petition for Reconsideration and/or Rehearing. DIUC's Petition succinctly explains that the

Order will force DIUC into default because the Order's approved rates do not provide DIUC sufficient income. On January 13, 2016, the Commission entered a Directive denying the Petition for Reconsideration and/or Rehearing.

Pursuant to S.C. Code Ann. 58-5-240, DIUC intends to put the rates requested in its Application into effect during the pendency of its further appeals. The new rates would be reflected in the April 1, 2016, billing which would be prorated between the two rates. The bond would be submitted to the Commission prior to that billing.

DIUC is in the process of securing a bond in the amount of \$700,000 from Hanover Insurance Company. The bond application process involves submission of personal financial statements from the individuals who own the stock of DIUC. *See* Guastella Affidavit at ¶ 14. Hanover Insurance Company also serves as surety for the water and the sewer performance bonds DIUC maintains in compliance with state requirements. *Id.*

The Order allows total revenue of \$1,536,375 of which \$37,508 is miscellaneous revenue. *See* DIUC's Petition for Reconsideration and/or Rehearing at 4 and Hearing Exhibit 3 at WJM-2. After subtracting this miscellaneous revenue, the remaining expected revenue to be generated from the rate structure is \$1,498,867. DIUC's Application seeks total revenue of \$2,267,721, which includes miscellaneous revenues of \$63,229. *See* Application for the Approval of an Adjustment in Rates and Charges, Schedule A-4. After subtracting this miscellaneous revenue, the remaining expected revenue to be generated from the DIUC rate structure is \$2,204,492. The difference between the Order's allowed non-miscellaneous revenue of \$1,498,867 and DIUC's proposed non-miscellaneous revenue of \$2,204,492 is \$705,625. The bond application, then, seeks issuance of coverage in the amount of \$700,000.

The only requirement for a bond under S.C. Code Ann. § 58-5-240 is that it be a “reasonable amount approved by the Commission, with sureties approved by the Commission.” The proposed bond amount is reasonable because it provides more than ample protection for any potential repayment(s). Once DIUC implements its proposed rates, it should collect approximately \$175,000 per quarter in addition to the rate currently authorized by the Commission. *See* Guastella Affidavit at ¶ 16. Coverage in the amount of \$700,000 will provide more than ample protection pending the appeal in this matter. Additionally, Hanover Insurance Company is a reliable and sound surety worth of the Commission’s approval.

For these reasons, DIUC respectfully requests the Commission enter an order approving the proposed bond in response to DIUC’s request pursuant to S.C. Code Ann. § 58-5-240.

Respectfully submitted,

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ATTORNEYS FOR DAUFUSKIE ISLAND
UTILITY COMPANY, INC.

January 20, 2016
Charleston, South Carolina

**PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA
COMMISSION DIRECTIVE**

ADMINISTRATIVE MATTER	☐	DATE	<u>January 13, 2016</u>
MOTOR CARRIER MATTER	☐	DOCKET NO.	<u>2014-346-WS</u>
UTILITIES MATTER	☒	ORDER NO.	<u></u>

SUBJECT:

DOCKET NO. 2014-346-WS - Application of Daufuskie Island Utility Company, Incorporated for Approval of an Increase for Water and Sewer Rates, Terms and Conditions – Staff Presents for Commission Consideration the Petition for Reconsideration and/or Rehearing Filed on Behalf of the Applicant.

COMMISSION ACTION:

Daufuskie Island Utility Company, Inc. ("DIUC" or "the Company" or "the Utility") has petitioned for Reconsideration and/or Rehearing of Order No. 2015-846 in this Docket. I move that the Petition be denied.

First, the Company has stated that it will default on its obligations with SunTrust Bank, and that its ability to provide service will be threatened if forced to implement rates required by Order No. 2015-846. In support of this contention, DIUC references the covenants contained in the DIUC loan documents for SunTrust Bank, and an attachment to the Petition entitled "Impact of Commission's Order Accepting ORS/POA Settlement." The difficulty is that neither the Covenants nor the Attachment referred to by the Company were ever pre-filed in advance of the hearing as required by Commission regulations, nor were they ever introduced into evidence in the hearing in this matter. The utility simply made bare assertions during the hearing. Therefore, with the documents not in evidence, the other parties were unable to cross-examine the Company regarding them.

In the alternative, the Utility asks that we revise our rate Order to substitute the calculations and analysis from the Company's Proposed Order regarding property taxes, management fees, rate case expenses, bad debts, and rate base. The arguments presented by the Company do not present any new information for our consideration, and the Commission's holdings were thoroughly discussed in Order No. 2015-846. Further, the conclusions reached by the Commission are supported by the substantial evidence of record. Also, the references to numbers contained in the Company's previous rate case are not contrary to law. Consequently, I move that we reject the Company's second ground for rehearing and/or reconsideration.

Also, in contrast to the allegations contained in the Petition, I believe that Order No. 2015-846 set rates sufficient to yield a reasonable return on the value of the property found to meet utility rate-making standards which is used to render service to the Company's ratepayers. We approved a return on equity of 9.28%, a return on rate base of 7.44%, and an operating margin of 16.18%, based on the new rates, fees, and charges approved for the Utility, so the argument that the rates set are not sufficient to yield a reasonable return are without merit. I would note that, under ratemaking principles, the Commission fully considered the Company's long-term debt and cost of debt when determining the required return on equity. The operating experience, rate base and rate of return approved in this case under the settlement agreement is sufficient to provide adequate revenues for the Company to service its debt and provide an appropriate return to the shareholders. The Commission only allows a Utility an opportunity to earn a reasonable rate of return, and the opportunity has been presented in this case. Such a return is not, however, guaranteed.

Based on these grounds, I move that the Company's Petition for Reconsideration and/or Rehearing of

Order No. 2015-846 be denied.

PRESIDING: Hall

SESSION: Regular

TIME: 2:00 p.m.

	MOTION	YES	NO	OTHER
ELAM	☐	☒	☐	
FLEMING	☒	☒	☐	
HALL	☐	☒	☐	
HAMILTON	☐	☒	☐	
HOWARD	☐	☒	☐	
RANDALL	☐	☒	☐	
WHITFIELD	☐	☒	☐	

(SEAL)



RECORDED BY: J. Schmieding

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2014-346-WS

IN RE:)
)
Application of Daufuskie Island Utility Company, Inc.)
For Approval of a New Schedule of Rates and)
Charges for Water and Sewer Service)

**DIUC’S RETURN TO ORS’S ANSWER TO AND INTERVENORS’ OPPOSITION
TO THE PETITION FOR RECONSIDERATION AND/OR REHEARING**

Acting in concert, ORS and the Intervenor presented this Commission with a “settlement agreement” and proposed rates that do not provide DIUC sufficient funds to operate. On December 8, 2015, the Commission entered its Order Approving Settlement Among Certain Parties and Ruling on Application for Adjustments in Rates (“Order”). That Order violates state and federal law by failing to provide DIUC with sufficient revenue to operate and the Order jeopardizes water and sewer service to the residents of Daufuskie Island.

To demonstrate the problems inherent in the “settlement agreement” and the Order adopting it, DIUC filed a Petition for Reconsideration and/or Rehearing on December 21, 2015. DIUC’s Petition succinctly presents the practical results of this flawed “settlement agreement.” The Petition includes one attachment labeled *Attachment A* and captioned *Impact of Commission’s Order Accepting ORS/POA Settlement*.

In response to DIUC’s Petition for Reconsideration and/or Rehearing, both ORS and Intervenor submitted short filings opposing the Petition. See ORS Answer to DIUC Petition for

Reconsideration and/or Rehearing and Intervenors' Response in Opposition to Petition for Reconsideration. Reserving all rights to oppose the assertions of ORS and Intervenors, DIUC files this Return and respectfully presents the following.

1. The Petition and Attachment.

Unable to mount a plausible argument that the approved rates will not cause a default on the SunTrust loan, ORS and Intervenors seek to distract the Commission from the substance of DIUC's Petition by arguing that somehow the issue of default on the SunTrust loan is not part of the record before the Commission. That is simply not accurate.

At the hearing DIUC witness John Guastella testified:

[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.

(R. p. 186, ll. 12-21) (emphasis added). As Mr. Guastella explained, because the "settlement agreement" (and therefore the Order) 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.

Commissioner Fleming also elicited testimony from Mr. Guastella on the issue of default, specifically regarding the SunTrust loan. Mr. Guastella testified:

What I'm a little more worried about is, the bank is looking at our operations now, and they are seeing us with a shortfall in meeting their coverage requirements. (R. p. 254, ll. 2-4).

[. . .]

... well, if you kind people accept ORS's adjustments, our rate base is going to be wiped out, essentially. (R. p. 255, ll. 8-10).

[. . .]

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. (R. p. 255, ll. 12-19).

[. . .]

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. (R. p. 256, l. 23 to R. p. 257, l. 7).

ORS and the Intervenors both had the opportunity to cross examine Mr. Guastella as to the basis of these statements 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. 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.

ORS and Intervenors also claim DIUC failed to tell the Commission at the hearing about the precise default that will result from the Order so reference to default should not be considered by the Commission. Obviously, DIUC could not tell the Commission about the exact impact of the Order until the Order was issued and its adjustments made available to DIUC. DIUC is certainly allowed to explain the impact of the Order in its Petition to Reconsider by directing the Commission to the costs and expenses in the record.

In another attempt to prevent the Commission from considering the severe financial duress the approved rates impose on DIUC, Intervenors cite *Kiawah Prop. Owners Group v.*

Pub. Serv. Comm'n, 359 S.C. 105, 113, 597 S.E.2d 145, 149 (2004) for the proposition that DIUC cannot raise issues in a Petition for Reconsideration that were not raised during the proceeding. However, as explained above, DIUC is not raising new issues. Default of the loan obligations to SunTrust was the subject of much unchallenged testimony by DIUC witness John F. Guastella. After choosing to ignore the testimony at the hearing as to the inevitable default and deciding not to cross examine about it, ORS and Intervenors cannot now assert such information is not in or should not be considered to be part of the record.

Intervenors also complain they did not have the opportunity to “test . . . the inputs and assumptions” in *Attachment A* to the Petition for Reconsideration. This is not an accurate statement. *Attachment A* merely reflects the \$1,536,375 of combined water and sewer revenues allowed by the Order then subtracts the actual cost of operations DIUC will incur and book. The actual operating expenses of \$1,355,363 listed in the Attachment are those reflected in DIUC’s Proposed Order and the filings in this case. There are no surprises here.

ORS further complains that the Petition for Reconsideration should not reference the terms of DIUC’s loan with SunTrust because the terms are not relevant. *See Answer* at 1-2. Of course DIUC’s loan obligations, financing, and debt service are relevant; page after page in the record specifically address these topics.

Even more important are the responsibilities of the Commission to make sure that there are fair and reasonable rates that allow a utility to provide good water and sewer service to its customers and that afford the owner a reasonable rate of return. Forcing the utility into an inevitable default with SunTrust on its total loans of \$3,250,000 jeopardizes the ability of the utility to provide service. Establishing rates that ignore the full amount of significant expenses that are known and measureable, simply to accommodate the unrealistic adjustments of ORS and

the Intervenor, deprives the owner of a fair and reasonable return. Under the Order, the individual principals in the owner will be unfairly exposed to personal liability on the guaranties SunTrust required. *See* R. p. 184, ll. 16-19 and R. p. 253, ll. 23-24.

Next, ORS asserts the SunTrust loan cannot be discussed in the Petition for Reconsideration because ORS's witness, Dr. Carlisle, "was not privy to these records and did not have the benefit of their review." ORS Answer at 2. However, the testimony cited by ORS for this position is not even related to the terms of the SunTrust loan:

Q [WALKER]: They almost had Wells Fargo to the alter; they dropped them. Then they got with SunTrust and they had to do the significant reorganization of the company and a complete redo of surveys demonstrating that every asset was either titled in the company or there was an easement for that. And that is a considerable undertaking in order to satisfy the requirements of a lender to obtain the loan, correct?

A [CARLISLE]: I would agree that sounds like a considerable undertaking. Not being privy to all the records, since they were outside the test year, I cannot and do not have the benefit of my colleagues' review of them.

(R. p. 534, ll. 9-20). From this exchange, it is clear that Dr. Carlisle was asked about the portions of the record demonstrating the considerable undertakings of DIUC and the corresponding expense incurred by DIUC simply to obtain financing, to refute ORS's adjustment limiting debt expense solely to the rate of interest. In response, Dr. Carlisle testified he did not have the benefit of his colleagues' review of records demonstrating this considerable effort to obtain financing.

ORS's Answer would have the Commission believe that DIUC somehow denied Dr. Carlisle access to records. To the contrary, if Dr. Carlisle was not privy to records, it was a failure of ORS to provide him with that information. DIUC provided ORS with the SunTrust Loan Covenants on June 26, 2015, in response to Continuing Information Request 1.77.

On August 26, 2015, DIUC also provided Intervenor with the SunTrust Loan Covenants by serving a CD containing a copy of all of DIUC's responses to ORS Information Requests, including the response to Continuing Information Request 1.77. Therefore, long before the hearing both Intervenor and ORS had possession of copies of the SunTrust loan documents that include the loan covenants. There is certainly no prejudice to either ORS or the Intervenor from DIUC's Petition or its Attachment.

The problem before the Commission is not that DIUC presents new issues or even new data in its Petition for Reconsideration. The problem is that the December 8, 2015, Order adopting the "settlement agreement" will not allow DIUC to earn enough income to meet its obligations which will put DIUC in default on its existing financing with SunTrust. For the Commission to refuse to consider the entire Petition for Reconsideration and Attachment, as suggested by ORS and Intervenor, would be to oblige them in their entreaties that the Commission overlook the hard and known expenses of DIUC and, instead, adopt a series of adjustments that in fact do not render the rate of return or operating margin they proclaim. Succumbing to their position will only force DIUC to engage in further costly and inefficient appeals in order to obtain lawful rates, all the while putting the sound operation of the utility at risk.

2. Adjustments Addressed in ORS's Answer and Intervenor's Opposition.

ORS's position on DIUC's property taxes reflects an inexplicable abandonment of the well-established rate setting concept of adjusting the test year for known and measurable changes, without which DIUC cannot cover the *actual cost* of property taxes even for the first year the new rates are in effect. Referring to Ms. Gearheart's testimony, ORS's position is that 2015 is a future year and DIUC has not been billed for 2015 taxes. *See* ORS Answer at 2. Both

statements are simply incorrect. DIUC was billed and has been paying for 2015 property taxes as part of the total installment agreement with Beaufort County.

ORS also states that it “does not know what the future taxes will be.” ORS Answer at 2. This position completely misses the purpose and intent of rate setting principles and practice, which is to establish the ongoing cost of providing service. In addition to the binding agreement with Beaufort County for the 8-year installment payments for the 2012, 2013, 2014 and 2015 property taxes, it is a known, indisputable fact that DIUC’s revenues must now —this year on a current basis— include accruals for 2016 property taxes. Both Mr. Guastella and Ms. Walls testified to that fact. Additionally, Ms. Walls warned that if accruals for 2016 property taxes, including ongoing installment payments for past taxes under the favorable settlement agreement with the Beaufort County, are not now allowed, DIUC will incur 15% penalties annually, and possibly other consequences. (R. p. 84, ll. 11-23 and R. p. 85, ll. 1-5).

The Order must be revised to establish rates sufficient to cover these known and therefore reasonably anticipated property tax liabilities.

ORS also significantly reduced its realistic adjustment to bad debt allowance to a far lower amount for no other reason than to reach its deal with the Intervenor. Simply reciting this negotiated result does not provide a factual basis as to why it was proper for ORS to disregard its own examination of DIUC’s books and records that demonstrated to ORS’s satisfaction the actual bad debt level should be in excess of \$100,000 per annum. This reduction is further evidence of why the Commission cannot accept “settlements” between ORS and parties without the consent of the Applicant because it gives the impression of validity to the adjustments that are part of the “settlement.” The only reliable evidence is that the approximate \$100,000 for bad

debts reflects the utility's known and measureable real loss. (R. p. 136, ll. 21-25 to R. p. 137, ll. 1-10).

ORS has still not provided any narrative or quantitative analysis that justifies its adjustments to limit recovery of the management fees charged by Guastella Associates. ORS continues to ignore the unrefuted evidence that:

1. DIUC's cost of operations, including management fees, compares favorably to other South Carolina water and wastewater utilities (R. p. 179, ll. 19 to R. p. 181, l. 5);
2. GA's capital fees are less than half of such typical fees (R. p. 206, ll. 7-14); and
3. Despite the three year effort to obtain essential financing, the existing debt rate, including GA's costs, is only 6.2%. That is less than the specified 6.5% effective debt interest rate allowed in the approved settlement of the last rate case. (R. p. 254, ll. 13-20).

The settlement of the last DIUC rate case (with the consent of *all* parties) and its approval by the Commission makes no mention of GA's management fees. That Order cannot properly be used as a basis for limiting the management fees allowed in this case. In sum, ORS's Answer provides no new arguments regarding management fees and charges due to GA. The Order should be modified as requested.

With respect to rate case expenses, ORS's Answer asserts that ORS expressed its concern about the level of such expenses during its audit. Discussing a matter during an audit or audit exit conference does not relieve ORS from providing the Commission with evidence that the challenged expenses are unreasonable. ORS provided no benchmark for measuring the reasonableness of the amounts due Guastella Associates under its management agreement. As the record reflects, DIUC was required by ORS to respond to voluminous discovery and to address the testimony of multiple witnesses and complex issues. ORS allowed only about 20%

of DIUC's actual costs under the management agreement, but still has not presented any valid argument for the reduction. On this subject, the Order is not supported by the record and should be changed.

ORS admits in its Answer that Mr. Sabry is not paying taxes on the elevated storage tank. 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. 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, that county's assessment for all the real property owned by Sabry does not include it, and DIUC also has an easement over the parcel for its utility facilities.

Also, contrary to ORS's Answer, DIUC did not revise its annual reports to the Department of Revenue ("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. 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. Finally, there is absolutely nothing in the record to suggest that DIUC claimed a lack of ownership of its elevated storage tank. Indeed, the proration of the \$5,000,000 rate base allocated all plant, including the elevated storage tank, as reflected in the report submitted to DOR. *See* R. at Exhibit 20, p. 2 ("Adjusted to reflect the rate base allowed in Docket No. 2011-229-WS.").

Conclusion

If the Order remains unchanged, DIUC cannot meet its obligations and will be in default of its debt service obligations, including its contractual debt obligation to SunTrust. At the hearing, John Guastella for DIUC testified that the adjustments proposed by the ORS/Intervenors and later accepted by the Order:

...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.

...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.

But the rate increase of the proposed settlement, that \$462,000, we're not going to be able to make debt service payments....

...the bank is looking at our operations now, and they are seeing us with a shortfall in meeting their coverage requirements.

DIUC, therefore, clearly provided ORS, Intervenors, and the Commission notice that the adjustments proposed by the "settlement agreement" and later accepted by the Order would result in default under the SunTrust loan requirements. Neither ORS nor the Intervenors asked Mr. Guastella to further explain his testimony, leaving his conclusions uncontradicted in the record. Therefore, the Petition and its Attachment are properly before the Commission.

Additionally, as set forth in the Petition for Reconsideration and in this Return, the Order's conclusions as to property taxes, management fees, rate case expenses, bad debts, and rate base are without factual foundation and ignore known and measurable expenses. If allowed to stand, the Order will put DIUC in default.

DIUC's Proposed Order submitted November 15, 2015, should be substituted in its entirety to replace the Commission's December 8, 2015, Order. Alternatively, the Commission

should revise the December 8, 2015, Order to substitute the information from DIUC's Proposed Order as to property taxes, management fees, rate case expenses, bad debts, and rate base. Should the Commission prefer to schedule a rehearing of this matter, DIUC remains willing to proceed expeditiously.

Respectfully submitted,

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ATTORNEYS FOR DAUFUSKIE ISLAND
UTILITY COMPANY, INC.

January 12, 2016
Charleston, South Carolina

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2014-346-WS

IN RE:

Application of Daufuskie Island Utility
Company, Inc. for Approval of an
Adjustment for Water and Sewer Rates,
Terms, and Conditions

)
)
)
) **RESPONSE IN OPPOSITION TO PETITION**
) **FOR RECONSIDERATION**
)
)

Haig Point Club and Community Association, Inc. ("HPCCA"), Melrose Property Owner's Association, Inc. ("MPOA"), and Bloody Point Property Owner's Association ("BPPOA") (together "POAs") hereby responds to the Petition filed by Daufuskie Island Utility Company, Inc. ("DIUC") on December 21st seeking reconsideration or rehearing of Commission Order No. 2015-846 (the "Order"). As set out herein, the Commission should deny the Petition for Reconsideration because the factual findings of the Commission are supported by substantial evidence and the Commission committed no error of law.

I. INTRODUCTION

The POAs support those arguments made by the South Carolina Office of Regulatory Staff ("ORS") in opposition to the Petition, and will not repeat those here. However, several specific points further demonstrate why reconsideration or rehearing is unwarranted. As set out herein, 1) substantial evidence in the record supports those adjustments approved by the Commission in the Order; 2) DIUC's contentions related to its Covenants are not properly before the Commission; and 3) The Commission's use of DIUC's previous rate case as a "starting

point” for its determinations in this case is not contrary to law.

II. ARGUMENT

A. The Order is Supported by Substantial Evidence and is Not Clearly Erroneous

The Commission’s determinations in the Order are consistent with South Carolina and should not be reconsidered:

The PSC is considered the “expert” designated by the legislature to make policy determinations regarding utility rates; thus, the role of a court reviewing such decisions is very limited. Therefore, the party challenging a PSC order must establish that (1) the PSC decision is not supported by substantial evidence and (2) the decision is clearly erroneous in light of the substantial evidence in the record.

Kiawah Property Owners Group v. Public Service Commission of South Carolina, 359 S.C. 105, 109, 597 S.E.2d 145, 147 (2004). Substantial evidence means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion. *Porter v. South Carolina Public Service Commission*, 333 S.C. 12, 23, 507 S.E.2d 318, 324 (1998). Under the substantial evidence standard a finding upon which reasonable people may differ will not be set aside. *Lark v. Bi-Lo, Inc.*, 276 S.C. 130, 137, 276 S.E.2d 304, 307 (1981). Further, the weight and credibility assigned to evidence presented is a matter peculiarly within the province of the Commission. *South Carolina Cable TV v. Southern Bell and the Public Service Commission*, 308 S.C. 216, 417 S. E. 2d 586 (1992).

B. The Covenants and Attachment A to the Petition Are Not Properly Before the Commission

DIUC putatively supports its contention that “[t]he rates as approved will force DIUC into default” (Petition at p.1) by reference to the covenants contained in DIUC loan documents

for SunTrust Bank financing (“Covenants”), and through an attachment to the Petition entitled “Impact of Commission’s Order Accepting ORS/POA Settlement” (“Attachment”). Neither the Covenants nor the Attachment were prefiled by any witness in this Docket as required by Commission Rule 103-845(C), nor were they introduced into evidence at the hearing in this matter. In addition, the Petition (at pp. 3-5) and Attachment A characterize the effect the Order will have on DIUC’s compliance with the Covenants, offering opinions that were not offered via testimony during the hearing. As such, the POAs cannot test those opinions, (or the inputs and assumptions leading to those opinions) by cross examining a witness making them. The Commission’s acceptance and consideration of the opinions in the Petition and Attachment A would substantially prejudice the POAs in violation of their due process rights. *See Ogburn-Matthews v. Loblolly Partners*; 332 S.C. 551, 562, 505 S.E.2d 598, 603 (Ct. App. 1998).

Even if the Covenants were provided to the Commission in Docket No. 2012-397-WS (and the DMS does not indicate that the Covenants were part of that Docket), that fact alone would not allow the Commission to consider them in this Docket. DIUC did not seek to make those documents part of the record in this Docket by means of Commission Rule 103-847.

Similarly, DIUC cannot raise issues in a Petition for Reconsideration that were not raised during the proceeding. *See Kiawah Prop. Owners Group v. Pub. Serv. Comm’n*, 359 S.C. 105, 113, 597 S.E.2d 145, 149 (2004); *Hickman v. Hickman*, 301 S.C. 455, 456, 392 S.E.2d 481, 482 (Ct. App 1990); *Patterson v. Reid*, 318 S.C. 183, 185, 456 S.E.2d 436, 437 (Ct. App. 1995). While Mr. Guastella made a bare contention at the hearing, referenced in the Petition, that the rates approved in the Settlement Agreement, the specific issues and characterizations of the Covenants, DIUC’s operation under the Covenants, and SunTrust’s putative actions pursuant to

the Covenants raised in the Petition and discussed in Attachment A were not raised during the hearing. As a result, the Commission cannot address these issues on reconsideration.

In sum, the Commission cannot consider that portion of the Petition characterizing the effect of the Order on the Covenants, or the entirety of Attachment A to the Petition.

C. The Commission's References to the Previous Rate Case Are Not Contrary to Law

DIUC maintains that it was error, based on *Utils. Servs. Of S.C. v. S.C. Office of Regulatory Staff*, 392 S.C. 96, 708 S.E.2d 755 (2011) ("*Utilities*") for the Commission to "rely on" Order No. 2012-515 in Docket No. 2011-229-WS (DIUC's most recent rate case) "for its reasoning in the current case" (Petition at p. 12) in considering ORS's adjustments to the management fees of Guastella Associates ("Management Fees"), as well as DIUC's rate case expenses. DIUC's application of *Utilities* is misplaced, as the Commission did not "rely on" Order 2012-515 in approving ORS's adjustments, but rather followed established South Carolina practice in using the rate increase approved by Order 2012-115 as a baseline for determination, and then "relying on" (or justifying) its decision with the evidence provided by ORS and the POAs

While *Utilities* does stand for the proposition that it is error to use a previous rate increase as *justification* for denying a rate increase, *Utilities*, 392 S.C. 115, 708 S.E.2d 765 (*emphasis added*), it 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.* The Commission used the information from Docket No. 2011-329-C as a baseline for consideration of DIUC's proposal, but used the evidence in this Docket as justification for its

decisions in the Order.

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, the POAs, or the Commission 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). In other words, amounts for management fees and rate case expenses in Docket No. 2011-229-WS provide the “baseline” or standard against which to compare DIUC’s proposed expenses for those items in this Docket, because those fees and expenses previously were deemed reasonable by the Commission.¹

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

¹ Contrary to the contention of DIUC, the management fee approved by Order No. 2012-515 in Docket No. 2011-229-WS was a “Commission-approved” fee. Order 2012-515 approved a Settlement Agreement specifically “based on the test year revenues after adjustments proposed by ORS in its pre-filed testimony and exhibits.” Settlement Agreement, Page 2. As such, the management fee (as well as all other ORS adjustments) were approved by the Commission.

reconsideration of the Order.

III. Conclusion

For the foregoing reasons, and those set out in the response of ORS, the Commission's determinations in the Order are fully supported by the evidence and its conclusions are not erroneous as a matter of law. The POAs respectfully request that the Commission deny DIUC's Petition.

Respectfully submitted,

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January 8, 2016
Columbia, South Carolina

BEFORE
THE PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA
DOCKET NO. 2014-346-WS

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

The South Carolina Office of Regulatory Staff ("ORS") respectfully submits this Answer pursuant to Reg. 103-826 to the Daufuskie Island Utility Company, Inc. ("DIUC") Petition for Reconsideration and/or Rehearing ("Petition") of Public Service Commission of South Carolina ("Commission") Order No. 2015-846 issued on December 8, 2015.

ORS disagrees with the DIUC testimony reproduced in the Petition which asserts the Settlement Agreement in this case will give DIUC no return on equity. The Settlement Agreement return on equity is 9.28% and the operating margin is 16.18%. Further, ORS witness Morgan affirmed that ORS has a statutory duty to protect the public interest and would not make a recommendation that would cause financial instability to any public utility. (R. p. 519, ll. 17-23).

DIUC states in its Petition that the loan documents for the SunTrust Bank financing approved by this Commission in Docket No. 2012-397-WS, Order No. 2013-605, include covenants that put DIUC in default if it does not maintain a minimum debt service coverage and minimum Earnings Before Interest, Taxes, Depreciation, and Amortization ratio. (Petition pg. 3). These referenced loan documents are not in the record and therefore not relevant to this case. Further, a review of Docket No. 2012-397-WS, Order No. 2013-605 shows that no loan documents were filed. Instead, an Application describing the

loan and requesting its approval was filed. The actual loan documents were not provided.¹ Returning to this case, ORS witness Carlisle also testified on cross examination that he was not privy to these records and did not have the benefit of their review. (R. p. 534 ll. 9-20).

DIUC asks the Commission to reconsider the property tax expenses allowed for DIUC. ORS's recommendation supports DIUC recovering \$171,492 annually from ratepayers to cover taxes utilizing the per book amount, the 2012 and 2013 tax amounts, and the 2014 test year amount. It is undisputed that DIUC did not pay Beaufort County taxes in 2009 and 2010. Unpaid property taxes were the cause of the delinquent tax sale of DIUC property in 2011. In addition, Beaufort County and DIUC entered into a Property Tax Settlement Agreement, amended once, for the payment of taxes for years 2012, 2013, 2014, and 2015. ORS recommended that DIUC receive \$30,612 annually for the 2012 and 2013 taxes totaling \$244,899 amortized over 8 years and \$140,880 for the 2014 or test year taxes. ORS allowed amounts for the 2012 and 2013 taxes, because DIUC did not have an opportunity to request a rate increase to cover the taxes after agreeing to a moratorium through July 1, 2014 in the settlement in Docket No. 2011-229-WS. With respect to the 2015 taxes, of which ORS declined to support recovery by DIUC, ORS understands that in the normal course, taxes are due the following tax year, 2016. Specifically, ORS witness Gearheart testified that 2015 was not allowed because 2014 was the test year, 2015 is a future year, DIUC has not been billed for the 2015 taxes, and ORS does not know what the future taxes will be. (R. p. 518, ll. 14-25; p. 519, ll. 1-16).

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

1. a management fee of \$13,596.85 a month with an annual 3.5% increase;
2. a finance fee of 2% of the principal amount of any loan or GA's actual total hourly rates for handling the loan, whichever is greater;

¹ Based on the description in the Application in Docket No. 2012-397-WS, ORS did not object to the approval of the loan.

3. a capital fee of 10% for the first \$50,000 of construction and 8% for construction costs over \$50,000;
4. an annual incentive fee of 20% of the total net utility operating income;
5. an incentive fee if DIUC is sold;
6. rate case expenses;
7. travel expenses; and
8. expenses related to regulatory investigations and proceedings.

In its Application, DIUC requested that ratepayers cover \$171,364 for outside management expenses. Per ORS, DIUC also included an incentive fee in its test year management expenses. ORS recommended that GA's management fees be limited to the previous Commission-approved amount of \$132,211 a year. ORS testified that it found no apparent increases in the scope of management services provided by GA and did not find the requested increase justified.

With respect to rate case expenses, ORS recommended \$75,000 as a reasonable recovery amount. Pursuant to the GA Management Agreement, rate case expenses are charged separately by GA to DIUC and during its audit, ORS alerted DIUC to concerns related to the large amount of rate case expenses attributed to GA.

DIUC asks the Commission to adopt the bad debt adjustment set forth in ORS's direct testimony instead of the Settlement Agreement. The Settlement Agreement bad debt adjustment simply uses the methodology proposed by the Company in its Application, which results in a lower number than the one put forth in the ORS direct testimony.

In its Petition, DIUC asserts that the elevated storage tank should be included in DIUC's rate base. ORS excluded the elevated storage tank from rate base for the following reasons:

1. The property on which the elevated storage tank sits was sold during a delinquent tax sale and the property is no longer owned by DIUC.

2. The elevated storage tank was excluded from the last rate case, Docket No. 2011-229-WS for the same reason in item #1 above.
3. The delinquent tax sale deed states that all "appurtenances" convey to the delinquent tax sale purchaser, Mr. Sabry. The Honorable Treasurer Walls was unable to opine whether or not the elevated storage tank is an appurtenance. If the elevated storage tank is an appurtenance, it would follow that it conveyed to Mr. Sabry per the Beaufort County delinquent tax sale deed. Honorable Walls provided testimony that DIUC is paying utility taxes on the elevated storage tank to Beaufort County; however, testimony showed that while Mr. Sabry is not paying taxes on the elevated storage tank, he is paying Beaufort County taxes on a building located on the same property the County describes as a "UTLSHED."
4. DIUC has not proven it owns the elevated storage tank.
5. ORS understands DIUC is pursuing condemnation proceedings for the property and such condemnation proceedings are not within the jurisdiction of this Commission.
6. DIUC revised its Annual Reports to the Department of Revenue 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.

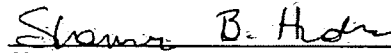
If DIUC produces a deed stating that it is the owner of the property on which the elevated storage tank sits or if a court issues an order in DIUC's condemnation proceedings stating it owns the elevated storage tank, then ORS would fully support the value of the elevated storage tank being in rate base in DIUC's next rate case. In the meantime, there is sufficient uncertainty regarding the elevated storage tank's ownership causing ORS to decline recommending that ratepayers pay DIUC a return on it.

DIUC asserts that the record lacks evidence on the ORS rate base adopted by the Commission. ORS disagrees. ORS fully supported its recommendations in testimony and exhibits and was available for cross examination to answer any questions on its recommendations. (*See also* R. p. 202, ll. 21-23; p. 203, ll. 1-5). Further, ORS shared the results of its audit with DIUC, as it does with all rate case applicants, prior to filing testimony. (R. p. 526, ll. 9-14). After sharing its audit results, ORS scheduled and conducted an exit conference with DIUC where ORS staff was available to answer questions or explain its computations to DIUC. (R. p. 202, ll. 21-23). As testified to by DIUC witness Guastella, "In the instant case, ORS provided DIUC with work papers as a follow up to our audit exit conference call that enable us to identify what we think are the specifics of its adjustments." (R. p. 202, ll. 21-23). Mr. Guastella references the availability of ORS work papers elsewhere in his testimony. (R. p. 150, ll. 22-25; p. 151, ll. 1-3; p. 158, ll. 11-13). ORS's audit is a collaborative and transparent process with the Applicant. An excerpt from Mr. Guastella's testimony provides insight to what appears to be DIUC's main issue:

They [ORS] don't present in their testimony – for you – what the breakdown of the million-six [excluded rate base] is, except what's water and what's sewer. They don't say what is the cost of the storage facilities. They don't say what's the cost of the invoices. They don't say what's the cost of the land they're excluding. They don't say that they're excluding Guastella's capital fee. We know that information from work papers from the last case and from the current case. (R. p. 158, ll. 5-13).

The issue may be that DIUC is dissatisfied that the Commission did not inquire to a level DIUC deems appropriate into the ORS adjustments. In this case, ORS followed its standard practice in presenting its proposed rate base in testimony. Further, 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, and answer questions. That the information was not presented in direct testimony as DIUC prefers is not grounds for rehearing.

In summary, ORS supports Commission Order No. 2015-846. The resulting return on equity of 9.28% and operation margin of 16.18% are fair, just, and reasonable to customers of DIUC while also providing DIUC an opportunity to earn a fair return.


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January 8, 2016
Columbia, South Carolina

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2014-346-WS

IN RE:	)	PETITION FOR
Application of Daufuskie Island Utility Company, Inc.)	)	RECONSIDERATION
For Approval of a New Schedule of Rates and	)	AND/OR
Charges for Water and Sewer Service	)	REHEARING

Summary

If forced to implement rates as established by the Commission's December 8, 2015, Order Approving Settlement Among Certain Parties and Ruling on Application for Adjustments in Rates ("Order"), DIUC will default on its obligations and its ability to provide service will be threatened. The Order's approved rates do not provide DIUC sufficient income to pay debt service (principal and interest) on the existing SunTrust Bank loans and to pay necessary operating expenses. The rates as approved will force DIUC into default.

The Commission's Order incorporates every adjustment, without exception, proposed by ORS, the largest being property taxes, management fees, rate case expenses, bad debts, and rate base. These adjustments are without factual foundation and ignore known and measurable expenses. As a result, the rate of return and operating margin stated in the Order are entirely illusory.

Pursuant to SC Code § 58-5-330 DIUC requests this Commission reconsider its December 8, 2015, Order and substitute DIUC's Proposed Order submitted November 15, 2015, to replace the Commission's Order in its entirety so as to prevent a host of problems, including DIUC's loan default.

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Cases Cited

<i>Bluefield Waterworks and Improvement Company v. West Virginia Pub. Serv. Comm'n</i> , 262 U.S. 679, 43 S. Ct. 675, 67 L. Ed. 1176 (1923).....	23
<i>Federal Power Commission v. Hope Natural Gas</i> , 320 U.S. 591 (1944).....	23
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<i>Porter v. S.C. PSC</i> , 333 S.C. 12, 21, 507 S.E.2d 328 (1998).....	12
<i>Southern Bell v Public Service Commission</i> , 270 S.C. 590, 244 S.E.2d 278 (1978).....	10
<i>Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff</i> , 392 S.C. 96, 708 S.E.2d 755 (2011).....	13, 17, 20, 22, 23

Default and Loan Compliance

At the hearing DIUC clearly explained the dire circumstances it will face if the Commission implemented ORS's adjustments and the proposed "Settlement Agreement" between ORS and the Intervenors. With respect to the proposed "Settlement Agreement,"¹ Mr. Guastella testified with specificity:

[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.

Transcript at 186. The Commission's Order does not demonstrate any consideration was afforded to this powerful warning.

DIUC's loan documents for the SunTrust Bank financing approved by this Commission in Docket No. 2012-397-WS, Order No. 2013-605, include covenants that put DIUC in default if it does not maintain a minimum debt service coverage and minimum EBITDA (i.e., Earnings Before Interest, Taxes, Depreciation, and Amortization) ratio. The lack of income allowed to DIUC by the recent Order will put DIUC in default on its \$2,500,000 term loan and will preclude DIUC's ability to repay its \$500,000 line of credit. It will also prevent DIUC from attracting additional capital for system improvements that are necessary to meet DHEC requirements.

Attached hereto is a schedule demonstrating the impact of the Commission's Order on DIUC's operations and how SunTrust will test DIUC's booked cost of operations. *See Impact of Commission's Order Accepting ORS/POA Settlement, Attachment A.* The Schedule reflects the

¹ Since DIUC was not a party to the agreement between ORS and Intervenors, the agreement did not actually settle any matters before the Commission. In its proposed order DIUC set forth the several legal reasons why the Commission had no authority to entertain the agreement or to enter its "Approval" of the agreement. *See DIUC Proposed Order at pp. 51-53.*

\$1,536,375 of combined water and sewer revenues allowed by the Order then subtracts the actual cost of operations DIUC will incur and book. The operating expenses of \$1,355,363 listed in the Schedule are those reflected in DIUC's Proposed Order because SunTrust uses these actual costs and booked figures to perform its tests of Debt Service Coverage and the EBITDA ratio.

In other words, when SunTrust analyzes DIUC's books to determine if DIUC is in compliance with the terms of its loan, SunTrust will review the books DIUC presented to the Commission that reflect the Utility's actual expenses and bad debts. SunTrust does not consider reductions or analysis of adjustments; instead, SunTrust looks at cash flow to test DIUC's compliance with the terms of the SunTrust loan.

For example, DIUC's ongoing property taxes are used by SunTrust at the levels that must be accrued in order for DIUC to make its monthly and annual tax payments. However, the Order includes ORS's alternatively calculated property tax expense allowance which is considerably less than the actual known and measurable property taxes that DIUC will have to pay. In addition to covering its actual monthly installment payments under the property tax Settlement Agreement with Beaufort County, SunTrust requires DIUC properly accrue amounts sufficient to satisfy S.C. Department of Revenue assessments and Beaufort County property tax rates. These amounts are not allowed by the Order. Also, SunTrust considers DIUC's obligation to pay management fees according to the GA management contract without regard to the reduction in the Settlement Agreement. Those costs, then, are booked in accordance with the agreement. The amortization of rate case expenses will actually be about 5 times higher than the adjusted level by ORS. Finally, the bad debt expense used by SunTrust is the booked amount for 2014 and the latest 12 month period.

Applying these entries and the cash flow allowed by the Order results in the following calculation which will form the basis of SunTrust's decision as to whether DIUC is in compliance with its loans:

Revenues	\$1,536,375
Operating Expenses	<u>(\$1,355,363)</u>
Net Operating Income	\$ 181,012
Interest Due	<u>(\$ 142,510)</u>
Net Income	\$ 38,501

After including depreciation of \$93,089 and deducting debt service from Net Operating Income, **cash flow will be a negative \$4,024.** This is a disastrous result.

Pursuant to the SunTrust loan, DIUC must maintain certain ratios of coverage for debt and EBITDA. *See* Schedule A. Collecting at the approved rates, there will be no money for equity return and DIUC will fail SunTrust's tests for debt service coverage and the EBITDA ratio. Accordingly, under the rates approved by the Order, DIUC will be in default on the SunTrust financing, DIUC will not be able to undertake a refinancing to pay off its \$500,000 line of credit, and it will not be able to attract capital to make further capital improvements necessary to provide adequate service and comply with DHEC requirements. The SunTrust refinancing is essential to the survival of the Utility.

DIUC respectfully asks the Commission to reconsider its Order.

Adjustments for Reconsideration

The DIUC Proposed Order must be substituted in its entirety so as to prevent a host of problems, including DIUC's loan default. Alternatively, DIUC requests this Commission revise the Order to substitute the calculations and analysis from DIUC's Proposed Order regarding

property taxes, management fees, rate case expenses, bad debts, and rate base. These sections of the Proposed Order are highlighted in this Petition. Although this Petition does not address every point of the Commission's Order, DIUC reserves its original positions as set forth in filings, testimony, and Proposed Order submitted to the Commission on November 15, 2015.

Property Taxes

The Order adopts ORS's proposed reduction for the recovery of property taxes. So, instead of allowing DIUC to collect the \$65,856 it is required to pay annually pursuant to the Amended Settlement Agreement between DIUC and Beaufort County for the 8 year payment plan, the Order allows DIUC to recover \$30,612. Likewise reducing DIUC's income below the annual amount of \$192,302 that must be collected by DIUC during 2016 in order to pay its 2016 property taxes, the Order only allows of payment of the 2014 annual taxes of \$140,880 and no amount for the 2015 taxes due at the end of 2015. This annual shortfall for the known property tax obligations of DIUC of more than \$80,000 is a huge deficit for a utility as small as DIUC.

The explanation provided in the Order for the Commission's acceptance of ORS's adjustments to property taxes is incomplete and it fails to address the actual amounts due, as set forth in the preceding paragraph. Additionally, it is inaccurate.

DIUC did not merely have "difficulties concerning property taxes," as stated in the Order. Instead, it was beyond DIUC's control that two governmental bodies failed to properly bill DIUC for property taxes: 1) Beaufort County sent tax bills and tax sale notices for the storage tank site to the wrong address, despite being informed of the correct address; 2) the County posted a notice of the tax sale at the wrong address; and 3) in the almost 30 years since 1985 when the water and sewer utilities on Daufuskie Island were created, the DOR never once

made a "Utility Tax" assessment until 2012, and then did so in arrears for three years all at once. Beaufort County then sent tax bills to DIUC for all three years -- 2010, 2011 and 2012.

DIUC successfully negotiated with Beaufort County to forgive the 2010 and 2011 Utility property taxes saving the rate payers over \$230,000, which is not mentioned by in the Order (and perhaps should have also been addressed by the Commission in reviewing the services provided DIUC by its management team). DIUC also negotiated with Beaufort County to pay the 2012, 2013, 2014 and 2015 Utility Property taxes over 8 years, providing a present value savings of over \$100,000 for the rate payers, not mentioned by ORS or in the Order. DIUC then negotiated with the S.C. Department of Revenue to reduce its assessment from the book value of all of DIUC's taxable assets to the rate base allowed by the Commission in the last rate case, another savings of over \$124,000 for the rate payers. Although ORS seems to fault DIUC for this negotiation, it was perfectly appropriate and has no bearing on the current rate case. *See <https://dor.sc.gov/tax/utilities> ("This property tax type is assessed based on fair market value, and the department may use any accepted or recognized valuation method which reflects the property's fair market value. This includes methods within the unit valuation concept.")*

The Order states that "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." That statement is speculative, incorrect, and contradicted by the testimony in the record. Along with the Utility property taxes for 2012, 2013 and 2014, the 2015 Utility Tax is payable in accordance with the Settlement Agreement with Beaufort County, under which DIUC was required to begin the 8 year installment payments of the total taxes for 2012, 2013, 2014 and 2015, on July 1, 2015 -- not 2016 as reflected in the Order. In addition, the original Settlement Agreement between DIUC and Beaufort County was

amended in accordance with a specific provision that allowed for a reduction if DIUC successfully negotiated a retroactive reduction and obtained revised assessment values from the DOR. The amendment to the Settlement Agreement with Beaufort County was not a renegotiation or a second contract for further forgiveness by the County; the amendment simply recognized the correct amount of taxes as was promised by Beaufort County in the original agreement. A review of the agreements in evidence clearly reflects this fact.

There is no provision in the original or amended settlement agreement, or any testimony or evidence in the record that Beaufort County would ever agree to a further amendment. In fact, Beaufort County Treasurer Maria Walls testified there will not be any further agreement to reduce taxes:

This is not a practice that we will continue. However, in the interest of getting the taxes paid, on behalf of Beaufort County government as well as the agencies we represent, we believed it was in the best interest of Beaufort County at that time to enter into an agreement with Daufuskie Island.

Transcript at 95. 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 then DIUC will begin a cycle of incurring 15% penalty every year.

Transcript at 85.

Ms. Walls also specifically addressed questions from ORS Counsel at the hearing and explained that ORS Counsel was mistaken in asserting information on the Beaufort County website regarding payment plans would apply to DIUC's Utility Tax. Below is an exchange between Ms. Hudson and Ms. Walls; Ms. Hudson is asking the witness questions on cross examination.

Q. You have a really good website.

A. Thank you.

Q. One of the items on the website is the opportunity to apply to pay taxes in installments, and I think it's property taxes.

A. Yes.

[...]

Q. I read that it applies to both commercial and residential property. Is that right?

A. Yes, that's correct. However, it would not apply to Daufuskie Island Utility.

[...]

Q. I'm confused. You're saying that the utility – Daufuskie Island Utility – cannot apply to pay property taxes –

A. Correct.

Q. – in installments?

A. [continuing] the land that's owned by Daufuskie Island Utility, the valuation or taxes are included in what they are paying, ultimately. It's included in DOR's valuation. So they [DIUC] would not be eligible for the installment program, first, but even if they were, they would need to have paid in full the taxes that were due before applying.

Transcript at 97-99.

The Order's speculation and conjecture regarding a future negotiation or payment plan is not only an inappropriate and an impermissible basis for denying DIUC's requested relief, it is against the weight of the clear evidence before the Commission.

ORS also recommended and the Order "declined to allow property taxes for 2015 since ORS utilizes a historical test year." Order at 23. That 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)).

The Order further states that it rejects the Company's property tax request and calculation since it is based in part on the questionable ownership status of real property as noted above. That statement in the Order is also contradicted by the testimony of the witness who has the most knowledge on this matter, Maria Walls, Beaufort County Treasurer, who attested the deed did not convey the utility facilities on the lot. She testified as follows:

Q. Did Beaufort County convey to Mr. Abdelrahman the elevated tank and other DIUC utility facilities located on the Elevated Tank Site?

A. No. The Tax Deed did not include the elevated water tank, the well, the water pump, system pipes, or other DIUC property located on the Elevated Tank Site. All of those items remain part of the DIUC water system infrastructure.

Q. Is Mr. Abdelrahman taxed for the elevated water tank, the well, the water pump, and system pipes located on the Elevated Tank Site?

A. No.

Transcript at 82 – 83.²

Mr. Guastella's calculation of the annual Utility Property Taxes in the amount of \$192,302 was made in accordance with the method of assessing utility property employed by

² The reference in the Beaufort County property record to a "UTILSHED" is not a reference to a utility facility that is used in the delivery of water to DIUC's customers. First, the record is a residential property record. Therefore, the term is used in that context to refer to a small shed where tools can be stored. Second, this "Residential Shed- Small Util" is the only item mentioned on the property record; there is no reference to the elevated storage tank or other utility facilities on the parcel.

DOR and the application of Beaufort County's tax rate. This calculation was not refuted. Guastella then included that amount in DIUC's proposed revenue requirement as a known and measurable charge. 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.

Transcript at 84 - 85.

Accordingly, the Order's approved allowance of \$30,612 is less than the actual annual payments (\$65,856) that DIUC is making 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 calculated according to the proper application of DOR and Beaufort County requirements.

There will be significant consequences of the Order's failure to allow rates sufficient to cover the utility's property taxes. In short, DIUC will be denied its actual cost of providing service. That denial of the ability to recover even its costs will result in penalties by Beaufort County that will ultimately add 15% annually to DIUC's ongoing utility property taxes and, as stated above, unpaid taxes will jeopardize DIUC's financing with SunTrust Bank in addition to risking tax liens. Not only does ignoring the reality of taxes risk the provision of service and punish DIUC and its owners, but the additional penalties and interest, which would be the result of this Order, will ultimately have to be borne by the rate payers.

Management Fees

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." *Porter v. S.C. PSC*, 333 S.C. 12, 21, 507 S.E.2d 328, 332 (1998). The adjustments adopted in the Order regarding management fees due Guastella Associates ("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..

Instead of presenting support and analysis, the Order simply restates the ORS recommendation that GA's fees "be limited to the previously Commission-approved amount of \$132,211 a year" and states that ORS "found no apparent increases in the management services

provided by GA and did not find the requested increase justified.” ORS presented nothing else in its direct testimony or surrebuttal testimony with respect to GA’s management fees. Those two statements in the record are ORS’s entire analysis of GA’s management fees and they are not even accurate.

First, 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). Neither the settlement agreement nor the Commission’s approval of it mentions the management fees or the amount of \$132,211. Moreover, it is error for the Commission to rely on a previous order for its reasoning in the current case. As the Supreme Court has explained, figures from past test year are only probative, if at all, as a starting point for analysis by the Commission. The discussion below from the Court 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 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. There is no “starting point” from which the analysis

may proceed. 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 capital costs and property taxes. *See* Transcript Exhibit 7, Report on Capital Improvements (prefiled as Exhibit to Guastella Direct Testimony).

After adopting ORS's erroneous and unsupported assumption that there was no increase in management services, the Order adds, "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." There is no evidence to support this conclusion, even if this focus is solely on the amount due to GA for its services. To the contrary, Mr. Guastella presented rebuttal testimony and *Exhibit 8* demonstrating that on a comparable basis 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. *See* Transcript Exhibit 8, Average Monthly Water and Sewer Costs - Based on Monthly Usage of 11,000 Gallons (prefiled as Guastella Rebuttal Exhibit 4). 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. *See* Transcript at 251. This testimony was not challenged or in any way disputed by ORS or Intervenor. Any conclusion that the GA's management fees are at an excessive level is simply not supported by the record. The Order also fails to accurately evaluate any concerns with GA's management. Referring to Mr. Guastella's testimony, the Order also states that, "Further, he stated that the Company's books are in either Boston, Florida, or New York at various times." DIUC

obtained permission to keep its books and records out of state soon after its acquisition by CK Materials, and ORS has not expressed any problem, concern or difficulty examining DIUC's books and records, or obtaining responses to every request for information during the course of its investigation of this rate application. The implication that the location of DIUC's books is an indication of poor management is not supported by the record. If ORS and the Commission felt that the location of the books and records somehow diminished their accuracy or caused a decreased level of service, neither of which is true, then DIUC should have been so informed and it would have immediately made arrangements to correct any problems.

The Order also states that, "It is undisputed that DIUC did not pay property taxes under GA's tenure (resulting in the tax sale described above)" The implication that GA's management is somehow responsible for the tax sale is not supported by any testimony or evidence in the record. On the contrary, the testimony and evidence demonstrates, without challenge or dispute, that Beaufort County sent the tax bill and notices of the tax sale in question to the wrong address, despite being notified by GA of the correct address at which to send tax bills, and that the required on-site notice of the tax sale was posted at the wrong property. *See* Late-Filed Exhibit 6 at Page 5 (Letter dated October 9, 2009 to Beaufort County Assessor informing County of new mailing address). The record clearly establishes that the tax sale was beyond the control of DIUC, and not an avoidable fault of GA's management.

Further, with respect to the Utility Tax, as distinguished from the real property taxes, it is undisputed that DOR never assessed DIUC's facilities until it did so in arrears in 2014. DOR failed to assess the Utility Tax; it was not GA who failed to pay them. When DOR and Beaufort County attempted to unfairly force DIUC to pay five years of utility taxes in arrears that were never billed to DIUC, DIUC diligently responded and successfully negotiated the forgiveness of two of the five years and obtained a favorable payment plan for the other three. The assault of

ORS and the Intervenor on GA's handling of tax matters is entirely unfounded. GA's handling, instead, demonstrates an astute response that reduced the tax liability and protected the rate payers. That is the opposite of what the Commission implies in going along with the groundless slight of ORS.

The record also established GA's high level of performance and includes DHEC's praise of GA's efforts in emails to Mr. Guastella, which state:

On August 12, 2014, the Department met with Mr. Mike Guastella, representing Daufuskie Island Utility Company (DIUC), regarding conditions, alleged violations and inspection results at and for wastewater treatment facilities owned and operated by DIUC. In attendance, in addition to Mr. Guastella, were Ms. Penny Cornett of the DHEC Low Country (Beaufort) Office and me. If necessary, I can scan a copy of the Conference Register and send it to you.

We would like to thank Guastella Associates for your attention, cooperation and assistance in addressing longstanding issues and violations at these facilities. 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.

See Transcript Exhibit 8, Email from H. Michael Longshore, MPH, Compliance and Enforcement Section, Water Pollution Control Division, Bureau of Water to John Guastella (prefiled as Guastella Rebuttal Exhibit 5).

Consideration of all of the above testimony and evidence of record is necessary to determine the reasonableness of DIUC's management expenses. The Commission should reconsider its decision as to allowable fees for GA's management of DIUC. Its decision to disallow a large portion of the contractual obligation of DIUC under the management agreement with GA is not supported by the preponderance of the evidence.

Rate Case Expenses

The Order also adopts the ORS allowance of only \$75,000 for rate case expenses based

upon DIUC's last rate case. Similar to the management fee adjustment by ORS, it is error for the Commission to rely on a previous order for its reasoning in the 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). Mr. Guastella also 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 requesting the Commission allow \$191,200. *See Transcript* at 181. 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. *See Docket No. 2011-317-WS, Order No. 2012-98*, approving rate case expenses of \$190,905.

The Commission should reconsider the allowance of DIUC's requested rate case expenses, which are only about one-half of the expenses actually incurred. These expenses are unavoidable in order to seek adjudication of a rate application. The Commission's decision to disallow 75% or more of the actual rate case expenses incurred is not supported by the preponderance of the evidence.

Bad Debts

The Order accepts the ORS/Intervenors' "settlement agreement" recommendation that reverses the ORS original adjustment up to \$108,349 of bad debts to allow only the \$30,852³ in DIUC's original Application. The original ORS level of \$108,349 was one of twenty adjustments accepted by DIUC as reflected in Mr. Guastella's rebuttal testimony. *See Transcript* at 199. The ORS reversal was made public with the submission of the "settlement agreement" on October 27, 2015, the day before the evidentiary hearing. The Order's acceptance of the bad debt expense methodology adopted by ORS and the Intervenors in their "settlement agreement"

³ 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.

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?

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.

Transcript 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. The Commission should reconsider the bad debt allowance. The Commission's decision to disallow almost \$100,000 of the actual bad debt expense suffered by DIUC is not supported by the preponderance of the evidence. There is no proof that \$30,852 is realistic or anywhere close to the actual amount.

Rate Base -- Lack of Evidence

The Order accepts the ORS/Intervenors' "settlement agreement" recommendation that reduces utility plant in service by a total \$1,624,696. The scant reasons for ORS's proposed adjustment are provided in Ms. Gearheart's testimony, which states the adjustment serves "to

reflect capital improvements, non-allowable plant, adjustments from the previous case not made by DIUC and retirements through July 31, 2015” and “undocumented expenses.” Transcript at 496 and Hearing Exhibit 18 and Audit Exhibit ICG-4, Page 5, ORS Adj. 10, respectively. From the ORS testimony of Mr. Morgan, it is revealed that the elevated storage tank is part of the \$1,624,696 adjustment to utility plant in service, but neither Mr. Morgan nor Ms. Gearheart provide the costs of the elevated storage tank or related facilities that are part of that total adjustment. Also, there is nothing in the record provided by ORS or the Intervenor 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”.

The Order states that “ORS Audit Exhibit ICG-5 (Hearing Exhibit 18) shows the specific items composing the \$1,624,696.” However, that statement is simply incorrect. Audit Exhibit ICG-5 has a column entitled “ORS Adjustment” below which are amounts reflected for primary plant accounts, not items of plant. The adjustments in that column, by plant account, cannot be identified with specific items of plant or the specific cost of the items being adjusted, or ORS’s stated reasons for the adjustments. 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.

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. *See* Transcript 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. ORS should have estimated the reasonableness of the costs recorded and booked rather than adjusting 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.” Transcript 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. It only appears in ORS’s proposed order. Again, as is more fully explained previously herein, 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.” *See* PSC Order 2012-515 and Transcript at 525. 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 Commission.

Rate Base -- Elevated Storage Tank and Related Facilities

The Order also adopts the ORS/Intervenors’ “settlement agreement” recommendation for an adjustment to the cost (unspecified amount) of the Elevated Storage Tank and related utility

facilities on the land that was sold in a tax sale, because of what is described as “reducing plant-in-service values for property tax purposes and uncertainty regarding what DIUC owns as a result of the delinquent tax sale.” However, the Order misinterprets the evidence.

DIUC put into evidence the perpetual easement that allows DIUC to construct, operate and replace utility facilities. *See* Hearing Exhibit 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. (DIUC), the Defendant herein. 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 ...

See Exhibit 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.

DIUC also put into evidence the Special Warranty Deed and Bill of Sale transferring the Elevated Tank Site with all facilities thereon located as personal property. *See* Exhibit 8. Maria Walls, Beaufort County Treasurer, 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 residential

property; the County was not authorized to utilize that procedure to sell utility infrastructure. When asked if there was a building listed on the printout from a website presented by ORS, she said "A residential shed or small utility, yes." Transcript at 103. That residential shed, as noted on the residential tax record, is not an elevated water tank or water system infrastructure.

There should be no uncertainty about ownership of DIUC's storage tank and 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.

Conclusion

The "fundamental role of the PSC" in ratemaking decisions is to "consider all evidence before it and it does not serve as a "rubber stamp" for ORS's recommendations." *Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff*, 392 S.C. 96, 115, 708 S.E.2d 755, 765 (2011). It is difficult not to see that the Commission's Order has effectively done just that by approving the proposed settlement between ORS and the Intervenors. For this reason, pursuant to S.C. Code § 58-5-330 and Regulation 103-854 of the South Carolina Code of Regulations, DIUC has submitted this Petition for Reconsideration and/or Rehearing.

The grounds for this Petition are that the Commission's Order dated December 8, 2015, is unlawful because it was not based upon reliable, probative, and substantial evidence on the

whole record, as is required by SC Code 58-5-240, and it does not establish rates which will produce revenues "sufficient to assure confidence in the financial soundness of the utility and . . . that are adequate under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties," as is required by the United States Constitution. See *Bluefield Waterworks and Improvement Company v. West Virginia Pub. Serv. Comm'n*, 262 U.S. 679, 692-693 (1923), and *Federal Power Commission v. Hope Natural Gas*, 320 U.S. 591 (1944); see also *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 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").

In considering this Petition, the Commission is empowered by SC Code §58-5-330 to "abrogate, change or modify" its December 8, 2015, Order and to substitute DIUC's Proposed Order "in the place of the order originally entered and with like force and effect." SC Code § 58-5-330. Respectfully, pursuant to SC Code § 58-5-330, DIUC requests this Commission rehear this matter and/or reconsider its December 8, 2015, Order Approving Settlement Among Certain Parties and Ruling on Application for Adjustments in Rates and that DIUC's Proposed Order submitted November 15, 2015, be substituted in its entirety to replace the Commission's Order.⁴ Alternatively, DIUC requests this Commission revise the December 8, 2015, Order Approving

⁴ DIUC requests its Proposed Order be substituted in its entirety. Although this Petition does not address every point of the Order, DIUC reserves its original positions as set forth in filings, testimony, and Proposed Order submitted to the Commission by DIUC on November 15, 2015.

Settlement Among Certain Parties and Ruling on Application for Adjustments in Rates to substitute DIUC's information from DIUC's Proposed Order as to property taxes, management fees, rate case expenses, bad debts, and rate base.

Respectfully submitted,

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ATTORNEYS FOR DAUFUSKIE ISLAND
UTILITY COMPANY, INC.

December 21, 2015
Charleston, South Carolina

ATTACHMENT A

Impact of Commission's Order Accepting ORS/POA Settlement

	PSC Revenue Allowance
REVENUES	
Operating Revenues-Water	\$821,375
Operating Revenues-Sewer	715,000
Total Revenues	<u>\$1,536,375</u>
OPERATING EXPENSES	
O & M Expenses	\$906,611
Rate Case Expense	47,800
Depreciation	b 93,089
Payroll Tax	13,212
Property Tax	258,227
Other Taxes	13,520
Income Taxes	22,904
Total Operating Deductions	<u>\$1,355,363</u>
Net Operating Income	a \$181,012
Interest Expense	<u>142,510</u>
NET INCOME	<u><u>\$38,501</u></u>
DEBT SERVICE	
\$2.75 Million Term Loan	\$265,974
\$500,000 Line-of-Credit	12,150
	c <u>\$278,124</u>
CASH FLOW	a+b-c <u><u>(\$4,024)</u></u>

SunTrust Bank - Loan Requirements

\$2.75M Note

Debt Service Coverage:

Net Income + Deprec + Amort + Interest \$274,101

Principal & Interest \$265,974

Coverage Ratio >1.50 1.03

Passed Test

NO

EBITDA Ratio:

NOI + IT + Deprec + Amort \$297,005

Total Debt \$2,750,000

Ratio < 6.00 9.26

Passed Test

NO

**PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA
COMMISSION DIRECTIVE**

ADMINISTRATIVE MATTER	☐	DATE	<u>December 02, 2015</u>
MOTOR CARRIER MATTER	☐	DOCKET NO.	<u>2014-346-WS</u>
UTILITIES MATTER	☒	ORDER NO.	<u></u>

SUBJECT:

DOCKET NO. 2014-346-WS - Application of Daufuskie Island Utility Company, Incorporated for Approval of an Increase for Water and Sewer Rates, Terms and Conditions – Staff Presents for Commission Consideration the Request for Approval of Daufuskie Island Utility Company, Incorporated's Application for an Increase of Water and Sewer Rates, Terms, and Conditions.

COMMISSION ACTION:

After hearing the testimony and examining all of the evidence in this case, I move that we approve the Stipulation referred to as the "Settlement Agreement" between and among the three Daufuskie Island Property Owners' Associations (POAs) and the Office of Regulatory Staff. The revenue reflected in this document reflects all of the adjustments made by ORS, with the exception of the bad debt methodology, which was originally proposed by the Utility. The POA-ORS Stipulation includes a combined revenue increase for water and sewer of \$462,798. The annual revenue increase for water is \$278,903, and for sewer is \$183,895. The resultant operating margin is 16.18%, with a return on equity of 9.28%. I am mindful of and have fully examined the evidence submitted by the Company in this case. However, the evidence presented by the three POAs and ORS has persuaded me that the rates in Exhibits 1 and 2 to the signatory document, along with the adjustments and revenues in Exhibits 3, 4, and 5 to the document are fair, just, and reasonable to customers of the Company's system, while also providing the Utility with an opportunity to earn a fair rate of return and operating margin. Accordingly, I move that this Commission approve the Stipulation between the three POAs and ORS as a fair and reasonable resolution of all issues in this proceeding, resulting in just and reasonable rates. Also, although we are aware that the matter of the tax sale land is presently before the Court of Appeals for resolution, we believe that the matter of the land at Bloody Point with the treatment plant on it is still unsettled, based on the testimony of public witness Delaney. The Company should address this issue promptly.

PRESIDING: WhitfieldSESSION: Regular

TIME: 2:00 p.m.

	MOTION	YES	NO	OTHER
ELAM	☐	☒	☐	
FLEMING	☐	☒	☐	
HALL	☐	☐	☐	<u>Absent</u> Annual Leave
HAMILTON	☐	☒	☐	

HOWARD	☐	☒	☐
RANDALL	☒	☒	☐
WHITFIELD	☐	☒	☐

(SEAL)



RECORDED BY: J. Schmieding

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2014-346-WS – ORDER NO. 2015- _____
DECEMBER ____, 2015

IN RE:	)	
Application of Daufuskie Island Utility Company, Inc.	)	ORDER APPROVING
For Approval of a New Schedule of Rates and	)	RATES
Charges for Water and Sewer Service	)	AND CHARGES

I. INTRODUCTION

This matter is before the Public Service Commission of South Carolina (the “Commission”) on the Application of Daufuskie Island Utility Company, Inc. (“DIUC” or “the Company”) for the Approval of an Adjustment in Rates and Charges for Water and Sewer Service (“the Application”). Filed on June 9, 2015, and pursuant to S.C. Code Sections 58-5-210 *et seq.*, and S.C. Code Ann. Regs. 103-514.4, Regs. 103-712.4, and Regs. 103-834 of the Commission’s Rules of Practice and Procedure, the Application seeks this Commission’s approval of a new schedule of rates and charges for water and sewer service.

DIUC is authorized by the Commission to be the exclusive provider of water and sewer service to a service area that encompasses Daufuskie Island, Beaufort County, South Carolina. According to water and sewer revenues reported in the Application for DIUC’s historical test year ended December 31, 2014, DIUC is classified as a Class A water and wastewater utility under the Uniform System of Accounts published by the National Association of Regulatory Utility Commissioners (“NARUC”) and prescribed by the Commission.

In considering the Application of DIUC, the Commission must ascertain and fix just and reasonable rates, standards, classifications, regulations, practices, and measurements of service to

be furnished. Thus, the Commission must give due consideration to the Company's total revenue requirement and review the operating revenues and operating expenses of DIUC to establish adequate and reasonable levels of revenues and expenses. The Commission will consider a fair rate of return for DIUC on the basis of the record, and any increase must be just and reasonable and free of undue discrimination.

II. PROCEDURAL HISTORY

In accordance with the Commission's requirements, the Office of the Clerk instructed the Company to publish an approved Notice of Filing, one time, in a newspaper of general circulation in the area affected by DIUC's Application. The Notice of Filing described the nature of the Application as follows:

[T]he current rates do not enable the Company to cover its cost of providing service and earn a fair return on its investment, and the Company has not applied for rate relief since 2012 and has not established unified rates under its current consolidated status. Daufuskie states that the proposed rates in its Application are essential for the Company to continue to provide its customers with adequate water and wastewater service. Further, the proposed rates would establish uniform rates for all of the Company's customers, including Haig Point and Melrose service area customers.

The Notice further advised all interested parties desiring to participate in the scheduled proceeding of the manner and time in which to file appropriate pleadings for inclusion in the proceedings as a party of record.

The Company was likewise required to notify directly, by U.S. Mail, each customer affected by the Application by mailing each customer a copy of the Notice of Filing. DIUC filed Affidavits of Publication demonstrating that the Notice of Filing had been duly published and provided a letter certifying that it had complied with the instructions of the Office of the Clerk and mailed a copy of the Notice of Filing to all customers.

On July 23, 2015, a Petition to Intervene was filed on behalf of the Haig Point Club & Community Association, Inc., Melrose Property Owner's Association, Inc., and Bloody Point Property Owner's Association, (collectively "Intervenors"). On July 27, 2015, a Petition to Intervene was also filed by Beach Field Properties, LLC ("Beach Field"), an owner of property within the DIUC service area. By letter dated July 31, 2015, the Intervenors requested the Commission schedule a public hearing "to provide a forum, at a convenient time and location, for the Utility's customers to present their comments regarding the services and rates of the Utility." The Intervenors further requested the hearing be held on Daufuskie Island at the Haig Point Club Clubhouse.

Pursuant to Commission Directive Order No. 2015-586, the Commission scheduled the requested night hearing and the Company provided affidavits certifying that it had provided notice to its customers via U.S. Mail of the date, time and location of the local public hearing. On September 15, 2015, the Commission held a night hearing at the Haig Point Club Clubhouse, 130 Clubhouse Lane, Daufuskie Island, South Carolina. During the hearing, statements were received from a number of customers and made part of the record in this proceeding. On October 28, 2015, the Commission, with Chairman Nikiya Hall presiding, conducted a hearing on the Application at the Commission's Hearing Room located at 101 Executive Center Drive, in Columbia, South Carolina.

At the hearing DIUC was represented by G. Trenholm Walker, Esquire and Thomas P. Gressette Jr., Esquire. The Intervenors were represented by John J. Pringle Jr., Esquire. Beach Field was represented by Margaret M. Fox, Esquire. The Office of Regulatory Staff ("ORS") was represented by Shannon Bowyer Hudson, Esquire and Andrew M. Bateman, Esquire.

After the hearing was called to order by Chairman Hall, Mr. Pringle asked to present a “preliminary matter” at which time he informed the Commission that the Intervenor and ORS had filed with the Commission a “settlement agreement.” Transcript at 40. Pursuant to the purported “settlement agreement,” ORS and the Intervenor 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.” *See* Transcript at 41-42.

DIUC objected to the purported “settlement agreement” asserting that the Commission should not consider it, take notice of it, or incorporate it into the record. *See* Transcript at 42-44. DIUC objected on the grounds that the “settlement agreement” endorses an even lower revenue number than originally proposed by ORS, that any agreement between ORS and Intervenor is irrelevant to the Application since the Company did not agree to the terms of the purported settlement agreement, and that admission of this particular “settlement agreement” is prejudicial to the Company. *Id.* The Commission overruled the Company’s objection.

DIUC presented the prefiled and summary testimony of John F. Guastella, President of Guastella Associates, LLC and Gary C. White, Vice President of Guastella Associates, LLC. *See* Transcript at 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 and summary testimony of The Honorable Maria Walls, Treasurer of

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.

Beaufort County, and prefiled testimony of and Eric Johanson, Chief Operator of DIUC. *See* Transcript at 73-111 and 112-118.

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. *See* Transcript at 347-464.

The Intervenors also presented prefiled and summary testimony of the following DIUC customers: Doug Egly, Tony Simonelli, Paul Vogel, and Harry Jue. *See* Transcript 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. *See* Transcript 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* Transcript at 466-543.

Pursuant to motions by each party, all prefiled testimony was read into the record as if given orally.

III. FINDINGS OF FACT

1. DIUC is a water and sewer utility providing water and sewer service in its assigned service area on Daufuskie Island, Beaufort County, South Carolina. Its operations in South Carolina are subject to the jurisdiction of the Commission, pursuant to S.C. Code Ann. Sections 58-5-10, *et seq.*(1976), as amended.

2. The appropriate historical test year period for this proceeding, selected by the Company, is January 1, 2014, through December 31, 2014, adjusted for known and measureable changes.

3. Based on the application of DIUC and the evidence presented to the Commission by the Parties, the Commission will use the rate base/rate of return methodology in determining the lawfulness of the Company's rates and in fixing just and reasonable rates.

4. Certain revenue, operating expense, and rate base adjustments proposed by ORS were accepted by the Company as listed in Mr. Guastella's rebuttal testimony; these adjustments will be used by the Commission in calculating DIUC's revenue requirement.

5. The original cost of DIUC's utility plant that is used and useful in providing service to its customers is \$3,949,956 for water and \$4,189,304 for sewer.

6. The accumulated depreciation for plant in service is \$427,962 for water and \$347,197 for sewer and the annual depreciation expense related to the utility plant in service is \$40,859 for water and \$52,230 for sewer.

7. The appropriate level of customer contributions in aid of construction net of amortization is \$402,768 for water and \$183,932 for sewer.

8. There is no reasonable basis upon which to make a negative acquisition adjustment.

9. A fair and reasonable rate of return for the Company is 7.94%. The resultant operating margin is 16.1% which is also reasonable.

10. The Company is entitled to total rate case expenses of \$191,200, which is approximately one-half of the \$380,000 rate case expenses actually incurred in this rate case by DIUC as of October 28, 2015. Allowed rate case expenses shall be amortized over a period of four years, ($\$191,200/4 \text{ years} = \$47,800 \text{ per year}$).

11. The actual and known and measurable amount for Utility Property Taxes necessary to cover the eight year installment payments under DIUC's Settlement Agreement Addendum with

Beaufort County Treasurer and its ongoing annual amounts are \$65,855 and \$192,372, respectively.

12. The management of DIUC's operation under the management agreement with Guastella Associates, LLC has been more than adequate, particularly given the challenges faced by the Company; the requested management fees in the amount of \$171,364 are reasonable and may be recovered.

13. DIUC seeks an increase in its rates and charges for water and sewer service. Under DIUC's proposed rates, the additional total operating revenues would be \$1,182,301.

14. The appropriate operating expenses for DIUC after accounting and pro forma adjustments and adjustments for known and measurable changes total \$1,537,203.

15. Applying the fair and reasonable rate of return established in Finding #9, a 7.94% rate of return, the total operating revenue requirement for DIUC is \$2,089,652.

16. In order for DIUC to have the opportunity to earn its total operating revenue requirement of \$2,089,652, DIUC must be allowed additional revenues totaling \$1,016,071. Although this revenue amount is lower than the amount requested by the Company, it is sufficient and reasonable based upon the testimony presented by all the parties to this proceeding.

17. The Company's proposed "single-tariff" rate structure for its "Haig Point" and "Melrose" customers was unopposed, is fair and reasonable, and will be used to reflect rates that generate the allowed revenues as determined by the Commission.

18. The proposed "settlement agreement" offered at the hearing by Intervenor and ORS is hearsay and does not present any probative facts. It does not bind the Company. Both Intervenor and ORS proceeded on the merits and presented testimony in addition to the prefiled testimony of their respective witnesses. The testimony of the Intervenor's witnesses contradicted

the terms of the “settlement agreement” and the testimony of the ORS witnesses. As such, the proposed “settlement agreement” will not be considered, and the Commission will decide the matter based on the testimony and other exhibits entered into the record.

IV. EVIDENCE AND CONCLUSIONS

1. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 1

The evidence supporting this finding concerning the Company’s business and legal status is contained in the Application filed by DIUC, testimony, and in prior Commission Orders in the docket files of the Commission, of which the Commission takes judicial notice. This finding of fact is informational, procedural, and jurisdictional in nature, and the matters which it involves are not contested by any party.

2. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 2

The evidence supporting this finding, that the appropriate historical test year period for this proceeding is January 1, 2014, through December 31, 2014, is contained in the Application filed by DIUC and in the testimony and exhibits of the Company, ORS, and Intervenors. No party contested the use of this historical test year proposed by DIUC in its Application. The Commission concludes that the historical test year ending December 31, 2014, is appropriate.

A fundamental principle of the ratemaking process is the establishment of a historical test year period. For ratemaking purposes, this Commission routinely examines the relationships between expenses, revenues, and investment in a historic test period because such examination provides a constant and reliable factor upon which calculation can be made to formulate the bases for determining just and reasonable rates. This method was recognized and approved by the South Carolina Supreme Court for ratemaking purposes involving utilities in *Southern Bell Telephone*

and Telegraph Company v. South Carolina Pub. Serv. Comm'n, 270 S.C. 590, 244 S.E.2d 278 (1978).

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).

3. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 3

The evidence supporting this finding, that Commission should and will use the rate base/rate of return methodology in determining the lawfulness of the Company's rates and in fixing just and reasonable rates, is contained in the Application filed by DIUC and in the testimony and exhibits of the Company, ORS, and Intervenors.

"The 'rate base' is the amount of investment on which a regulated public utility is entitled to an opportunity to earn a fair and reasonable return." *Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff*, 392 S.C. 96, 101 n.2, 708 S.E.2d 755, 758 (2011). Rate base "represents the total investment in, or the fair value of, the used and useful property which [a utility] necessarily devotes to rendering the regulated services." *Id.* The rate of return on rate base is calculated by dividing the net income for return by the rate base. *Id.* Citing *Heater of Seabrook, Inc. v. Public Service Comm'n of S.C. (Heater of Seabrook II)*, 332 S.C. 20, 24 n.2, 503 S.E.2d 739, 741 n.2 (1998).

In its Application, DIUC requests rates be set on the basis of a rate of return on rate base ("rate base/rate of return"), similar to its most previous rate application. *See* Application for

Approval of Rates and Charges, January 10, 2012, Docket 211-229-WS. The Commission approved a settlement of DIUC's most recent prior Application based on rate base/rate of return and specified an operating margin as well as a rate of return on equity and the Company's rate base. *See* Order No. 2012-515, Docket 211-229-WS. In this proceeding, ORS and Intervenors also presented testimony as to their contentions regarding a suitable rate base and overall rate of return, including the cost of debt and rate of return on equity.

Neither S.C. Code Ann. Section 58-5-240, nor any other statute, prescribes a particular method to be utilized by the Commission to determine the lawfulness of the rates of a public utility. *See Porter v. South Carolina Pub. Serv. Comm'n*, 333 S.C. 12, 26, 507 S.E.2d 328, 335 (1998) ("It is within PSC's discretion to adopt the rate-setting method it believes is appropriate, provided that method complies with the statutes.") ((citing *Heater of Seabrook, Inc. v South Carolina Pub. Serv. Comm'n*, 324 S.C. 56 at 64, 478 S.E.2d 826, 830 (holding "PSC generally has wide latitude to determine an appropriate rate-setting methodology") and *Nucor Steel v. South Carolina Pub. Serv. Comm'n*, 312 S.C. 79, 85, 439 S.E.2d 270, 273 (1994) (holding "nothing in statute requires PSC to adopt any particular price-setting methodology in determining fair rate of return."))).

The Commission finds that the weight of the evidence, including the Application and testimony of witnesses Guastella, White, Gearheart, Carlisle, Loy, and Lanier as to their respective determinations associated with the rate base/rate of return, supports the use of a rate base/rate of return methodology in this case. The Commission further finds use of a rate base/rate of return methodology has allowed the Commission to determine fair, just, and reasonable service rates and charges for the Company.

4. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 4

The evidence supporting this finding, that certain revenue, operating expense, and rate base adjustments proposed by ORS were accepted by the Company as listed in Mr. Guastella's rebuttal testimony and that these adjustments will be used by the Commission in calculating DIUC's revenue requirement, is based upon the Application and testimony of witnesses Guastella, White, Gearheart, and Morgan.

In his rebuttal testimony, Mr. Guastella lists twenty (20) line items of revenue requirement adjustments proposed by ORS that he accepts on behalf of DIUC, as follows: Total Revenues, Wages, Benefits, Directors' Fees, Power, Chemicals, Supplies and Maintenance, Outside Services-Engineering, Outside Services-Accounting, Outside Services-Legal, Outside Services-Testing, Outside Services-Other, Transportation, Bad Debt, Insurance, Regulatory Commission Expense, Other A&G Expenses, Revenue Taxes, Payroll Taxes, and Average Unamortized Balances (the only rate base adjustment; the other 19 adjustments were made to revenues and operating expenses).

In her testimony for ORS, Ms. Gearheart relies on the testimony and exhibits of Mr. Morgan of ORS's Water and Wastewater Department for the adjustment for total revenues. The primary adjustment to revenues reflects the annualization of customers for the historical test year and the exclusion of the Company's allowance for growth in customers, along with other minor adjustments. The other adjustments accepted by DIUC are explained in Ms. Gearheart's testimony and were not subject to objection by the testimony of the Intervenor's witnesses.

As set forth in Ms. Gearheart's testimony, ORS initially asserted that the bad debt adjustment should be \$108,349, as opposed to the lower proforma adjustment in the amount of \$16,090 proposed by DIUC in its Application. Mr. Guastella testified that the Company was

willing to accept the bad debt adjustment by ORS and that it was more accurate than the Company's proposed adjustment based on the actual experience of the Company. *See Transcript at 136-137.* At the hearing, Ms. Gearheart changed her exhibits from her prefiled testimony in order to reflect the change as stated in the purported settlement agreement between ORS and Intervenor. *See Transcript at 485-486.*

Ms. Gearheart did not provide any explanation or analysis as to why she and ORS reversed its bad debt allowance and neither did any witness on behalf of the Intervenor, other than to make the testimony and Ms. Gearheart's exhibits consistent with the purported "settlement agreement." On the other hand, Mr. Guastella testified that he found ORS's initial bad debt allowance acceptable because it better reflects DIUC's actual experience than the conservative allowance he originally included in DIUC's application. Mr. Guastella testified that ORS's allowance of bad debts was about \$100,000, almost the same as the actual bad debt level of \$105,667 in the historical 2014 test year. He further testified that on the basis of updated financial data available at the time of his rebuttal testimony, the bad debts of the Company for the latest 12 month period were also about \$100,000. *See Transcript at 136-137.* The Commission has not been provided any support for ORS's rejection of its own original bad debt adjustment or the bad debt adjustment proposed by Intervenor. Mr. Guastella's testimony actually provides further support for the original ORS adjustment and the Commission finds that the original ORS bad debt allowance is fair and reasonable. We will, however, only increase the bad debts for additional revenues under the rates we allow herein to 50% of the existing ratio of bad debts to revenues as a more conservative measurable change for rate setting purposes in this case.

Accordingly, as demonstrated in the Application and testimony of witnesses Guastella, White, Gearheart, and Morgan, the Commission finds that the evidence supports that all of the 20

line item adjustments proposed by ORS and accepted by DIUC, as stated in Mr. Guastella's Rebuttal Testimony and his testimony before the Commission, are fair and reasonable and, thus, will be used by the Commission in determining the adjusted financials for the test year and DIUC's revenue requirement.

5. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 5

The evidence supporting this finding, that the original cost of DIUC's utility plant, which is used and useful in providing service to its customers is \$3,949,956 for water and \$4,189,304 for sewer, is based upon the Application and testimony of witnesses Guastella, White, Gearheart, and Morgan.²

The Application presents \$8,139,260 as the total cost of plant in service for water and sewer combined that is used and useful in providing service to the DIUC customers. *See App. at Schedules W-B and S-B.*

Ms. Gearheart proposes in her testimony with respect to Adjustment 10 that the Commission should reduce DIUC's gross plant in service by \$1,624,696 "to reflect capital improvements, non-allowable plant, adjustments from the previous case not made by DIUC and retirements through July 31, 2015." *See Gearheart Direct Testimony at 9.* Her description of Adjustment 10 in Audit Exhibit ICG-4, Page 5 states the adjustment is intended "[t]o remove undocumented expenses from gross plant in service" and shows the total reduction for "Combined Operations" of \$1,624,696 segregated between Water Operations and Sewer Operations in the amounts of \$1,353,024 and \$271,672, respectively. As Mr. Guastella pointed out, however, Ms. Gearheart does not identify nor provide any description or amount of the reductions she is

² Intervenors do not make adjustments to specific items of utility plant but propose treating large portions as CIAC, which will be addressed later.

proposing for the specific capital improvements, non-allowable plant, previous adjustments or retirements, on either a combined basis or separately for water and sewer operations.

Mr. Morgan provided some information regarding ORS's proposed adjustment when he testified that DIUC's 125,000 gallon elevated storage tank and facilities and the Bloody Point Well #1 are assets that were not included in ORS's rate base calculations, but he did not provide the specific costs of those assets that were used by ORS to reduce the Company's rate base. Mr. Morgan does not identify any other rate base adjustments. The Intervenor's witnesses' also propose adjustments to rate base, but they do not identify any specific assets or their costs.

Thus, neither ORS nor Intervenor's have established a record upon which this Commission can make adjustments to the specific itemized costs of DIUC's utility plant in service. Moreover, the premises of ORS's adjustments are unclear. For example, Audit Exhibit ICG-4, Adjustment 10, attributes "undocumented expenses" as the reason for ORS's total reduction to plant in service. Yet, Mr. Morgan's direct testimony contradicts Ms. Gearheart's reason. He instead attributes a lack of ownership, not a lack of documentation, as the reason for the reduction of the cost (unstated) of the elevated storage tank, Bloody Point Well #1, and related facilities. These inconsistencies demonstrate contradictions among ORS's positions.

Rather than dismissing ORS's utility plant adjustments out-of-hand for failure to sufficiently present this Commission with non-contradictory evidence as to the specific items and their costs, we will address Mr. Guastella's rebuttal testimony in which he discusses ORS's utility plant adjustments, as he understands them on the basis of the ORS work papers provided to DIUC following ORS's audit exit conference call with the Company. *See* John F. Guastella Rebuttal Testimony at 5.

A. Elevated Storage Tank, Well, and Related Facilities

ORS does not dispute that the elevated storage tank, well, and related facilities have continued to be used and useful since their installation, and ORS has not presented any testimony to contradict the proof of cost of these facilities entered into evidence by DIUC nor that the cost attributable to each of these assets of the Company is reasonable.

In his direct testimony, the only reason Mr. Morgan offers to exclude the cost of these facilities on the elevated tank site parcel is that documents obtained online from Beaufort County identify the tax sale deed of the real property parcel showing an owner different from the Company; he then concludes that DIUC does not own the utility facilities located on the parcel. *See* Prefiled Direct Testimony of Willie J. Morgan at 7.

In his rebuttal testimony, Mr. Guastella testified as to the ownership of the elevated storage tank, well, and related facilities:

DIUC owns those facilities and they were never sold, as reflected in a Special Warranty Deed and Bill of Sale dated April 1, 2001 by and between Haig Point, Inc. and Haig Point Utility Company, Inc. See Exhibit 1. DIUC's initial and supplemental response to ORS Request #1.79 documents that DIUC, as the successor utility to Haig Point Utility Company, Inc. ("HPUC"), has the right to construct, operate, maintain and replace utility facilities on any parcel of land on the 1,040 acres of the Haig Point Plantation being developed by Haig Point, Inc., formerly International Paper Realty Corporation of South Carolina, provided there were no existing plans for a building construction. See Exhibit 2. The approved joint application of Haig Point, Inc. and CK Materials LLC for the sale of the stock of HPUC includes on Schedule 3.13(a), page 3, the cost of the storage tank and well in the amount of \$1,303,083.97. The Beaufort County property record reflected in Exhibit WJM-7 does not include any of DIUC's utility facilities. Moreover, the testimony of Maria Walls, Treasurer of Beaufort County, confirms that Beaufort County did not sell DIUC's storage tank, well, pump, pipes and other utility facilities in the tax sale to Mr. Sabry, and that Mr. Sabry is not paying property taxes on those utility facilities. DIUC, however, is paying Utility Taxes for them on the basis of assessments by the Department of Revenue ("DOR"). The original cost of these facilities is reflected on DIUC's books and they have continued to be used and useful, without interruption, in providing water service to DIUC's customers since they were first placed into service.

See Transcript at 201-202.

In addition to this testimony of Mr. Guastella, Beaufort County Treasurer Maria Walls confirmed that the tax deed for the real property did not convey DIUC's facilities to Mr. Sabry and that the South Carolina Department of Revenue ("SCDOR") includes the tank and facilities as part of the DIUC system for assessment of the Utility Property Tax. *See Transcript at 82- 83.* We find the testimony of Treasurer Walls persuasive on this issue.

Upon review of Mr. Morgan's Exhibit WJM-7 and upon consideration of Ms. Walls' testimony and the testimony of Mr. Guastella, the Commission cannot conclude that DIUC does not own those utility facilities on this real property. Accordingly, ORS's position that DIUC lacks ownership of the elevated storage tank, well, and related facilities is rejected as a basis for deducting the cost of those facilities from utility plant in service. Again, there has been no testimony to dispute that the elevated tank and associated facilities are used and useful in providing water service to DIUC's customers. They are devoted to providing water service and their value is calculable. Based upon the testimony of Ms. Walls and Mr. Guastella and after thorough analysis of the testimony of witnesses White, Gearheart, and Morgan, we find that the elevated storage tank, well, and related facilities are used and useful, DIUC has control of those facilities, and their cost as proposed by DIUC is reasonable.

Even though title to the land and title to the utility facilities are separate, the Commission also notes that DIUC has initiated condemnation proceedings to re-acquire legal ownership of the real property and the court has ruled that such condemnation is legally proper. *See Transcript at 52.* Upon initiation of these proceedings, the Company had a right to possession of the land. "A condemnor may take possession of property: ... (3) upon deposit with the clerk of court in the

county in which the property to be condemned is situated, the amount stated in the Condemnation Notice as just compensation for the property, the amount having been determined by the condemnor pursuant to § 28-2-70(a) before initiating the action.” S.C. Code Ann. § 28-2-90(3).

The Commission also rejects Mr. Morgan’s alternative reason for excluding the elevated storage tank, well, and related facilities based upon the gross value used by the SCDOR to assess DIUC’s Utility Tax for the years 2012 and 2013. In his surrebuttal testimony, Mr. Morgan proposes that “DIUC should not be allowed to earn a return on the elevated storage tank for ratemaking purposes while at the same time having taken action that could reduce property taxes by revising annual reports to deduct a value corresponding to the elevated storage tank value.” *See Surrebuttal Testimony of Willie J. Morgan at 516-517.*

We disagree in principle with Mr. Morgan’s assertion that SCDOR tax assessment values are both relevant and controlling for our rate making analysis. The Commission’s analysis of ratemaking must be based on the allowance of return on the actual net investment of used and useful plant, which is not the same as a value assessed for taxation. This Commission is hesitant to endorse using tax assessment values for ratemaking purposes as such assessments do not reflect the actual cost of facilities that are used and useful in providing service. Further, in this instance, it would be counter-productive to penalize DIUC for its actions to reduce property taxes that benefit the ratepayers.

Additionally, even if the values the SCDOR to assess DIUC’s Utility Tax were to be considered, the revised Schedules 201 of the annual reports, Surrebutal Exhibit WJM-1, Pages 2 and 4, for 2012 and 2013, respectively, clearly state that the values included reflect the rate base allowed in DIUC’s last rate case, Docket No. 2011-229-WS, not the actual book cost of utility plant in service for those years, and also not the book costs reflected in the supporting schedules

submitted by DIUC in this rate case. A review of the differences in the totals between the original and revised Schedules 201 for 2012 and 2013, demonstrates pro-rata adjustments to the list of primary plant accounts, and do not support the assertion by Mr. Morgan that SCDOR reduced the overall assessed value by \$863,379 for the cost of the elevated storage tank as Mr. Morgan states in his testimony. *See* Transcript at 515. Indeed, the original Schedules 201 show \$863,379 in Account 330.4 Distribution Reservoirs and Standpipes, but the revised schedules still show in excess of \$600,000 in that account, which contradicts Mr. Morgan's statement that the differences correspond to the \$863,379 value for the elevated tank as identified in Docket No. 2011-229-WS.

Finally, the settlement in Docket No. 2011-29-WS does not indicate the components of the \$5.0 million rate base; there is no mention of the elevated storage tank or its cost in that approved settlement. *See* Order No. 2012-515, Docket 211-229-WS. The settlement also states:

3. The Parties agree and stipulate that DIUC shall be allowed to set rates and charges on a rate base of \$5,000,000. 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.

See Order No. 2012-515, Docket 211-229-WS, and attached Settlement Agreement. By asking this Commission to use the SCDOR assessment, which is based on Order No. 2012-515, Docket 211-229-WS, ORS essentially asks the Commission to do what ORS agreed not to do -- to use the \$5,000,000 rate base as evidence in this later rate case.

For all of the reasons stated above, the Commission finds the elevated storage tank, well, and related facilities have continued to be used and useful since their installation and should be included as part of the DIUC plant in service.

B. Bloody Point Well #1

ORS proposes an adjustment to plant in service to exclude Bloody Point Well #1. The sole reason offered by ORS is found in Mr. Morgan's direct testimony wherein he states that documents obtained online from Beaufort County indicate a party other than DIUC owns the real property on which Bloody Point Well #1 is located. *See* Direct Testimony of Willie J. Morgan at 7. Mr. Guastella's rebuttal testimony, however, responds to Mr. Morgan's claim that the Bloody Point Well is not owned by DIUC. Mr. Guastella cites two grounds for inclusion of the well in DIUC's plant in service.

First, Exhibit 3 to Mr. Guastella's rebuttal testimony is an Indenture Grant of Easement and Bill of Sale for Personal Property between the Bloody Point Group Limited Partnership and Melrose Utility Company. This uncontradicted exhibit establishes that the Company possesses an easement over the real property for access, use, and operation of its facilities. This exhibit also demonstrates the Company holds title to those facilities by virtue of the bill of sale. Second, Mr. Guastella testified that the Bloody Point Well #1 is reflected on DIUC's books and it has continued to be used and useful in providing service to the Company's customers. *See* Transcript at 287 (testimony of Mr. White as to "original cost numbers in the books and records of International Paper" which were transferred to DIUC's books.).

The rate base we seek to determine must include "the total investment in, or the fair value of, the used and useful property which it necessarily devotes to rendering the regulated services." *Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff*, 392 S.C. 96, 101 n.2, 708 S.E.2d 755, 758 (2011). After consideration of Mr. Guastella's testimony and the Indenture Grant of Easement and Bill of Sale for Personal Property between the Bloody Point Group Limited Partnership and

Melrose Utility Company, the Commission rejects the adjustment proposed by ORS and finds DIUC may include the cost of the Bloody Point Well #1 in its utility plant in service.

C. Absence of Invoices for Certain Facilities

Again, as previously discussed, Ms. Gearheart's testimony does not itemize the specific assets or their costs that are the basis of ORS's proposed adjustments to utility plant in service. Rather than dismissing ORS's utility plant adjustments out-of-hand for failure to present evidence as to the specific items and their respective costs it proposes be removed, we will address Mr. Guastella's rebuttal testimony in which he discusses ORS's utility plant adjustments, as he understands them based on the ORS work papers provided to DIUC following ORS's audit exit conference call with the Company. *See, infra*, John F. Guastella Rebuttal Testimony at 5.

According to Mr. Guastella's rebuttal testimony, information provided to DIUC by ORS indicates a portion of ORS's total adjustments to utility plant relates to the absence of invoices confirming the original construction costs of particular facilities used and owned by the Company. Mr. Guastella testified, however, that the absence of those invoices does not constitute a lack of documentation of cost for ratemaking. *See* Guastella Rebuttal Testimony at 6. Mr. Guastella explained that DIUC provided ORS with itemized assets, by primary plant account, description, original costs as booked, year of installation and in service dates. *See* Transcript at 150-153. Mr. Guastella also testified at the hearing it was the now defunct Melrose Utility Company that failed to retain many of the invoices sought by ORS. *Id.*

The Commission agrees with Mr. Guastella that lack of invoices does not necessarily constitute an absence of evidence as to the reasonableness of the cost of a utility's assets that are providing service. With regard to documentation, Mr. Guastella testified at length as to how DIUC documented the costs by providing documentation from its books and records as to the cost of

plant and identification of the plant. *See* Transcript at 151-152. The absence of invoices is not equivalent to a total absence of documentation of the cost of these particular assets that are in service.

Mr. Guastella also testified that it is consistent with the NARUC Uniform System of Accounts (“NARUC USoA”) to estimate the cost of utility plant in the absence of the original documentation, pointing out that Intervenor’s witness, Mr. Loy, also made that observation in his testimony with respect to another issue. Mr. Loy testified that “The NARUC USoA requires an ‘estimate’ of plant values when there is no supporting documentation available.” *See* Transcript at 385. When asked on cross-examination about this estimating procedure, Ms. Gearheart testified that she was not aware of that provision in the NARUC USoA. *See* Transcript at 530.

The Commission finds that based upon the Application and the testimony of witnesses Guastella, White, Gearheart, and Loy, ORS’s adjustment for “undocumented expenses” is not supported and is rejected.

D. Capitalized Legal and Consulting Fees

Another element of Ms. Gearheart’s proposed reduction of utility plant in service relates to legal and consulting fees. The following questions and answers in Mr. Guastella’s rebuttal testimony provide a thorough factual summary of the circumstances that created the need for legal and consulting fees, and Mr. Guastella’s justification for including the fees as part of the cost of utility plant in service:

- Q. What adjustments did the ORS propose with respect to legal and consulting fees that are reflected in DIUC’s utility plant in service?**
- A. Ms. Gearheart’s testimony and exhibits do not specifically identify the amounts of those adjustments. They are lumped in with her adjustment to utility plant in service. It is our understanding that she proposes to eliminate the legal fees incurred in connection with the condemnation of the Sabry parcel and to eliminate GA consulting fees that were capitalized. I would

note that Ms. Gearheart's statement that the legal costs of \$29,511 were for condemnation of the water tower is incorrect. DIUC is condemning the land, not the water tank that DIUC already owns.

Q. Why was the condemnation action required?

A. When we learned of the tax sale of the storage tank parcel, our first reaction was to reason with Mr. Sabry. When that was unsuccessful, we filed a legal action to reverse the tax sale. Subsequently, however, our attempt to finance with CoBank and then Wells Fargo fell through, and our need to obtain financing for capital improvements had to be our primary objective. It became evident that the proceeding to reverse the tax sale would be drawn out and result in an unacceptable delay in obtaining a loan. The best course of action was to withdraw the law suit and initiate a condemnation, an action that SunTrust would accept -- and made it a requirement of the loan.

Q. Why should the legal fees be included in the cost of providing service?

A. The tax sale was beyond our control. Upon managing DIUC, we notified Beaufort County of the new address, and we received regular property tax bill from Beaufort County at that address. For an unknown reason, Beaufort County sent a tax bill for the storage tank parcel of land to the wrong address without our knowledge, as well as notices of a delinquency and a tax sale. It even posted a notice of the tax sale at the wrong property, and our operators never observed any notice at the storage tank site which they visit daily. The legal fees were, therefore, unavoidable and included in the cost of land.

Q. Why should GA's fees related to capital improvements be included in the cost of providing service?

A. GA's management agreement contains a provision under which work performed in connection with capital improvements is not part of the routine day-to-day management of DIUC and, therefore, would be billed at 10% of the first \$50,000 of improvements and 8% of capital costs over \$50,000. The work involves establishing the improvements that are needed or desirable, establish priorities in terms of their impact on service and available funding cost, solicit and obtain contractors' proposals, select contractors, schedule and coordinate work with DIUC's routine operations, and supervise the construction work.

Q. Did ORS provide any reason for eliminating GA's fees related to capital improvements?

A. Not that I could find.

Q. Why should GA's fees related to capital improvement be included in rate base as part of the cost of the improvements to utility plant is service?

- A. GA's capital fees are not only part of an arms-length management agreement, they are necessary and the cost is reasonable. It is obvious that capital improvements cannot be made without the work I describe above. The 10% and mostly 8% of the construction costs are significantly less than the 15% to 20% typically allowed for administration and supervision of construction work.

See Transcript at 204-206.

In reply to DIUC's discovery requests, ORS agreed that: (1) the consulting services related to capital improvements were performed; (2) the consulting services related to capital improvements were in accordance with provisions in GA's management agreement with DIUC; and (3) the facilities to which those consulting services related are used and useful in providing service to DIUC's customers. *See Response to Company's First Set of Interrogatories and Requests for Production to ORS at #3, Exhibit 10 to Transcript.* Mr. Guastella also testified that the work performed by GA was necessary to initiate, implement, supervise and account for capital improvements.

On the basis of the record in this case, we reject ORS's adjustment to utility plant in service related to legal and consulting fees that were added to the capital costs of utility plant in service. We find the Company's inclusion of these in the test year as well as the amounts used to be fair and reasonable.

E. Land Values

With regard to land values, we learned from Mr. Guastella's rebuttal testimony that part of Ms. Gearheart's proposed reduction of total utility plant in service relates to land owned and/or used by the Company for which no value was recognized by ORS. Mr. Guastella testified that the land value included in utility plant in service for all of DIUC's land is \$109,560, which includes \$3,700 related to the elevated storage tank site but excluding capitalized legal fees, determined on

the basis of an appraisal by an independent land appraiser who was used to value the site of the elevated storage tank. *See* Transcript at 206-207. The actual value asserted by DIUC in Mr. Guastella's testimony was not challenged, nor was the reasonableness of the land value. As indicated previously herein, the Commission finds that the real property included by DIUC in plant in service is used and useful. Further, ORS has not presented any testimony that the per-acre, appraisal-based cost proposed by DIUC is unreasonable. On the basis of the record in this case, we find that DIUC's submitted values for this land are fair and reasonable and reject ORS's proposed adjustment to utility plant in service related to land values.

In summary, Finding of Fact #5, that the original cost of DIUC's utility plant that is used and useful in providing service to its customers is \$3,949,956 for water and \$4,189,304 for sewer, is based upon the Application, discovery responses, and testimony of witnesses Guastella, White, Gearheart, Loy, and Morgan. ORS's proposed reduction to total utility plant in service on a combined basis and for water and sewer operations is denied.

6. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 6

The evidence supporting this finding, that the accumulated depreciation is \$427,962 for water and \$347,197 for sewer and that the annual depreciation expense related to the utility plant in service is \$40,859 for water and \$52,230 for sewer, is based upon the Application and testimony of witnesses Guastella and White.

Both DIUC and ORS use the system utilization factor methodology for calculating depreciation expense and accumulated depreciation. ORS uses slightly different depreciation rates, but does not explain the reason for the differences. The level of depreciation expense and accumulated depreciation depend on the amount of utility plant in service that the Commission has accepted for rate setting purposes. Because we have accepted DIUC's utility plant in service,

without adjustment, we will accept its depreciation rates and resultant depreciation expense and its accumulated depreciation in determining rate base.

Intervenors' witness, Mr. Loy, disagrees with the use of the utilization factor in calculating depreciation expenses, which he proposes should be based on full depreciation rates. *See* Transcript at 371. Mr. Loy also proposes to increase DIUC's booked accumulated depreciation, which he asserts is necessary in order to comply with GAAP and the appropriate accounting used for setting rates. *See* Transcript at 372. Finally, Mr. Loy alleges that the Company's booked accumulated depreciation does not properly reflect the age and condition of the plant. *See* Transcript at 404-405.

In support of his positions, Mr. Loy relies on the testimony of Harry Jue, who is a DIUC customer and former employee of the City of Savannah where he served as the Water and Sewer Bureau Chief for 31 years. Mr. Jue inspected the water and wastewater systems, and on the basis of his observations, assigned an accumulated depreciation of 30% of the total cost of utility plant in service. *See* Transcript at 362-363.

On the basis of Mr. Jue's analysis, Mr. Loy proposes to increase accumulated depreciation and establish a deferred amount of accumulated depreciation of \$316,142 for water and sewer combined (\$141,194 for water and \$174,948 for sewer), which he states the Company should be able to recover over seven years, or \$45,000 annually. *See* Transcript at 379.

Mr. Guastella responds to Mr. Loy's position on depreciation in rebuttal, focusing on the characteristics and nature of newly formed developer-related water and sewer utilities that were created as part of a new real estate project. *See* Transcript at 160-163, 206-209. Mr. Guastella testified that he developed the system utilization factor methodology for depreciation along with the complete system analysis in setting rates for water and sewer utilities for developer-related

utilities. *See* Transcript at 208. His motivation to do so was based on his experience regulating some 400 small, mostly developer-related water and sewer utilities, after he observed the difficulty they invariably had in attracting capital on the strength of their own financial condition once the real estate development was completed. Mr. Guastella testified that he continued using a complete system analysis as a consultant so that the existing utility customers would not subsidize the cost of the real estate project or even bear the risk of the success of the real estate project. Mr. Loy's approach places the burden of depreciation of the Company's entire plant in service on a fraction of the utility's ultimate customer base. Mr. Guastella explained that the complete system analysis which bases depreciation on system utilization (i.e., actual utilization as a percentage of capacity rather than the full level of depreciation), mitigates the problem of newly formed developer-related utilities that have insufficient revenues during the growth years with which to cover operating expenses, including depreciation. Accordingly, the book value would not be understated after completion of the real estate project, leaving the utility in a weak financial position. *See* Transcript at 207-210.

Mr. Guastella also responded to Mr. Loy's position that DIUC's accumulated depreciation does not properly reflect the age and condition of the plant. In rebuttal, Mr. Guastella testified that depreciation is caused not only by wear and tear, action of the elements, and decay (the physical condition) but also changes in art, obsolescence, and changes in regulatory requirements. *See* Transcript at 209.

The testimony of Mr. Guastella demonstrates his significant experience with newly formed developer-related utilities and the calculation of depreciation rates and expense. His testimony further establishes that the use of the complete system analysis used by him and ORS is fair and reasonable.

In his surrebuttal testimony, Mr. Loy does not accept Mr. Guastella's reasoning for the complete system analysis claiming that it is a concealed request for rate base treatment of deferred depreciation expense because it is improperly reflected in the books for regulatory and rate making purposes. *See* Transcript at 403. The Commission does not agree that the Company's request conceals its position on depreciation, or the impact on expenses and rate base. DIUC's Application clearly sets forth the utilization factor methodology for calculating depreciation expense and rate base, and ORS not only understands the Company's method of calculation but concurs in it. *See* Transcript at 494. The Commission fully understands that the depreciation expense allowed for rate setting will be lower due to the utilization factor, and that the rate base will be higher because of the commensurate reduction of accumulated depreciation related to a lower level of depreciation expense. We also find that the revenue requirement will be less under the system utilization factor methodology because the lower depreciation expense has more of an impact than the additional return related to the incrementally higher rate base.

Mr. Loy also states that application of the utilization factor extends the book value of the DIUC assets beyond their useful life. *See* Transcript at 364. The "useful" life or average service life of DIUC's assets on a composite basis or for individual primary plant accounts, is not known but instead is estimated on the basis of depreciation studies. Such studies account for the fact that some units of depreciable assets will be retired before and some after the average service life on which depreciation rates are, in part, established. Utilities ultimately stop taking depreciation on accounts that are fully depreciated, so that they never recover more than the original cost of the depreciable assets. As Mr. Guastella testified, depreciation rates can be revised over time to reflect a range of average service lives, and it would not be unreasonable at some point to increase the depreciation rates. *See* Transcript at 209. This Commission's rate setting authority includes the

establishment of allowances for depreciation that takes into account all elements affecting depreciation rates.

Accordingly, we find that the system utilization factor methodology for depreciation as used by DIUC and the ORS is reasonable and beneficial to the customers for rate setting purposes in this case.³ As such, we find the accumulated depreciation for plant in service is \$427,962 for water and \$347,197 for sewer. We further find the annual depreciation expense related to the utility plant in service is \$40,859 for water and \$52,230 for sewer.

7. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 7

The evidence supporting this finding, that the appropriate level of customer contributions in aid of construction net of amortization is \$402,768 for water and \$183,932 for sewer, is based upon the Application and testimony of witnesses Guastella, White, Gearheart, and Loy. ORS proposes to reverse the Company's increase in contributions in aid of construction (CIAC). Although the Company is silent as to this adjustment, it did accept ORS's adjustments for growth with respect to both revenues and expenses. We will, therefore, accept ORS's adjustment to CIAC. The ORS proposes only a very small adjustment of \$216 to the Amortization of CIAC, which slightly increases rate base, but it is primarily due to its depreciation rates that we will not use and, therefore, we do not accept its adjustment to the amortization of CIAC.

Intervenors assert that a large part of the utility plant should be treated as CIAC, surmising that it was contributed by International Paper to HPUC. In support of this contention, Mr. Loy

³ While we base our conclusions on the merits of the testimony of the witnesses, we are mindful of their qualifications and experience in weighing their respective opinions. Mr. Jue has never performed a depreciation study to establish average service lives, salvage values or depreciation rates, nor has he been qualified as an expert in depreciation in a rate proceeding. Mr. Loy has never performed a depreciation study using the actuarial or simulated plant balances methods, has never worked for a regulatory agency or developer-related water or sewer utility, and has never prepared initial rates for a newly formed water or sewer utility. Intervenors' Responses to DIUC Second Interrogatories and Requests for Production, Hearing Exhibit 10.

testified that in his opinion, “the majority of plant purchased by DIUC from HPU should be reflected as Contributions in Aid of Construction (CIAC), not as invested plant.” Transcript at 379. That is incorrect. DIUC did not purchase the plant from HPUC; instead, this Commission approved the purchase of the *stock* of HPUC by CK Materials LLC from Haig Point, Inc. which Mr. Loy later recognized in his direct testimony.

With respect to Mr. Loy’s opinion, Mr. Guastella stated in rebuttal:

Q. When you prepared the last rate analysis on behalf of DIUC, did you find anything unusual in the relationship between Haig Point, Inc. and HPUC as reflected on the balance sheet as of December 31 2007 before the acquisition by CK Materials?

A. No. I found what I have always found for the hundreds of my developer-related utility clients. When a water or sewer utility is created as part of a real estate project, it has no customers and no revenues, because the utility system has not yet been constructed. The developer owner, individual or corporate, funds the construction of the utility system. At some point, sooner or later – it doesn’t matter, the assets are transferred from the developer to the utility at their original cost and a liability is reflected on the utility’s books in some form of open account, typically as Advances in Aid of Construction or some other named contributed capital account, which represents the developer’s equity investment. In sum, there is absolutely no indication that there were customer contributions in aid of construction as defined in the NARUC USoA, and Mr. Loy’s proposal to assume contributions is simply unsupported with any substantive analysis.

Transcript at 211-212.

Mr. Guastella also addressed the erroneous assumptions by Mr. Loy regarding contributions by International Paper, as follows:

Q. Do you agree with Mr. Loy’s analysis to support his position that the plant should be treated as contributed?

A. No. Mr. Loy’s analysis is a fabrication. Mr. Loy begins his analysis by claiming that Haig Point, Inc. treated the utility plant as inventory and expensed these costs as development costs. He provides no support for that statement, and it’s rather far-fetched. Under the tax code, one affiliate cannot expense plant for tax purposes and then transfer it to an affiliate who depreciates the cost that was

already expensed. On page 14 of his testimony, Mr. Loy states that “Working with Mr. Guastell, (sic), HPUC developed an original cost trending study...” That never happened! On page 19, Mr. Loy states that “Mr. Guastella probably inventoried the plant and identified certain records that helped date the plant. He probably then performed an original cost trending study...” Again, that never happened! GA was retained by HPUC in 2004 only to prepare a rate analysis, which we did on the basis of information provided by HPUC’s representatives. HPUC’s rate application was examined by the ORS and it prepared a report of its audit, which included the following:

“AUDIT EXHIBIT SGS-10; BALANCE SHEET

Shown in this exhibit is the balance sheet of HPUC as of June 30, 2004. ORS verified the balances contained in this statement to the books and records of HPUC.”

On page 18, Mr. Loy states that “HPUC hired Mr. Guastella to ready HPUC for sale.” Not true! I never knew there would be a sale until 2008 when a member of CK Material LLC contacted me to help him purchase HPUC.

Intervenor’s position regarding contributions is not consistent with the books and records of DIUC or its predecessor HPUC, and is not accepted.

On the basis of the evidence and the merits of the testimony and relative expertise of the witnesses regarding developer-related utilities, we will accept ORS’s adjustment to CIAC but not ORS’s adjustment to the amortization of CIAC.

8. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 8

The evidence supporting the finding that there is no reasonable basis upon which to make a negative acquisition adjustment is based upon the Application and testimony of witness Loy.

Mr. Loy recommends in his surrebuttal testimony that if the Commission finds that International Paper did not donate the water plant in service to HPUC and CIAC was not misclassified, then a negative acquisition adjustment should be made in rate base only if there is a good reason to do so. *See Transcript at 411-412.* Typically, positive acquisition adjustments are considered under special circumstances to encourage large water utilities to acquire small troubled

water utilities in order to improve service. In his direct testimony, Mr. Loy states that a negative acquisition adjustment should not be made; that many Commissions exclude either a positive or negative acquisition adjustment in order to maintain a consistent original cost standard; and that he believes as a general rule of thumb that including a negative acquisition adjustment in rate base will cause more harm than good, unless there is a good reason to do so. *See* Transcript at 392. We also note that this Commission did not impose an acquisition adjustment in the prior rate proceeding and further that in their purported settlement agreement neither ORS nor the Intervenor advocates for an acquisition adjustment. In this case we believe that a negative acquisition adjustment would harm DIUC. We therefore find that no acquisition adjustment should be made.

9. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 9

The evidence supporting this finding -- that a fair and reasonable rate of return for the Company is 7.94%, resulting in an operating margin of 16.1% which is also reasonable, is based on the testimony of witnesses Guastella, Carlisle, and Lanier.

Before addressing the specific rate of return, the Commission must address the cost of capital of the Company with respect to the Company's debt and the true cost of that debt. Mr. Guastella testified that the Company must refinance the existing \$2,750,000 term loan with SunTrust in order to pay off the existing \$500,000 line of credit that is due, to fund additional capital improvements, and to reduce accounts payable. The intended financing would be a \$3,750,000 term loan, increasing the portion of debt in DIUC's capital structure, which will have the benefit of lowering the overall cost of capital and income taxes. *See* Transcript at 192.

In his analysis Mr. Guastella used a debt rate of 6.2%, which he refers to as the "effective" interest rate of the existing SunTrust term loan. *See* Transcript at 193. Mr. Guastella used "effective

interest rate” to refer to the actual cost of the loan – the interest rate charged on the amount borrowed as well as the known and measurable costs associated with obtaining and closing the loan. This effective interest rate was calculated by amortizing the costs of undertaking the existing loan over 15 years and adding the annual amount to the stated 5.29% interest. On the basis of the total capital on the Company’s balance sheet, DIUC’s proposed \$3,750,000 equates to a debt ratio of 41.2% and an equity ratio of 58.8%. *See Transcript at 193.*

Noting that small water and sewer utilities rarely, if ever, obtain financing on the strength of their own financial condition, particularly those as small as DIUC, Mr. Guastella proposes an equity rate of return of 10.5% and on the basis of his experience and judgment with respect to small water and sewer utilities testified that:

... the return to the equity holder should be commensurate with risks on investments in other enterprises having corresponding risks and that equity return should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital. That standard is not satisfied if DIUC’s equity return would be determined by applying such typical rate of return analyses as the discounted cash flow method or capital asset pricing model. Those methods have value for large utilities but not for DIUC. For example, in the last rate case the settlement included a return on equity of 8.81% which was estimated to produce some \$176,215 in net income. The rate increase went into effect on August, 15, 2012. From August 15, 2012 to December 31, 2014, DIUC’s net income should have been a total of about \$418,000 if it achieved the 8.81%, but instead its actual net income was less than \$90,000 for that period. For 2015, we project a loss of about \$450,000.

Transcript at 193-194. We find Mr. Guastella’s testimony persuasive and that it demonstrates the sensitivity to earning erosion issues that this Commission must consider when evaluating rate applications for small utilities like DIUC.

Mr. Guastella proposes an overall rate of return of 8.73%. *See* Transcript at 126-127 and Schedule A-3. ORS proposed an overall rate of return that equates to 7.46%.⁴ *See generally* Testimony of Douglas H. Carlisle, Transcript at 467-484 and 520-522.

The ORS recommendations regarding cost of capital and rate of return were presented by Dr. Douglas H. Carlisle who proposes a rate of return on equity of 9.31% and an interest rate on debt of 5.29%, which is the rate charged by SunTrust. *See* Transcript at 474. Dr. Carlisle suggests we use “the average capital structure used by water companies in the United States with publicly traded stock (Common Equity). That ratio is 46% Long-Term Debt and 54% Common Equity.” Transcript at 473 citing Exhibit DHC-1. Dr. Carlisle’s debt rate is limited to the stated interest rate of the SunTrust term loan, without adjustment for any of the costs that we know must be incurred by DIUC in order to obtain that loan. Next, because Dr. Carlisle also considers the Company’s intended refinancing in the amount of \$3,750,000 to be speculative, he uses an imputed debt/equity ratio on the basis of an average capital structure of water utilities in the United States whose stock is publically traded. *See* Transcript at 473. For his proposed equity rate, Dr. Carlisle used the Comparable Earnings Model (CEM), the Discounted Cash Flow (DCF) Model, and the Capital Asset Pricing Methods (CAP-M). *See* Transcript at 474-475.

On the other hand, Mr. Guastella disputes Dr. Carlisle’s decision to base ORS’s position on use of publicly traded companies on the grounds that the publicly traded companies’ data are not comparable. *See* Transcript at 221. The Commission is likewise wary of the comparison proposed by ORS, since the only grounds offered to support the same are that “there is more data on publicly traded companies than on private held companies” and Dr. Carlisle “used publicly

⁴ Although an overall rate of return is not included in the testimony of Dr. Carlisle, using his proposed debt and equity rates and capital structure ratios, the overall rate of return equates to 7.46%.

traded water utilities since they are in the same line of business as DIUC and share similar risks.” *See* Transcript at 475. The record and testimony in this case demonstrate the many reasons why the Company is quite dissimilar from the large publicly traded utilities providing the data Dr. Carlisle relies upon; at the very least, the risk of investing in DIUC is much greater than an investment in these significantly larger publicly traded corporations.

The Intervenor’s position on rate of return is provided through the testimony of Mr. Lanier. With respect to the Company’s proposed interest rate of 6.2%, Mr. Lanier states “that while this rate is relatively high in the current interest rate environment, this is probably a reasonable rate for DIUC, given its precarious financial state.” *See* Transcript at 436. With respect to a rate of return on equity, Mr. Lanier refers to a number of sources: a Connecticut Department of Public Utility Control test that produces a 10.69% equity rate of return formula that adds basis points for small utilities and performance⁵; a Florida Public Service Commission leverage formula that suggests a range of ROE from 7.79% to 11.51% depending on equity ratios of 100% to 40%, respectively; and Dr. Carlisle’s recent testimony in the United Utility Companies rate case with a range of 8.86% to 9.60%, wherein the Commission settling on 9.35%. *See generally* Transcript at 439. Ultimately, Mr. Lanier proposes an equity rate of 8.75%, which is the mid-point of his lower range of reasonableness. His overall rate of return is 7.28% on the basis of a capital structure consisting of 57.55% debt and 42.45% equity. *See* Lanier Exhibit Three, Schedule C-3. Mr. Lanier justifies his recommendation of a rate of return on equity at the low end of his proposed range of reasonableness because he believes that the Company has demonstrated a degree of irresponsibility in its operations and use of debt funds since the last rate case that warrants the use of a low end of

⁵ Mr. Lanier could not locate the reference but does not suggest it does not exist.

the range of reasonableness for the rate of return on equity. We do not find the record demonstrates DIUC has improperly handled its debt and we do not agree that DIUC's rate of return on equity should be adjusted as suggested by Mr. Lanier.

We find that DIUC's intent to refinance the existing debt with a \$3,750,000 term loan is reasonable. We also find that it is reasonably likely the Company will be able to secure the financing from SunTrust, its existing lender. The proposed financing will lower the overall rate of return and income tax allowance, provide funds to repay the \$500,000 line of credit and enable DIUC to make additional improvements to pay down accounts payable.

However, we will not use the capital structures proposed by the Company, ORS, or that proposed by the Intervenor. Instead of using the debt to equity ratio from the Company's balance sheet, we will use a capital structure that equates to the \$6,958,724 rate base we are allowing in this case, assuming \$3,750,000 of debt and \$3,208,724 of equity, or a debt to equity ratio of 53.9% debt and 46.1% equity.

With respect to the cost of debt, we agree with the Company that the cost of undertaking financing is a reality that must be recognized. The Company did so by amortizing the cost over the life of the 15 year term loan, which is consistent with the NARUC USoA, Account 181, Unamortized Debt Discount and Expense, that provides for such expense to be amortized over the life of the respective issues under a plan which will distribute the amounts equitably over the life of the securities. *See* NARUC USoA, Account 181, Unamortized Debt Discount and Expense, paragraph c. The high cost of undertaking the Company's existing financing was unusual but an understandable and unavoidable effort under the circumstances experienced by this small utility as it sought to obtain funding that was essential to make improvements and to provide adequate service. *See* Transcript at 141-142.

We further find Mr. Guastella's testimony persuasive as to the cost of the loan, what he called the effective interest rate, particularly given Mr. Guastella's testimony that he has "never seen a utility's debt rate be based strictly on the nominal interest rate, because there's always a cost that is incurred in order to undertake financing." Transcript at 183. However, we will adjust the 6.2% "effective" interest rate sought by the Company. Mr. Guastella testified that he used the effective rate of the existing term loan because he did not yet know what the actual rate will be for the proposed financing, but he did not expect the cost of undertaking the refinancing to be as high. *See* Transcript at 253. For the purposes of this rate case, we find that several of the costs incurred in securing the first loan will not be incurred again in obtaining the second loan and it is reasonable to estimate a 5.75% effective interest rate.

The Company, ORS, and Intervenors all have a different approach for proposing an allowable return on equity. Addressing that issue requires consideration of the testimony of Mr. Guastella which highlights the unique circumstances facing DIUC.

Mr. Guastella identified the significant challenges that small utilities face in obtaining financing simply because of their size and sensitivity to earnings erosion that large utilities do not experience. *See* Transcript at 194. He quantified DIUC's significant loss over the last three years, despite the rate increase in August of 2012 that anticipated reasonable profits. *See* Transcript 193-194. Additionally, small utilities' stakeholders must also provide personal guarantees and stake personal assets as collateral in order to obtain financing as they have done here, which is something that is not required of large utilities in order to obtain financing. *See* Transcript at 185. He also described DIUC's three year process of securing financing, rejection by three banks, and the relatively massive documentation that was necessary to satisfy its lender. *See* Transcript at 184. Mr. Guastella testified that this reality of small utilities and of DIUC is not measured by typical

CEM, DCF and CAP-M methods using proxy groups of large utilities for data. *See* Transcript at 193.

ORS, via Dr. Carlisle, used comparison proxy groups including large utility companies for data. *See* Transcript at 473. Likewise, the Intervenor propose Mr. Lanier's analysis of equity rates of return, which are also based on comparatives. *See Generally* Transcript at 436 to 441. We find that the utilities suggested as comparables by Dr. Carlisle and Mr. Lanier are not substantially similar and are not truly comparable to the Company.

The South Carolina Supreme Court has prohibited ratemaking decisions on such comparisons without substantiation. "We have held on several occasions that it is improper for the PSC to draw comparisons with other entities without stating its basis for finding the entities sufficiently similar for comparison purposes." *Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff*, 392 S.C. 96, 114, 708 S.E.2d 755, 765 (2011) citing *Heater of Seabrook II*, 332 S.C. 20, 26, 503 S.E.2d 739, 742. In order to support the requested relief presumably evidenced by a comparison to other utility or utilities, the proponent of the same must provide the Commission with sufficient evidence in the record of the proposed comparison entities; without such evidence the comparison must be disregarded. *Id.*

The record in this case demonstrates a lack of information as to the utilities proposed for comparison by ORS and Intervenor. This Commission cannot assume the referenced utilities are similar, comparable, or sufficient to establish even the most basic of standards. On the other hand, Mr. Guastella's testimony describes real differences in the ability of small utilities to attract capital as compared with large utilities. *See* Transcript at 185. His experience in both regulating and consulting for hundreds of small water and sewer utilities, as well as large utilities, allows him to

provide a realistic and valid analysis that supports DIUC's need for a higher return on equity than that of an average large utility.

Using a capital structure of 53.9% debt and 46.1% equity, an aggregate cost of debt rate of 5.75% per annum and the Company's proposed 10.5% return on equity, the result is an overall rate of return of 7.94%. That rate is less than DIUC's proposed 8.73% and higher than the overall 7.46% reflected in ORS's recommendation and the 7.28% reflected in Intervenor's recommendation, and properly addresses the irrefutable differences between DIUC and large utilities as to their ability to attract capital.

Accordingly, we find that an overall rate of return of 7.94% is reasonable. At this rate of return, DIUC's indicated operating margin is 16.1%, which we find is also reasonable. We further find this rate and operating margin are required to allow the Company to yield a reasonable return, as is required by law. *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 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").

10. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 10

The evidence supporting this finding, that the Company is entitled to total rate case expenses of \$191,200, which is approximately one-half of the \$380,000 rate case expenses actually incurred in this rate case by DIUC as of October 28, 2015. And shall be amortized over a period of four years, ($\$191,200/4 \text{ years} = \$47,800 \text{ per year}$), is based upon the Application and testimony of witnesses Guastella, White, and Gearheart.

DIUC's application includes rate case expenses in the amount of \$191,200, estimated on the basis of its rate case expense requested in the last rate case. *See* Transcript at 218. The \$191,200 is allocated equally between water and sewer operations and amortized over a 4 year period. *See* Transcript at 218. The ORS proposes an amount for the instant rate case which it "capped" at \$75,000, plus unamortized rate case expenses of \$22,500 from the previous rate case, to be amortized over a 5 year period. However, ORS did not provide testimony to support its position.

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.) 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 not necessary. *See generally* Transcript at 484-500. This is insufficient to support the cap generally and in light of the presumed reasonableness of the expense. Even without the benefit of any presumption, in his rebuttal testimony Mr. Guastella outlined the extensive work involved in this proceeding and explained that the amount of information and paperwork required of DIUC was equal to that required of large utilities in rate cases. *See* Transcript at 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.⁶

Regarding amortization of expenses, Mr. Guastella testified that because the last DIUC rate case ended in mid-2012, only three years ago, that the Company's proposed 4 year amortization is more realistic than the 5 year amortization adjustment proposed by ORS. *See* Transcript at 218. At the hearing, Mr. Guastella also stated 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 requesting the Commission allow \$191,200. *See* Transcript at 181. DIUC's requested rate case expense of \$191,200 is similar in amount with the rate case expenses that we allowed in another 2012 contested rate decision.⁷ For these reasons, the requested total rate case expenses of \$191,200 will be allowed in this case and the same shall be amortized over a 4-year period, as proposed by the Company.

11. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 11

The evidence supporting this finding, that the actual and known and measurable amounts for Utility Property Taxes necessary to cover the eight year installment payments under DIUC's Settlement Agreement and Addendum with Beaufort County Treasurer and its ongoing annual amounts are \$65,855 and \$192,372, respectively, is based upon the Application and testimony of witnesses Guastella, White, Walls, Gearheart, and Loy. The property tax expense at issue in this matter has two components: the recovery of past due taxes in accordance with a settlement

⁶ The Commission notes that in this case, ORS required the Applicant to respond to 82 Continuing Information Requests and more than 40 individual Audit Requests.

⁷ In Docket No. 2011-317-WS, Order No. 2012-98, we allowed rate case expenses of \$190,905.

agreement between DIUC and Beaufort County Treasurer, and sufficient income to address current and future annual property taxes.

The record demonstrates that soon after 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. *See* Transcript at 50-51. This was the first time that SCDOR had ever assessed and Beaufort County had ever billed DIUC for a utility property tax. For this reason, Beaufort County billed DIUC for taxes in arrears even though the DIUC had not been billed in those prior tax years. DIUC had previously received property tax bills annually for individual parcels, totaling about \$10,000 annually, but neither DIUC nor its predecessors had ever received a Utility Property tax bill of such magnitude.

Testimony of Maria Walls indicated “that DOR did not identify Daufuskie Island Utility as a utility at all” and for that reason the Utility Property Tax had never been assessed to DIUC or its predecessors. Transcript 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.

Mr. Guastella met with Maria Walls, Beaufort County’s Treasurer, to explain the rate setting process, DIUC’s cash flow problem, and the impact that this enormous tax liability that was recently imposed would have on the Company’s customers. *See* Guastella Rebuttal Exhibit B and Transcript at 82. As a result, on February 18, 2015, DIUC and Beaufort County entered into a Settlement Agreement that allows DIUC to pay past taxes for 2012, 2013, 2014 and 2015 over an eight year period without penalty or interest. *See* Walls Exhibit A. It 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. *See* Transcript 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. 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). The monthly payment was reduced from \$6,784.04 to \$5,487.95. *See* Walls Exhibit A Addendum. The Company began making the monthly payment on July 1, 2015, which equates to an annual amount of \$65,855.40, and it remains current on those payments. *See* Transcript at 83.

ORS proposes 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. Or, stated differently, the ORS adjustment excludes \$281,944 of currently owed taxes, even though the Company is contractually bound to make those payments. In testifying as to this issue, Ms. Gearheart provides no allowance for the portion of the 8 year payments related to 2014 and 2015 taxes that are part of the Settlement Agreement Addendum. The reason she provides for allowing only the past taxes for 2012 and 2013 is that, "In accordance with the settlement for the previous rate case Docket No. 2011-229-WS, the Company agreed not to file for an application for an increase before July 1, 2014." *See* Transcript at 495. We fail to understand how the negotiated rate application delay period in the

settlement of the last rate case is connected with the specific payment requirement in the Utility Property Tax Settlement Agreement Addendum.⁸ The \$65,856 annual payment is a known cost under a 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, and it should be allowed for recovery in the rates.

With respect to the ongoing annual level of Utility Property Taxes, the Company requests \$192,372 for the combined water and sewer ongoing annual Utility Property Tax, which is calculated on the basis of its December 31, 2015, book value, application of DOR's method of assessment, and application of Beaufort County's current tax rate, which will be the basis for the 2016 Utility Property taxes. *See* Transcript at 168-170. ORS's proposed adjustment would allow only \$140,881, which is the total test year 2014 taxes based on a \$5,000,000 rate base. The 2014 taxes, however, are also being recovered over an 8 year period as part of the Settlement Agreement Addendum. The next annual Utility Property tax bill that DIUC will receive will be in the fall of 2016, payable in full on January 15, 2017. DIUC must collect funds now to pay that tax bill which will be higher than the amount in 2014. The rates resulting from this case will only become effective in early 2016. Thus, the allowance of ongoing annual taxes must be reflected in this revenue requirement for accrual during 2016 so that DIUC can make the January 2017 payment. Mr. Guastella's calculation⁹ of the annual tax amount of \$192,372, using the DOR assessment

⁸ Mr. Guastella also points out that if DIUC had been able to rush a rate increase in time to pay the 2014 and 2015 Utility Property taxes, the customers would have paid about \$280,000 over the subsequent two years; but by spreading the recovery over 8 years, the customers benefitted by present value savings of over \$100,000. *See* Transcript at 213.

⁹ There was an objection at the hearing that Mr. Guastella is not a DOR expert. As an expert in utility rate setting, Mr. Guastella's use of information obtained from third parties may certainly be accepted by this Commission.

methodology, is a reasonable estimate that qualifies as a known and measurable change, and will be allowed.

12. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 12

The evidence supporting this finding, that the management of DIUC's operation under the management agreement with Guastella Associates, LLC has been more than adequate, particularly given the challenges faced by the Company, and the management fees in the amount of \$171,364 are reasonable and may be recovered, based upon the Application and testimony of witnesses Guastella, Gearheart, and Lanier.

The management fees included in DIUC's application reflect charges under the agreement between Guastella Associates, LLC (GA) and DIUC and its owners. That agreement spells out GA's responsibilities and duties, and has provisions for fees and charges, including day-to-day management, finance, capital, and incentive fees. *See Exhibit 9.*

In the last rate case, ORS, Intervenor and the Company agreed via settlement that an acceptable allowance of 6.5% interest rate for a future loan later secured with SunTrust; this Commission approved that settlement. *See Order No. 2012-515, Docket 211-229-WS.* The finance fees charged by GA according to the management agreement for that loan, plus the legal fees incurred in obtaining the loan and applying to the Commission for approval of the financing, increased the "effective" interest rate on the SunTrust loan from 5.29% to 6.2%. *See Transcript at 220-221.* Even with the charges, this interest rate is still lower than the allowable 6.5% to which ORS and the Intervenor agreed. No party in this case has offered testimony that GA did not perform the work over the three-year period during which DIUC sought to obtain financing and no party has asserted that the work was not essential for improvements to the water and sewer systems or that the work was not necessary. As discussed above, the Commission will allow a

5.75% interest for the anticipated refinancing. That amount, again, is lower than the rate previously agreed to among the parties.

As with the finance fees, no party took the position that GA's work with respect to the capital fee was not performed or that it was unnecessary. Mr. Guastella testified that GA's charges for the administration and supervision of the capital improvements was less than half of such typical costs. *See* Transcript at 172 and 206. His testimony was unchallenged and unrefuted.

With respect to the incentive fee set forth in the management agreement, Mr. Guastella testified that the owners, not the customers, are responsible to pay that fee out of their equity.

We now turn to the day-to-day management fee, which DIUC proposes at \$171,364 in accordance with the management agreement. ORS proposes to reduce the management fee to \$132,211, a level that it claims the Commission previously approved.¹⁰ The only reason Ms. Gearheart provides in support of that reduction is that the management services provided by GA did not increase, stating "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." *See* Transcript at 493. ORS does not provide any other analysis, nor does ORS identify the services that were performed at the time of the last rate case or after the last rate case. In response to interrogatories, however, ORS acknowledges that the management services were performed by GA, they were necessary to provide service, and that GA was qualified to manage DIUC.

With respect to Ms. Gearheart's proposed adjustment to the GA management fee:

- a. Is it ORS's position that GA does not perform the services as set forth in its management agreement with DIUC?

¹⁰ The Commission approved a settlement in DIUC's last rate case that does not make any reference to the management fee.

RESPONSE: No.

- b. Is it ORS's position that the management services performed by GA are not necessary for the operation and management of DIUC?

RESPONSE: No.

- c. Is it ORS's position that GA is not qualified to perform the management services?

RESPONSE: No.

Response to Company's First Set of Interrogatories and Requests for Production to ORS at #8, Exhibit 10 to Transcript.

Intervenors do not propose a specific dollar adjustment for management fees, but Mr. Lanier does state that he "would support any reductions in expenses proposed by the ORS staff," without providing any rationale, standard, or benchmark for any such reduction. *See* Transcript at 435. Mr. Lanier also accuses the Company of not being operated in the most efficient and economical fashion, claiming it has had such "major lapses" in its operations as sale of the storage tank parcel, enormous increase in property taxes, DHEC issues, and control of operating expenses. *See* Transcript at 421. However, the record does not support a finding of a failure of management with respect to Mr. Lanier's claimed lapses. Mr. Guastella's testimony establishes that, as manager of the Company, GA acted in a reasonable, diligent, and timely manner to each of the items mentioned by Mr. Lanier.

Neither ORS nor Intervenors presented any performance analysis or review of the events and issues faced by DIUC since it was acquired from Haig Point, Inc. in 2008. The Company, on the other hand, provided the Commission with a comprehensive Report on Capital Improvements that includes information regarding the very unusual problems faced by the Company and how those problems were addressed by GA pursuant to its management agreement. *See* Exhibit 9. Of equal significance is the fact that neither ORS nor Intervenors performed any analysis to evaluate

whether the GA's management fees are competitive or whether DIUC could have obtained management with the same level of expertise as provided by GA at a lower cost. On the other hand, the record provides the following, as obtained from Mr. Guastella's testimony and exhibits, regarding the work of GA for DIUC:

- The hiring of GA was required in the settlement with an intervenor for the purchase of the stock of HPUC from Haig Point, Inc. to assure that DIUC would have competent management. *See* Transcript at 213.
- GA directed the transition for the HPUC acquisition as well as the merger of MUC, improving records, billing and operations. *See* 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. *See* Exhibit 7.
- GA directed the operation of MUC, when its owners abandoned the utility operations and filed for bankruptcy in order protect the MUC's customers from interruption of water and sewer service, without compensation and despite DIUC's cash shortage. *See* Transcript at 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. *See* Transcript at 220.
- GA worked with the president of DIUC to use his contracting firm to make temporary repairs to the failed wastewater lagoon liner, when there were insufficient funds to pay for the improvements. *See* 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. *See* Transcript at 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. *See* Transcript at 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. *See Transcript at 173.*

- GA has been complimented by DHEC for its cooperation and efforts to make improvements, and its thorough communications with DHEC that are not typical. A corrective action plan prepared by GA was approved by DHEC within hours of submittal. *See Transcript at 215, and Exhibit 8.*
- GA's stated priority has been to provide adequate service to DIUC's customers. The owners have not been paid a dividend to date, and GA is owed thousands of accrued payments because cash flow is always first used to operate the water and sewer systems. Mr. Guastella noted that past due accounts payable to GA will eventually be paid by the owners not the customers. *See Transcript at 141 and 247.*

In accordance with the management agreement, GA's scope of services include:

1. Supervise the day to day operation and maintenance of the Company's system, including supervision of operating employees, vendors and contractors.
2. Maintain books and records, including accounting, financial and operation records, in accordance with the uniform system of accounts prescribed by the PSC and required by the DHEC.
3. Perform all billing, accounting and collecting (other than commencing litigation), including the preparation of customer account records and billing analyses as necessary for rate filing requirements.
4. Prepare financial and operating reports to regulatory agencies, including annual reports to the PSC and monthly operating reports to DHEC. Prepare annual budgets and financial reports to stockholders, as well as periodic (quarterly) financial and operating reports.
5. Provide information and assistance to outside tax accountants, consultants, engineers and attorneys as required in the normal course of business.
6. Obtain short and long term financing, as available and necessary, for operations and capital improvements and prepare the necessary documentation for lenders.
7. Employ and supervise all employees, vendors, contractors and outside professionals as appropriate to operate, maintain and expand the Company's system, to direct and supervise all plant expansion, capital improvements and replacements, and to carry out all other services required of GA under this Agreement.
8. Implement existing contracts with developers and customers, and negotiate and implement new contracts and applications for service.
9. Revise and maintain general tariff provisions as to rates and terms of service, in compliance with changes approved by the PSC.
10. Be responsible for and carry out all other business incidental to the ordinary course of business management and operation of the Company.

It is apparent that without the management agreement with GA, the Company would have to hire employees or another firm to perform these services, and it is not a given that such options would reflect the same qualifications and experience. While we are certainly aware of the customers' concerns about significant rate increases, it must also be noted in the context of management fees that there have been no customer complaints as to the water and sewer service provided by the Company.

With respect to the amount of GA's fees, Mr. Guastella provided a schedule comparing the costs per customer of DIUC with municipal water and sewer utilities in South Carolina. *See* 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. Also, DIUC is on an island accessible only by boat. *See* Transcript at 216. One of the customers, Mr. James Woodward, testified at the public hearing on September 15, 2015 that:

"...Our members and our Haig Point residents already bear substantial costs for the pleasure, granted, of living on a private island. Building costs here, service costs, everything like that, you're just gonna' tack on 20 percent. I just got a quote recently from another company that said, Here's a quote that I normally do this job for, but on Daufuskie Island we triple it.'..."

Mr. Guastella's testimony and exhibits as to GA's qualifications and performance in managing DIUC and the competitive level of its fees and charges are persuasive. We find no basis for reducing the Company's proposed management fees.

13 – 16. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NOS. 13 – 16

The evidence supporting these findings, as more fully stated above, is based upon the Application and testimony of witnesses Guastella, White, and Gearheart.

The Application before us seeks a 108.9% rate increase on a combined basis for its water

and sewer operations, or a revenue increase of \$1,182,301. On the basis of our findings as discussed above, we have prepared the attached schedules containing operating statements for DIUC's combined water and sewer operations, along with separate schedules for water and sewer. These schedules reflect the Company's pro forma operations under its proposed rates and the operations that reflect the Commission's findings in this Order. The approved rate increase is 94.6%, on a combined basis for its water and sewer operations. *See* Application Schedule A.

A review of the evidence presented indicates the appropriate operating expenses for DIUC for the test year under present rates and after accounting and pro forma adjustments and adjustments for known and measurable changes total \$1,537,203. Applying the fair and reasonable rate of return established in Finding #9, a 7.94% rate of return on rate base, the total operating revenue requirement for DIUC is \$2,089,652. *See* Application Schedule A.

In order for DIUC to have the opportunity to earn its total operating revenue requirement of \$2,089,652, DIUC must be allowed additional revenues totaling \$1,016,071. *See* Application Schedule A. Although DIUC requested a higher increase, the Commission finds this additional revenue amount is sufficient and reasonable based upon the testimony presented by all parties to this proceeding.

Under the guidelines applicable to this Commission and articulated in the decisions of *Bluefield Waterworks and Improvement Company v. West Virginia Pub. Serv. Comm'n*, 262 U.S. 679 (1923), and *Federal Power Commission v. Hope Natural Gas*, 320 U.S. 591 (1944), this Commission does not ensure through regulation that a utility will produce specific net revenues. However, employing fair and enlightened judgment and giving consideration to all relevant facts, the Commission should establish rates which will produce revenues "sufficient to assure confidence in the financial soundness of the utility and ... that are adequate under efficient and

economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties." *Bluefield, supra*, at 692-693.

The rates as contained in Schedule A to this Order and explained herein are hereby approved and effective for service rendered on or after the date of this Order. We find that the rates and charges approved herein achieve a balance between the interests of the Company and those of its customers. These rates and charges result in a reasonable attainment of the Commission ratemaking objectives in light of applicable statutory safeguards.

17. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 17

The evidence supporting these findings, as to establishing a single tariff rate structure, is based upon the Application and testimony of witnesses Guastella, White, Gearheart, Morgan, and Lanier.

DIUC's application proposes to establish a single tariff rate structure, instead of its existing rate structure that has different rates for the Haig Point and Melrose service areas. See Application at Schedules W-E2 and S-E2. No party has objected to this revision. The Company's water and sewer systems are sufficiently integrated as to operations, management, billing, financing, and regulations to justify the use of a single tariff pricing. The tariff rates set forth in Schedule A reflect single tariff pricing and rates that will generate the allowed revenue requirement as approved in this Order. Therefore the Company's request for a single tariff rate structure is approved and established as set forth in Schedule A.

18. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 18

A compromise and settlement is an agreement between adverse parties that resolves the proceeding between them. *W. T. Ferguson Lumber Co. v. Elliott*, 171 S.C. 455, 459, 172 S.E. 616, 617, 1934 S.C. LEXIS 20,*8 (S.C. 1933) ("... an action will be held to be ended when the parties

agree upon a compromise and settlement of the cause of action and the terms of the agreement are complied with.”) “It is said of compromise and settlement agreements in 15 Am. Jur. (2d) 951, that “the mutual concessions which constitute a compromise generally involve the performance or promise (express or implied) of (1) the relinquishment of a claim by one party in return for the relinquishment of a claim by the other party; or (2) the relinquishment of a claim by one party in return for a payment or transfer of property by the other party; or (3) a payment or transfer of property by one party in return for a payment or transfer of property by the other party -- accompanied by at least an implied relinquishment of one or more claims.” *Brazell Bros. Contractors v. Hill*, 245 S.C. 69, 75, 138 S.E.2d 835, 838, 1964 S.C. LEXIS 38, *8-9 (S.C. 1964)

Here neither ORS nor the Intervenor were the applicant nor did ORS have a claim against the Intervenor or vice versa. Both Intervenor and ORS are adverse to the Company, not to each other. While each took separate positions in relation to the application of the Company, there can be no resolution of the rate proceeding without the agreement of the Company. Neither ORS nor the Intervenor has the authority to compromise and settle the lawful right of the Company to seek an adjustment of its rates and charges.

Further, to the extent that ORS and the Intervenor 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.

Moreover, both Intervenors and ORS proceeded on the merits and presented testimony in addition to the prefiled testimony of their respective witnesses. The testimony of the Intervenors' witnesses contradicted the terms of the "settlement agreement" and the testimony of the ORS witnesses. There would have been no need for either Intervenors or ORS to proceed with proof of any kind, much less offering evidence in addition to their respective prefiled testimony, if the matter had been resolved.

For these reasons, the Commission puts no evidentiary weight on the proposed "settlement agreement," which is also hearsay, and receives it basically as a brief or other filing asserting a position statement of Intervenors and ORS as to the outcome that they are advancing rather than as evidence. As stated previously, since the Company was not a party to the agreement and the agreement did not settle any matters before this Commission without the concurrence of the Company, the Commission does not approve the "settlement agreement" as a settlement of this rate application.

As indicated throughout this Order, the Commission has decided the matter based on the testimony and other exhibits entered into the record and the applicable law. A ratemaking proceeding is quasi-judicial proceeding and, as such, the Commission determines admissibility of evidence as well as what weight should be given to testimony and exhibits. *See* 26 S.C. Code Ann. Regs. 103-846(A) ("The rules of evidence as applied in civil cases in the Court of Common Pleas shall be followed" in ratemaking proceedings); Rule 402, SCRE ("All relevant evidence is admissible, except as otherwise provided by the Constitution of the United States, the Constitution of the State of South Carolina, statutes, these rules, or other rules promulgated by the Supreme Court of South Carolina.").

The purported “settlement agreement” is not compelling proof of any issue in this proceeding, and by law the Commission considers only “reliable, probative, and substantial evidence.” S.C. Code 58-5-240.

The willingness of two parties, to the exclusion of the Company, to agree upon a position does not make that position more correct or more reliable. Further, this Commission must be wary not to open the door to the use of partial settlement agreements that do not include the applicant as a means for adverse parties to consolidate their position in hopes of directing proceedings which they themselves did not initiate. ORS and Intervenors ask this Commission to embark on a new trend which the Commission is not willing to embrace.

V. CONCLUSION

As set forth above, this Commission has, in compliance with S.C. Code §58-5-240, determined a fair rate of return for the Company and has documented fully the reasons for its determination in its Findings of Fact which are based exclusively on reliable, probative, and substantial evidence on the whole record.

IS THEREFORE ORDERED THAT:

1. The proposed schedule of rates and charges as filed in the Company's Application is found to be reasonable, as modified herein, and is granted.
2. The schedule of rates and charges attached hereto as Appendix A is hereby approved for service rendered on or after the date of this Order. The schedule is deemed filed with the Commission pursuant to S.C. Code Ann. Section 58-5-240.
3. The Company shall maintain its books and records in accordance with the NARUC Uniform System of Accounts as adopted by this Commission.

4. The Company shall notify each customer in each class of the customers' increase in rates with the first bill that includes the new increase in rates made subject to this Order.

BY ORDER OF THE COMMISSION:

Nikiya Hall, Chairman

ATTEST:

Swain E. Whitfield, Vice-Chairman

BEFORE
THE PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA
DOCKET NO. 2014-346-WS – ORDER NO. 2015-__
DECEMBER __, 2015

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

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I. INTRODUCTION

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

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

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

DIUC’s South Carolina operations are classified by the National Association of Regulatory Utility Commissioners (“NARUC”) as a Class B water and wastewater utility according to water and sewer revenues reported on its application for the test year ending

December 31, 2014. The Commission approved service area for DIUC is on Daufuskie Island located in Beaufort County, South Carolina.

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

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

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

Island; South Carolina.¹

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

DIUC was represented by G. Trenholm Walker, Esquire and Thomas P. Gressette, Jr., Esquire. The POAs were represented by John J. Pringle, Jr., Esquire, John F. Beach, Esquire and Lyndey Ritz Zwing, Esquire. Beach Field was represented by M. John Bowen, Jr., Esquire and Margaret M. Fox, Esquire. ORS was represented by Shannon Bowyer Hudson, Esquire and Andrew M. Bateman, Esquire.

At the hearing on October 28, a Settlement Agreement² between the POAs and ORS was entered into the record after an objection to it by DIUC was overruled. The Settlement Agreement is attached to this Order as Order Attachment 1. DIUC, the POAs and ORS presented testimony and exhibits after one public witness, Mr. Reid Delaney,³ testified. Mr. Delaney testified that he owns property on which assets are located and utilized by DIUC for its regulated water and sewer business.

DIUC presented the testimony of: John F. Guastella⁴ (direct and rebuttal testimony), President of Guastella Associates, LLC ("GA"), a utility management, valuation and rate consulting firm headquartered in Boston, Massachusetts; Gary C. White (direct), Vice President and Director of Accounting at GA; Eric Johanson (direct), DIUC Chief Operator; and the

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

² The Settlement Agreement containing five exhibits was entered into the record as Hearing Exhibit 3.

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

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

Honorable Maria Walls⁵ (rebuttal), Beaufort County Treasurer. Mr. Guastella and Mr. White testified as a panel about the management and finances of DIUC. Mr. Johanson's testimony addressed the operations of DIUC. Mr. Johanson was excused from the hearing without appearing before the Commission after 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 Vogel⁶ (direct), Haig Point Club and Community Association resident; Doug Egly⁷ (direct), Chief Operating Officer of the Haig Point Association; and Tony Simonelli (direct), real estate broker on Daufuskie Island. The second panel consisted of Lynn M. Lanier⁸ (direct) and Charles Loy⁹ (direct and surrebuttal), Principals of GDS Associates, Inc., a utility consulting and engineering firm with its principal offices in Marietta, Georgia; and Harry Jue¹⁰ (direct), water and sewer consultant with Hussey Gay Bell Engineering. POA witnesses Vogel, Egly, and Simonelli presented testimony illustrating the points of view of their respective organizations, and each providing various facts and opinions opposing DIUC's request. POA witness Loy provided expert testimony regarding accounting and rate base issues. POA witness Lanier provided expert testimony on the overall Application and incorporated Mr. Loy's recommended adjustments. Beach Field did not pre-file or present testimony or cross examine any witness at the Commission hearing.

ORS presented the testimony of Douglas H. Carlisle¹¹ (direct), ORS Economist; Ivana C.

⁵ Hearing Exhibit 5 consists of Walls Rebuttal Exhibit A.

⁶ Hearing Exhibit 11 is Vogel Exhibit 1.

⁷ Hearing Exhibit 12 is Egly Exhibit 1.

⁸ Hearing Exhibit 14 consists of Lanier Exhibits 1 through 5. Exhibit 3 was revised at the hearing.

⁹ Hearing Exhibit 15 is Loy Surrebuttal Exhibit 1. Hearing Exhibit 16 is Loy Direct Appendix A.

¹⁰ Hearing Exhibit 13 is Jue Exhibit 1.

¹¹ Hearing Exhibit 17 is Carlisle Direct Exhibits 1 through 10.

Gearheart¹² (direct), ORS Audit Manager; and Willie J. Morgan¹³ (direct and surrebuttal), ORS Deputy Director for the Water and Wastewater Department. Dr. Carlisle's testimony included an analysis and recommendation for an ROE. Ms. Gearheart's direct testimony described ORS's examinations of the application and DIUC's books and records as well as the subsequent accounting and pro forma adjustments recommended by ORS. Mr. Morgan's direct testimony focused on DIUC's compliance with Commission rules and regulations, ORS's business audit of DIUC's water and wastewater systems, test-year and proposed revenue, and performance bond requirements.

II. REVIEW OF THE EVIDENCE AND EVIDENTIARY CONCLUSIONS

Standards and Required Findings

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

¹² Hearing Exhibit 18 is Gearheart Direct Exhibits 1 through 8.

¹³ Hearing Exhibit 19 is Morgan Direct Exhibits 1 through 8. Hearing Exhibit 20 is Morgan Surrebuttal Exhibits 1 and 2.

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

The evidence supporting the Company's business and legal status is contained in the Application filed by DIUC, testimony, and in prior Commission Orders in the docket files of the Commission, of which the Commission takes judicial notice. This finding of fact is informational, procedural and jurisdictional in nature, and the matters which it involves are not contested by any party.

Test Year

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

A fundamental principle of the ratemaking process is the establishment of a historical test year as the basis for calculating a utility's operating margin or, in this case, a return on rate base, and, consequently, the validity of the utility's requested rate increase. In order to determine what a utility's expense and revenues are for purposes of determining the reasonableness of a rate, one must select a 'test year' for the measurement of the expenses and revenues. *Heater of Seabrook v. Public Service Commission of South Carolina*, 324 S.C. 56, 478 S.E.2d 826, 828 n.1 (1996).

While the Commission considers a utility's proposed rate increase based upon occurrences within the test year, the Commission will also consider adjustments for any known and measurable out-of-test year changes in expenses, revenues, and investments, and will also consider adjustments for any unusual situations which occurred in the test year. Where an unusual situation exists which shows that the test year figures are atypical, the Commission should adjust the test year data. See *Southern Bell v. The Public Service Commission*, 270 S.C. 590, 244 S.E. 2d 278 (1978); see also, *Parker V. South Carolina Public Service Commission*, 280 S.C. 310, 313 S.E.2d 290 (1984), citing *City of Pittsburgh v. Pennsylvania Public Utility Commission*, 187 P.A. Super. 341, 144 A.2d 648 (1958); *Southern Bell v. The Public Service Commission*, 270 S.C. 590, 244 S.E.2d 278 (1978). Based on the information available to the Commission and that all parties agreed to a 2014 test year, the Commission is of the opinion, and therefore concludes, that the test year ending December 31, 2014 is appropriate for the purposes of this rate request.

Rate of Return on Rate Base

DIUC requested that its rates be determined in accordance with the rate of return on rate base methodology. The determination of rate of return on rate base requires three components: 1) capital structure; 2) cost of debt; and 3) cost of equity (or return on equity). However, by statutory requirement, the Commission must specify an allowable operating margin in all water and wastewater orders. Although the Commission must specify an operating margin in its order, this does not mean that the operating margin methodology must be used in determining a fair rate of return. *Heater of Seabrook* at p. 64 and 830. Operating margin "is less appropriate for utilities that have large rate bases and need to earn a rate of return sufficient to obtain the necessary equity and debt capital that a larger utility needs for sound operation." *Id.* No party

contested the use of the rate of return on rate base methodology and given DIUC's large rate base, the Commission finds the rate of return on rate base methodology appropriate in this case.

Capital Structure and Cost of Debt

With respect to the capital structure, DIUC recommended a pro forma capital structure of 41.2% debt and 58.8% equity. ORS witness Dr. Carlisle testified there are two concerns with the method DIUC used to calculate its capital structure: 1) DIUC included pro-forma long-term debt in its long-term debt calculation; and 2) DIUC proposed an inflated equity amount. (Carlisle Direct R. p. 472). Dr. Carlisle noted that both result in an increase in the ROE. (Id.) The pro forma debt is based on the cost of debt DIUC expects, and as Dr. Carlisle noted, the outcome of DIUC's negotiations with banks or lenders is unknown at this time; therefore, DIUC's pro forma debt should not be included. (Carlisle Direct R. p. 473). The POAs also agreed that debt should not include future amounts. (Lanier Direct, R. p. 436, ll. 8-14). Dr. Carlisle further testified that DIUC's capital structure is weighted more heavily with equity, which is more expensive than debt. (Id.) In contrast to a projected or pro forma capital structure, ORS recommended a hypothetical capital structure of 46% long-term debt and 54% equity calculated by averaging the known capital structure used by water companies in the United States with publicly traded stock. (Id.) The POAs produced an adjusted capital structure of 57.55% debt and 42.45% equity (Hearing Exhibit 14, Amended Lanier Exhibit 3), based on a downward adjusted rate base, which is discussed later in this Order.

As to the specific cost of debt rate, DIUC recommended 6.20%. The POAs testified that 6.20% is relatively high in the current interest rate environment, but is probably a reasonable rate given DIUC's precarious financial state. To calculate the 6.20% debt rate, DIUC included anticipated legal and GA fees in the financing fees. In support of the debt amount, Mr. Guastella

testified the debt he used is based on his knowledge of prior financing costs applied to the costs expected to be incurred for future refinancing. As a percentage of the total debt, the anticipated fees are 13.56% per ORS's calculations. ORS did not incorporate the additional fees into the debt rate because the fees are a large percentage of the total debt and did not originate from a lending institution. ORS recommended that the actual debt rate being paid by DIUC to the current lending institution, 5.29%, be used.

Upon consideration of evidence, the Commission adopts the capital structure, 46% long-term debt and 54% equity, and debt rate, 5.29%, recommended by ORS since they are based on known data instead of expected events. The Commission declines to use the POAs capital structure because it is based on a downward adjusted rate base (discussed in the Rate Base section below) that this Commission declines to use.

Cost of Equity/Return on Equity

DIUC witness Guastella testified that the requested 10.5% ROE is based on his experience and judgment. The POAs witness Lanier testified, "This is the same rate the Company requested in its 2012 rate case¹⁴, which was a specified rate, rather than a rate developed through justification of the ROE required to meet its needs for profit margin and to attract the needed debt capital." (Lanier Direct, R. p. 437, ll. 1-4). In contrast to DIUC, ORS's Dr. Carlisle recommended an ROE of 9.31% based on a range of 8.91% to 9.71% using results from the Discounted Cash Flow model ("DCF"), Capital Asset Pricing Method ("CAPM") and the Comparable Earnings Model ("CEM"). (Carlisle Direct R. pp. 471 and 474). Dr. Carlisle testified the DCF and CAPM are known and generally accepted methods for determining a recommended ROE. (Id.) The POAs testified that the DCF is the prevailing method used for

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

determining appropriate ROEs. The POAs also testified that while the DCF and CAPM are recognized as methods for calculating ROEs, the DCF and CAPM provide challenges since there are not many publicly traded companies similar to DIUC. For his analyses, Dr. Carlisle examined data on companies with publicly traded stock of which more data is available, because DIUC requested rates based on rate of return. (Carlisle Direct R. p. 475). Companies with publicly traded stock yield more data than what is available for privately held companies. (Id.) Specifically, Dr. Carlisle testified that he used publicly traded companies classified as “water utilities” by Value Line or *Yahoo! Finance* for his DCF and CAPM since they are in the same line of business as DIUC and share similar risks. (Id.) For his CEM analysis, Dr. Carlisle used companies with comparable betas to those of the companies used in his DCF and CAPM group. (Id.)

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

Connecticut DPUC Formula:

Average Large Company	9.69%
Small Company Adder	0.50%
Performance Adder	<u>0.50%</u>
	<u>10.69%</u>

Florida PSC Leverage Graph Formula:

$5.6\% + (2.279 / \text{Equity Ratio})$	= ROE
Range	100% = 7.88%
	40% = 11.30%
Equity Ratio	58.8% = <u>9.47%</u>

There is no discussion of these components in Schedule A-3 or testimony, with the exception of Mr. Guastella’s rebuttal testimony containing the following single sentence, “Under the Connecticut Public Utilities Regulatory Authority formula for return on equity for small companies, the rate of return on equity for DIUC is 10.69%.” ORS provided no testimony on

either the Connecticut or Florida ROE formulas. The POAs could find no other reference to the Connecticut formula and challenged DIUC's portrayal of the Florida formula. Witness Lanier for the POAs testified, "[S]imply including a formula on a schedule and a calculated number is not sufficient rationale to support a ROE, particularly of 10.5%, when the company is requesting a revenue increase of over 100% in order to achieve such return." (Lanier Direct, R. p. 439, ll. 7-9). The POAs acknowledged Dr. Carlisle as a source to support an appropriate ROE, and the POAs pre-filed direct testimony recommended an ROE in the range of 8.5% to 9.0% in consideration of a lower rate base and based on various examples of DIUC's "irresponsibility in its operations since the rate increase authorized in 2012 and in the use of debt funds, in view of the critical need for cash." (Lanier Direct, p. 441, ll. 2-3).

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

Upon consideration of the various witnesses, the Commission adopts the range set forth in evidence as produced by ORS. ORS used the well-known and commonly-accepted DCF method, CAPM, and CEM for developing its range of 8.91% to 9.71%. Those methods, as applied by ORS, are grounded in sound analysis. While the POAs also used the well-known analyses, this Commission declines the range proposed by the POAs. The Commission finds DIUC's ROE recommendation lacking in support and analysis.

Rate Base

The rate base proposed by DIUC for combined operations was \$7,085,475.¹⁵ In support

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

of its rate base, DIUC included several plant assets, particularly a 125,000 gallon elevated water storage tank, well and facilities (the “facilities”) which are located on real property not owned by DIUC. Specifically, the facilities are located on real property (the “Site”) that, as described below, was sold at a delinquent tax sale. DIUC does not dispute that it is not the owner of the Site.¹⁶ However, DIUC offered testimony and evidence that it owns these facilities, namely that 1) the tax sale did not include the storage tank, well and facilities, only the Site; 2) DIUC pays property taxes to Beaufort County for the facilities; 3) DIUC has the right to operate those facilities on any parcel of land in the Haig Point development¹⁷; and 4) these facilities are “used and useful” in providing water service. (Guastella Direct, R. p. 195, Walls Rebuttal, R. pp. 82-83). DIUC offered the testimony of the Beaufort County Treasurer who stated the Company is paying a utility tax on water system infrastructure. (Walls Rebuttal R. p. 83).

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

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

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

states the “Elevated Tank Site’s” “premises” and “appurtenances” are granted to Mamdouh Sabry Abdelrahman (“Mr. Sabry”). Mr. Sabry, the grantee, is not associated with DIUC. (R. p. 156).

With respect to the overall rate base, the POAs recommended that DIUC’s rate base as proposed \$7,085,475 be reduced by \$3,745,530 as a result of 1) increased accumulated depreciation, 2) contributions in aid of construction (“CIAC”) and 3) CIAC amortization. (Loy Direct, Table 1, R.p. 371). Witness Mr. Loy for the POAs testified that Generally Accepted Accounting Principles (“GAAP”) and appropriate regulatory accounting required that accumulated depreciation be calculated on a straight-line basis from the “in service” date through the end of the test year. (Loy Direct, R. p. 371). In addition, Mr. Loy testified that an adjustment increasing accumulated depreciation “reflects the proper age and condition of the utility property,” (Loy Direct, R. p. 371). POAs witness Mr. Jue echoed Mr. Loy’s conclusion, opining that the DIUC system “would be expected to reflect accumulated depreciation of approximately 30%.” (Jue Direct, R. p. 362). Mr. Loy also testified that certain DIUC plant purchased from Haig Point Utility Company (“HPUC”) should be classified as CIAC rather than invested plant. According to Mr. Loy, International Paper (the original owner of HPUC) and later Haig Point, Inc. (“HPI”) treated the utility plant in HPUC as inventory, expensed those costs, and donated those assets to HPUC. (Loy Direct, R. p. 380). As support for this conclusion, Mr. Loy testified that HPUC Water Annual Reports for the years 2000-2003 showed no plant balances at all. (Loy Direct, R. p. 381). The failure to classify plant as CIAC requires adjustments to both to net plant and CIAC amortization. Mr. Loy also testified that the appropriate characterization of DIUC plant as CIAC would greatly reduce the DIUC property tax

burden, both for back taxes (a reduction of \$402,108 for tax years 2011-2013) and in the test year (a reduction of \$115,995 for tax year 2014). (Loy Direct, R. p. 396).

In sum, the POAs recommended adjustments, largely to net utility plant, accumulated depreciation, contributions in aid of construction, and accumulated amortization to CIAC that would reduce the rate base for combined operations to \$3,276,311.

By contrast, ORS used the carryforward rate base from the last rate case in Docket No. 2011-229-WS, \$4,615,755, and made adjustments through December 31, 2014¹⁸. (R. p. 524.) Using DIUC's utilization factor method with ORS's adjustments, ORS recommended that \$1,932,858 be deducted from the Company's December 31, 2014 Application rate base. Of the amount deducted, \$1,624,696 is gross plant in service representing non-allowable plant, adjustments from the previous case not carried forward by DIUC in this Application, and retirements. (Gearheart Direct R. p. 496.) ORS Audit Exhibit ICG-5 (Hearing Exhibit 18) shows the specific items composing the \$1,624,696. ORS also deducted \$141,198 from accumulated depreciation and \$254,853 from Construction Work in Progress ("CWIP"). Accumulated amortization of CIAC added \$213 to the above gross plant in service, accumulated depreciation, and CWIP adjustments to arrive at a total net plant deduction of \$2,020,534. When \$87,676 in working capital was added, the total rate base reduction became \$1,932,858. (R. ORS Audit Exhibit ICG-1, Hearing Exhibit 18). After deducting the rate base adjustment from the Application Schedule W-B and S-B December 31, 2014 rate base of \$6,914,024, ORS's recommended rate base for combined operations was \$4,981,166. In summary, DIUC's recommended rate base was \$7,085,475, the POAs' was \$3,276,311, and ORS's was \$4,981,166.

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

After reviewing the evidence presented by DIUC, ORS, and the POAs, the Commission accepts the rate base determination methodology and adjustments proposed by ORS. The 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.

The Facilities

DIUC bears the burden of demonstrating the reasonableness of the plant values included in its proposed rate base, particularly when, as here, ORS and the POAs have challenged some of those values. Utility Services of South Carolina, Inc. v. SCORS, 392 S.C. 96, 109, 708 S.E.2d 755 (2011). The Commission agrees that DIUC has not met its burden in demonstrating the reasonableness of the plant values associated with the facilities. DIUC is permitted to earn a return only on that plant it owns. 10 S.C. Code Ann. Regs. 103-716.16 defines “plant” as “[a]ll facilities *owned* by the utility for the collection, production, purification, storage, transmission, metering, and distribution of potable water.” (Emphasis added). It is undisputed that DIUC does not own the Site, the real property upon which the elevated storage tank is located.

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

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

With respect to the question of whether DIUC pays property taxes to Beaufort County based upon the value of the facilities, the record is also unclear. ORS witness Morgan testified that based on conversations with the SC Department of Revenue (“DOR”), Beaufort County and DIUC, ORS understands that DOR utilizes the utility plant-in-service values DIUC lists on Schedule 201 (Utility Plant-in-Service) of the Water Annual Report to value the amount of property subject to tax by Beaufort County. DIUC submitted Revised Water Annual Reports to ORS and the Commission for years 2012 and 2013. (Hearing Exhibit 20). In the Revised Water Annual Reports filed by DIUC, DIUC made adjustments on Schedule 201, adjusting the value of the utility plant-in-service by (\$1,110,715) for 2012 and (\$893,781) for 2013. ORS testified these amounts appear to correspond to the plant asset value of \$863,379 removed by ORS for the elevated storage tank in Docket No. 2011-229-WS.

ORS witness Morgan testified that it was his understanding that DIUC specifically filed Revised Water Annual Reports for 2012 and 2013 to reflect the rate base allowed in Docket No. 2011-229-WS which would likely result in a reduction of the property valuation computed by

DOR for DIUC. Mr. Morgan stated it also appears that the Water Annual Report filed by DIUC for 2014 includes similar adjusted plant-in-service values. ORS's position is that DIUC should not be allowed to earn a return on the elevated storage tank for ratemaking purposes while at the same time having taken action that could reduce property taxes by revising annual reports to deduct a value corresponding to the elevated storage tank value.

The Commission agrees with ORS that DIUC's adjustments reducing plant-in-service values for property tax purposes, as well as the uncertainty regarding what DIUC owns as a result of the delinquent tax sale, support removing the value of the facilities from DIUC's rate base. DIUC's actions in removing plant for reporting purposes and thereby removing the corresponding tax obligations associated therewith, are inconsistent with the proposition that DIUC owns those assets for ratemaking purposes. While DIUC may not have adjusted its utility plant-in-service by the exact value of the elevated storage tank, in at least two tax years DIUC has reduced its total utility plant-in-service by a value very similar to (and actually exceeding) that of the elevated storage tank. In other words, and contrary to its testimony, DIUC does not pay taxes on all of its utility plant-in-service that it claims to be part of its rate base in this Docket. The Commission concludes that removal of the facilities from rate base is therefore appropriate in these circumstances.

The POAs arguments are compelling. However, given the number of rate cases that have occurred since International Paper owned the utility, the Commission declines to adopt a different rate base than the one carried forward from the last rate case by ORS. However, the Commission's conclusions regarding DIUC's rate base do not preclude the POAs or the ORS from taking a different position in future proceedings.

Property Taxes

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

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

With respect to its property tax request in this case, DIUC requested additional annual property tax expense of \$65,856 for the 2012, 2013, 2014 and 2015 taxes and \$ 188,093 for the annual amount of taxes going forward. DIUC's property tax expense request totaled \$258,158 (\$4,209 per books plus \$65,856 plus \$188,093). The POAs recommended that DIUC's tax expense be based on the POAs' downward-adjusted rate base. ORS testified that DIUC's current books reflected approximately \$4,000 annually for property taxes and, with the ORS adjustments, DIUC would have \$171,492 annually to cover property taxes. Specifically, ORS recommended that DIUC receive \$30,612 annually for the 2012 and 2013 taxes totaling

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

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

Management Fees, Rate Case Expenses, and Other Expenses

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

the total net utility operating income; an incentive fee if DIUC is sold; rate case expenses; travel expenses; and expenses related to regulatory investigations and proceedings.

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

DIUC requested \$191,200 for current and unamortized rate case expenses to be recovered over 4 years. DIUC also testified that it would update its rate case expenses at the hearing to show the additional expenses incurred since the Application. ORS proposed that rate case expenses total \$97,500 and be amortized over five years. 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.

ORS excluded from operating and maintenance expenses the incentive fee¹⁹ included in the test year and \$25,439²⁰ representing GA's management fee, legal expenses related to the property tax appeal and tax sale of the water tower, and other expenses not allowable for rate making purposes. DIUC witness Guastella disputed all exclusions noting "[GA's] efforts reflect an unequivocal commitment to provide adequate service to the customers, some of which were

¹⁹ See ORS Adjustment 4(m).

²⁰ See ORS Adjustment 4(g).

achieved because of GA's rate setting expertise that is not typical of other managers." "Having consulted for some 600 developer-related water and sewer utilities, I am not aware of any that had managers with the regulatory, utility accounting, valuation, or rate setting experience that GA applied in meeting the challenges of managing DIUC." DIUC witness Guastella also testified, contrary to ORS's testimony, that the existing and proposed rates do not include any allowance for GA's incentive fee.

Upon review of the evidence, the Commission adopts ORS's adjustments for management fees, rate case expenses, and non-allowable expenses. We agree that GA provides services to the ratepayers, but disagree that the services are at a level that warrant the amount set forth in the management services contract. We think it is appropriate for DIUC stockholders to have responsibility for the difference. While customer service complaints are few in number, this Commission did hear testimony at the night hearing and the merits hearing that GA was an absentee management company and had very little presence on the island. It is undisputed that DIUC did not pay property taxes under GA's tenure (resulting in the tax sale described above), that required regulatory reports and fees have been filed and paid late (R. p. 244), and that the South Carolina Department of Health and Environmental Control ("DHEC") issued a notice of violations against DIUC (Vogel Direct, R. p. 319, ll. 14-16). We conclude the ORS-recommended amount for management expenses strikes a reasonable balance. The Commission agrees with ORS's judgment that \$75,000 in rate case expenses is a reasonable amount to pass to ratepayers for this rate case. We also agree that the amortization period and the inclusion of unamortized rate case expenses from the last rate case are reasonable. The reasons set forth for excluding the non-allowable expenses is based on sound rate-making principals and those costs should not be passed to ratepayers.

Bad Debt Expense

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

Other Adjustments

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

Performance Bond

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

maintain its performance bond in the amount of \$350,000 for water and \$350,000 for sewer operations.

Settlement Agreement

On October 27, 2015, the POAs and ORS filed with the Commission a Settlement Agreement whereby the POAs and ORS agreed to recommend to the Commission a revenue increase of \$462,798 for DIUC's combined water and sewer operations. The Settlement Agreement includes five exhibits based on the settlement revenue with the first exhibit setting forth a proposed rate structure, the second exhibit showing the percentage increase for the proposed rates and the third, fourth, and fifth exhibits showing the operating experience, rate base and rates of return. The Settlement Agreement is attached to this Order as Order Attachment 1. The revenue was determined by accepting all of ORS recommended adjustments, with the exception that ORS agreed to recalculate its recommended bad debt expense to adopt the calculation utilized by DIUC in its Application. No other changes were made by ORS to its adjustments. The Settlement Agreement states the \$462,798 revenue increase produces an ROE of 9.28% and an operating margin of 16.18% for the combined operations.

The Settlement Agreement's proposed revenue increase, \$462,798, is 39.1% of the Company's requested revenue. Notably, the direct testimonies of Lanier and Loy for the POAs produced a revenue increase of \$429,442 or 39.9% based on their adjustments and recommendations. The Settlement Agreement closely mirrors the results produced and recommended by the adjustments of both the POAs and ORS.

At the outset of the hearing and after counsel for the POAs introduced the Settlement Agreement into the record, DIUC objected to its inclusion stating that it would be improper for the Commission to consider or rule upon its terms without hearing all evidence. The objection.

was duly noted and overruled as it is the Commission's practice to accept Settlement Agreements when presented, but continue to hear all evidence in the case prior to making a ruling on the merits of the case. The Commission continued to follow its practice in this case.

The Commission finds, based on the testimony of DIUC, the POAs and ORS, that an increase in rates is supported by the evidence presented. DIUC has not applied for a rate increase in several years as it was prevented from doing so pursuant to the settlement agreement approved in its last rate case in Docket No. 2011-229-WS. Expenses have increased during the last four years, and the Company is entitled to a fair and reasonable return to: 1) allow it to serve its customers at the same level and 2) place it in a more favorable position to borrow or acquire capital.

After reviewing the evidence in this case, we adopt and approve the Settlement Agreement and its exhibits. The Settlement Agreement includes all ORS adjustments with the exception of the bad debt expense. ORS testified that it recalculated its bad debt expense to reflect the calculation recommended by DIUC in its Application. The use of the Company's bad debt expense calculation causes a downward adjustment of working capital and therefore rate base. The rate base ORS recommended in its direct testimony changes from \$4,981,166 to \$4,962,927 in the Settlement Agreement. We find the use of the Company's recommended bad debt expense calculation non-objectionable and approve the resulting rate base and Settlement Agreement in its entirety. The Settlement Agreement revenue amount produces an operating margin of 16.18%. Further, the 9.28% ROE is within the ORS-recommended range adopted by this Commission of 8.91% to 9.71% and very close to the ORS-recommended ROE of 9.31%. The Settlement Agreement will permit the Company to cover operating costs and provide an opportunity to earn the approved rate of return on rate base. The resulting ROE allows DIUC the

opportunity to earn a fair return and we agree with ORS that the Settlement Agreement is in the public interest.

III. FINDINGS OF FACT

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

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

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

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

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

6. The Commission adopts and approves the Settlement Agreement and its exhibits (Order Attachment 1) in its entirety as it sets forth a fair return along with just and reasonable rates.

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

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

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

10. The approved Settlement Agreement's revenues and expenses establish a fair and reasonable operating margin of 16.18%. S.C. Code Ann. § 58-5-240(H).

IV. CONCLUSIONS OF LAW

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

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

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

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

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

5. The rates as set forth in the attached Order Attachment No. 1 are approved for use by DIUC and are designed to be just and reasonable without undue discrimination and are also designed to meet the revenue requirements of DIUC.

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

IT IS THEREFORE ORDERED THAT:

1. The Settlement Agreement including its attached Exhibits (Order Attachment 1) is approved, adopted, and accepted into the record, and is incorporated into and made part of this Order by reference. Further, we find the Settlement Agreement is in the public interest and constitutes a reasonable resolution of this proceeding.

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

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

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

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

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

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

BY ORDER OF THE COMMISSION:

Nikiya "Nikki" Hall, Chairman

ATTEST:

Swain E. Whitfield, Vice-Chairman

DAUFUSKIE ISLAND UTILITY COMPANY, INC.

DOCKET NO. 2014-346-W/S

Testimony of Eric Johanson

Before the South Carolina

Public Service Commission

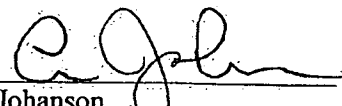
Testimony Prepared: September 18, 2015

Hearing Date: October, 28, 2015

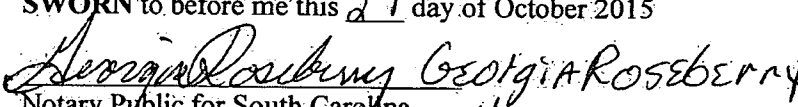
STATE OF SOUTH CAROLINA)
COUNTY OF BEAUFORT)

AFFIRMATION OF TESTIMONY

PERSONALLY appeared before me, Eric Johanson, who, being duly sworn, deposes and says that he has read and does hereby affirm the foregoing Testimony and that said Testimony is true and correct of his own knowledge.


Eric Johanson

SWORN to before me this 29 day of October 2015


Notary Public for South Carolina
My Commission Expires: Sept 26th, 2018

APPEARANCES [Cont 'g]:

JOHN J. PRINGLE, ESQUIRE, representing HAIG POINT CLUB & COMMUNITY ASSOCIATION, MELROSE PROPERTY OWNERS ASSOCIATION, and BLOODY POINT PROPERTY OWNERS' ASSOCIATION, INTERVENORS

SHANNON BOWYER HUDSON, ESQUIRE, and **ANDREW M. BATEMAN, ESQUIRE**, representing THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF

MERITS HEARING - VOLUME 2 OF 2
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PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

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P R O C E E D I N G S

CHAIRMAN HALL: Thank you. Be seated. Good morning, everyone. We will call this hearing to order and ask Mr. Butler to please read the docket.

MR. BUTLER: Thank you, Madam Chair and members of the Commission. This is Docket No. 2014-346-WS; it's the Application of Daufuskie Island Utility Company, Incorporated, for approval of an adjustment for water and sewer rates, terms, and conditions.

Please take notice that a hearing on this matter has been scheduled to begin on Wednesday, October 28, 2015, at 10:30 a.m., before the Commission in the Commission's hearing room at 101 Executive Center Drive, Saluda Building, Columbia, South Carolina 29210, for the purpose of receiving testimony and evidence from all interested parties.

Madam Chair and members of the Commission, the Docket is in order.

CHAIRMAN HALL: Thank you, Mr. Butler.

Let me ask that the attorneys make their appearances. Who appears for Daufuskie Island Utility Company?

MR. GRESSETTE: Good morning. I'm Tom Gressette, on behalf of Daufuskie Island Utility.

1 MR. WALKER: And Trenholm Walker, as well.

2 Thank you.

3 CHAIRMAN HALL: Okay. Good morning.

4 MR. WALKER: Tom and I are working together.

5 CHAIRMAN HALL: Okay. And for Haig Point Club
6 & Community Association, Melrose Property Owners
7 Association, and Bloody Point Property Owners'
8 Association?

9 MR. PRINGLE: Good morning, Madam and
10 Commissioners. My name is Jack Pringle,
11 representing Haig Point, Melrose, and Bloody Point
12 - the POA Intervenors, as we like to call them.

13 CHAIRMAN HALL: Okay. Thank you. Welcome.
14 And for Beach Field Properties?

15 MS. FOX: Good morning, Madam Chair,
16 Commissioners. I'm Peg Fox, here representing
17 Beach Field Properties.

18 CHAIRMAN HALL: Okay. And for ORS.

19 MS. HUDSON: Good morning, Madam Chairman,
20 members of the Commission. I'm Shannon Bowyer
21 Hudson. With me is Andrew Bateman. We're here on
22 behalf of the South Carolina Office of Regulatory
23 Staff.

24 CHAIRMAN HALL: Okay. All right. Thank you.
25 And before - we'll take up preliminary matters

1 in a minute, but we need just to tell you, tell
2 everyone, the schedule for this morning. We'll
3 break for lunch at about 12:15 for about an hour or
4 so. We will break every hour and a half, or so, to
5 give our court reporter a break, and let everybody
6 have their own personal break. And – this is the
7 clincher – we're going to go as late as we can
8 today, to finish today. We have a night hearing in
9 Rock Hill tomorrow, so we want to try to finish
10 today, so that we don't interfere with that
11 tomorrow. So, late as we can, to finish today.
12 Six o'clock, 6:30 – so we'll see.

13 Now, any preliminary matters we need to take
14 up?

15 MR. PRINGLE: Madam Chair, Jack Pringle, with
16 one preliminary matter. Yesterday afternoon, a –

17 CHAIRMAN HALL: Mr. Pringle you're getting the
18 evil eye.

19 MR. PRINGLE: Do we have any Lavalieres?
20 [Indicating.] It's all right, I'll do this quick.
21 How's this?

22 CHAIRMAN HALL: That's perfect. Thank you.

23 MR. PRINGLE: Okay. Yesterday afternoon, the
24 POA Intervenors and the ORS filed a settlement
25 agreement with the Commission. That settlement

1 agreement includes a settlement document somewhat
2 similar to the ones that the Commission has seen in
3 the past, as well as several exhibits that describe
4 the settlement entered into by the POA Intervenor
5 and the ORS, in terms of a rate of return, or
6 return on equity, and as well as the additional
7 revenues to which at least my clients and the ORS
8 have determined to be a reasonable settlement.

9 And just to be clear, this is between my
10 clients and the ORS. It does not include the
11 Applicant and it does not include Ms. Fox's client.

12 That's been filed with the Commission, so at
13 this time I'd like to – we certainly have folks
14 here, and I want to make this clear, too, that the
15 settlement is, by and large, a result of ORS'
16 testimony and adjustments, with one exception, as
17 described in the cover letter: a change or an
18 amendment in the way that the ORS views bad-debt
19 expense, and changing that to make it consistent
20 with what the company sought in its Application.
21 Otherwise, the adjustments – and this is described,
22 to some extent, in the exhibits – and the numbers
23 that are used, as well as the final number, are all
24 the result of ORS' testimony in this case. And the
25 exhibits reference that and discuss, you know, how

1 those numbers were arrived at.

2 So with that having been said – and,
3 certainly, to the extent that there are questions
4 about it and the exhibits, those witnesses will be
5 appearing in the case-in-chief in the same way that
6 they would in any other contested case. And so,
7 with that being the case, I'm going to ask that the
8 settlement agreement and its exhibits be moved into
9 the record and made part of the record and the
10 hearing.

11 CHAIRMAN HALL: All right.

12 MR. GRESSETTE: Good morning – [Indicating.]
13 Do we need to turn this on?

14 CHAIRMAN HALL: You're on.

15 MR. GRESSETTE: Okay. Good morning, Madam
16 Chairman and Commissioners. When we received
17 notice of this document being filed yesterday, we
18 were a bit surprised. While it is appropriate for
19 the document, presumably, to be filed in the Docket
20 because it's been reached between two parties in
21 the case, we do not believe it's appropriate for
22 the Commission to consider it, to take notice of
23 it, or to incorporate it into the record.

24 The reason for that is that it is not a
25 settlement. We, on behalf of Daufuskie Island

MERITS HEARING - VOLUME 2 OF 2
10/28/15

PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

1 Utility Corporation, have filed a rate application.
2 ORS provided its input. There were a set of
3 Intervenors. And now the Intervenors and ORS have
4 reached an agreement as to what they purport to be
5 a reasonable resolution of my client's Application.
6 So, it's not a settlement, because, if it were a
7 settlement, we wouldn't all be here. But taking a
8 step back from that, if there are issues remaining
9 between the Applicant for the Commission to hear,
10 it's not a settlement. If the Commission takes
11 into account and incorporates into the record the
12 settlement agreement, our concern is this: that not
13 only will it be unfair to our client because,
14 essentially, it purports to assert that a number
15 less than even what ORS originally proposed through
16 its adjustments is the appropriate resolution of
17 this matter, it attempts to bootstrap the two
18 parties' positions together and support them in
19 front of the Commission.

20 In other words, if this were a document we
21 were taking into evidence, we would first look at
22 the Regulations; I would tell you that it's
23 irrelevant and immaterial. You would then look at
24 the South Carolina Rules of Evidence; I would tell
25 you that it's not relevant and, because it's not

1 relevant, it shouldn't be admissible. Even if it
2 is relevant, it's prejudicial. The reason it's
3 prejudicial is twofold: First, it's hearsay,
4 because it seeks to present to this court matters
5 outside of the court as fact, for the Commission to
6 consider. And, additionally, in violation of Rule
7 408, it seems to present to the court my client's
8 behavior with regard to settlement. In other
9 words, because the Applicant hasn't settled, it
10 should be somehow punished or looked at askance
11 because two of the three parties have agreed. And
12 for those reasons – a very lengthy list of reasons,
13 which I appreciate your indulgence, first thing –
14 we don't believe that it, in fact, is a settlement
15 agreement, as purported, or that it should be part
16 of the record or noted by the Commission.

17 **CHAIRMAN HALL:** Go ahead, Mr. Pringle.

18 **MR. PRINGLE:** Mr. Gressette makes some good
19 arguments, but ultimately there are a number of
20 things that doesn't get him to excluding this
21 settlement agreement. The first is, is that we
22 certainly never represented it as a full
23 settlement. You know, we said this is, very
24 clearly, a partial settlement that is the result of
25 the things between these two parties. And as I

1 mentioned when I presented it initially, the
2 numbers that are contained in it are part of
3 testimony and evidence that will be given in this
4 particular proceeding. As such, they are reliable
5 from that standpoint, and, certainly, subject to
6 discussion in the case.

7 It is certainly relevant, because all of the
8 information that is contained in it has to do with
9 - and, in fact, the Commission's charge in this
10 case is to determine what is a reasonable rate or
11 set of rates or a rate of return or, you know, what
12 is the proper result in this case, taking into
13 consideration all the factors in 58-5-240 and
14 elsewhere. So it clearly pertains to this case.

15 With respect to the prejudice that may result
16 to DIUC, I would maintain that that's not unfair
17 prejudice at all, because this Commission still has
18 the ability to give and decide whatever weight or
19 other consideration that it wants to make to the
20 settlement agreement and what's in it, and it
21 doesn't stop the Commission or preclude the
22 Commission or tie the Commission's hands in any
23 way, in performing its ratemaking function and
24 hearing this contested case and considering all the
25 evidence and getting to a result. None of that -

1 the settlement agreement doesn't do any of that, in
2 terms of what – it does not change what the
3 Commission is doing, so it can't be unfairly
4 prejudicial to DIUC.

5 Furthermore, with respect to Rule 408, nothing
6 about this settlement between the ORS and the
7 Appli- – not the Applicant – the Intervenor
8 characterizes or has anything to do, or describes
9 any discussions that may have been had with the
10 Applicant in the process of where we got to. Rule
11 408 prevents a party from coming in, in an
12 adversarial case or a contested case, and asking a
13 witness, like, "Hey, when we were talking, you were
14 going to agree to settle this case, weren't you?"
15 "Well, we almost reached something. We almost
16 reached an agreement." And you can't use that as
17 evidence in a case to try to show that your case is
18 better or worse than it otherwise would be. That's
19 what stays out. This is between the ORS and the
20 Intervenor, and so it does not run afoul of Rule
21 408, at all.

22 So, ultimately, what I'd say is that it's
23 certainly not hearsay because it's got its numbers
24 and information that have been filed and are being
25 used in this case. It's not Rule 408 for the

1 reasons that I just described. And there's no
2 unfair prejudice for the reasons I described, and
3 particularly more because you're not a jury, and
4 you have the ability to weigh the documents and
5 information that are before you; and having that
6 settlement is not going to unfairly prejudice DIUC,
7 because of your ability to assess and consider all
8 the evidence, in the same way you do in every case.

9 **CHAIRMAN HALL:** Thank you, Mr. Pringle.

10 Ms. Hudson?

11 **MS. HUDSON:** Yes, thank you, Madam Chairman.
12 I'd like to make two points here. First, based on
13 the Applicant's argument, I'm not sure that it
14 would ever be appropriate to present a settlement
15 agreement to you, if you accept the Applicant's
16 argument. Second, when ORS approaches a rate case,
17 as it does with anything, it looks to its statutory
18 mandate, and that is to represent the public
19 interest. There's a three-prong – three prongs to
20 that definition: to protect all classes of
21 customers, the using-and-consuming public, make
22 sure the utility can maintain its infrastructure,
23 also to encourage economic development. We think
24 the settlement ticks all those boxes, so, of
25 course, we would want to present that to you.

1 We're proud of the settlement.

2 **CHAIRMAN HALL:** Okay, thank you.

3 Mr. Gressette, your objection is overruled. I
4 think that the document's value is more probative
5 than prejudicial. I think that the Commission is
6 sophisticated enough to weigh the value of the
7 document, as Mr. Pringle indicated. And I don't
8 agree that the settlement indicates any behavior on
9 the Applicant's part, as to settlement behavior.
10 So your objection is overruled. We will – okay, so
11 we'll make it Hearing Exhibit No. 1 – no, I'm
12 sorry, No. 3. The night hearings, we had some
13 exhibits from those, Nos. 1 and 2, so the
14 settlement agreement will be Hearing Exhibit No. 3.

15 **MR. PRINGLE:** And would Madam Court Reporter
16 like a copy?

17 **CHAIRMAN HALL:** Madam Court Reporter is
18 sophisticated and already has one.

19 **MR. PRINGLE:** No prejudice there.

20 **CHAIRMAN HALL:** None at all.

21 [WHEREUPON, Hearing Exhibit No. 3 was
22 marked and received in evidence.]

23 So if any parties would like to make an
24 opening statement, now is the time if that is
25 desirable.

1 MR. WALKER: [Indicating.]

2 CHAIRMAN HALL: Okay.

3 MR. WALKER: Good morning. Thank you, Madam
4 Chairman. My name, again, is Trenholm Walker.
5 We've got a lot of ground to cover today, so I'm
6 not going to spend a horribly long time going over
7 the whole case. What I do want to do is set the
8 context for the request that's being made by
9 Daufuskie Island Utility.

10 The rate request before you is a considerable
11 rate request. The reason it's considerable is
12 there's considerable need for additional revenues
13 for this utility.

14 When we were last before you three years ago,
15 you may remember that the utility was basically on
16 life support. And thanks to, I say the Commission,
17 even though we resolved it through a settlement
18 approved by the Commission, we were able to move
19 forward and to do a tremendous amount of deferred
20 maintenance in the system. We were also able to
21 obtain a much-needed loan that allowed those
22 repairs to be funded. Part of that settlement
23 agreement and part of the Commission's order was
24 that monies be set aside for capital improvements
25 of \$700,000, and we more than spent those on

1 capital improvements. But, despite that, the
2 utility has continued to suffer from cash deficits.

3 A loan that we thought was going to be easy to
4 acquire was almost impossible to acquire. At the
5 time we were before you, we thought CoBank would
6 lend the money; they didn't do it. Then Wells
7 Fargo said it would lend the money and we went down
8 the road with Wells Fargo, and they didn't lend the
9 money. And, finally, we were able to make the loan
10 with SunTrust that basically saved the utility.

11 And the key issues that you will have before
12 you today are those normally attendant to the case,
13 but I'd just like to give you the short list in our
14 mind of what we are going to feature for you and
15 what, really, the issues are. First, on expenses,
16 there is a sharp disagreement about expenses that
17 should be allowed, and a huge expense for this
18 utility is property taxes. I think you are aware,
19 from your review of the materials, that we learned
20 that there were deferred or unreported property
21 taxes of in excess of \$365,000. What happened was,
22 these taxes were not on the books when Mr.
23 Guastella took over. The notices went to the wrong
24 address. And he, after the last rate case – not
25 before – received a notice from Beaufort County

1 that they were going to assess for 2010, 2011, 2012
2 – actually, it was assessed by DOR and collected by
3 Beaufort County. But we ended up with a tax
4 liability that was enormous, something like
5 \$565,000, which, through negotiations, we managed
6 to work with Beaufort County to eliminate two years
7 of those tax revenues and have an installment
8 agreement that requires payments over the next
9 eight years. And we are seeking to recover for
10 those. Both ORS and the Intervenorors say you
11 shouldn't be able to recover those taxes. But
12 they're an ongoing obligation; there's nothing we
13 can do about it.

14 We also have what we believe to be the current
15 tax bills that are due. And utility infrastructure
16 is taxed or assessed at 10 percent or 10.5 percent,
17 so the taxes are very high. That's a huge expense.
18 Our expense for taxes in the years moving ahead, as
19 appropriately adjusted, is well in excess of
20 \$250,000. And according to the adjustments of ORS
21 and the Intervenorors, they would like to leave us
22 about \$70,000 to \$80,000 shy of that. So that's a
23 big issue.

24 Another big issue will be plant-in-service.
25 We have two pieces of property that are not

1 currently – the land is not owned by the utility.
2 One is the elevated storage tank. This was
3 discussed at the last hearing. It was sold at a
4 tax sale, again, because the bills were going to
5 the wrong address. We've attempted to get it back.
6 We have a condemnation action. We have succeeded,
7 basically, in proceeding with the condemnation
8 action. The only defense to it would be that the
9 utility did not have the right to condemn, and the
10 Circuit Court has said, "You do have the right to
11 condemn," so, legally, we have possession of the
12 land. But more important than that is that the tax
13 deed did not convey the utility facilities. They
14 were never on the books and assessed by Beaufort
15 County. The utility still owns the elevated tank,
16 the wells that are on that parcel. We will show
17 you that those have been taxed by DOR and that
18 those are appropriately included in rate base.
19 There is an adjustment in our DOR return
20 proportionately to get our plant-in-service to \$5
21 million, which was the amount we agreed on last
22 time, but it was not done to eliminate the elevated
23 storage tank, as suggested by ORS; it was a
24 proportional reduction. So that's going to be a
25 huge issue for you.

MERITS HEARING - VOLUME 2 OF 2
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PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

1 You also will have the question of Mr.
2 Guastella's management contract. ORS and the
3 Intervenors are claiming that he charges too much.
4 You will hear all the services that are being
5 performed by Mr. Guastella. He's tremendously
6 accomplished in the field of water and sewer,
7 ratemaking, and has been on the faculty of several
8 national ratemaking conferences. He also brings a
9 tremendous amount of experience. His company does
10 everything that is office work for this utility.
11 He doesn't - his office does the billing, they do
12 the - they have an engineer on staff. They do
13 construction oversight. Everything that you can
14 think of, they do, and they do it through a
15 management agreement in lieu of hiring people - the
16 utility's hiring individuals who they would have to
17 pay for, who would do those jobs, who wouldn't have
18 a fraction of the experience.

19 You'll also hear about depreciation. That's
20 at issue, because the plant-in-service is at issue,
21 and if there's less plant-in-service, there's less
22 depreciation. So that's another issue.

23 So those are the main ones that come to mind
24 right now. Mr. Guastella is going to testify and
25 he will feature those in his summary, but I wanted

1 you to know where we're coming from.

2 Essentially, we are asking for a 100 percent
3 increase, and it's a 100 percent increase because
4 we need a 100 percent increase to pay the bills and
5 to have some return to the owners. There has never
6 been a dividend paid. In fact, as you will hear
7 from Mr. Guastella, 2015 could have a deficit well
8 in excess of \$250,000, projected maybe at \$450,000.
9 So this utility needs to be funded. And I realize
10 that that's a big ask, but at the same time, I do
11 think that it serves the ratepayers, it serves the
12 State, and it accomplishes the mission of the
13 Commission to make sure that it's a viable entity
14 and we're not living hand to mouth. And there are
15 these criticisms that we don't pay on time – I
16 mean, there are all these criticisms about we don't
17 pay vendors on time. We don't have enough money to
18 pay vendors on time. But you will hear that as you
19 assess the testimony, and we'd ask you to keep an
20 open mind and look at where we end up at the end of
21 the day, because Mr. Guastella will explain to you
22 the rate is still reasonable. We're dealing with a
23 very small utility, 600-plus water customers. We
24 are not a big utility. Money makes a big – slight
25 charges can make a big difference in the return to

1 this utility, and not having enough money to make
2 the tax bill or pay the interest – that's going to
3 be another big expense is what is the interest rate
4 that you should approve on the debt that we have.
5 If we don't have enough money to pay the tax debt,
6 if we don't have enough money to pay the loan which
7 is now due, we're in trouble. So please keep this
8 in mind, and thank you.

9 **CHAIRMAN HALL:** Okay. Thank you, Mr. Walker.

10 Any other parties wish to make an opening
11 statement?

12 **MR. PRINGLE:** I'm not going to make an
13 opening.

14 **CHAIRMAN HALL:** Okay. Ms. Hudson?

15 **MS. HUDSON:** Good morning, again. Thank you.
16 We want to take the opportunity to point out what
17 ORS sees as the three big issues in this case. To
18 us, those three issues are: property taxes, the
19 elevated storage water tank – you'll hear me call
20 that the water tower – and the management fees.

21 Let's begin with the property taxes. You will
22 hear that the utility is saying that it does not
23 have enough money for its property taxes. I want
24 this Commission to know that ORS is supporting
25 \$170,000 annually for taxes, for perpetuity, or

1 until the utility comes back before you to request
2 another rate adjustment.

3 Second, the water tower: The utility will tell
4 you it owns the water tower. It's not so clear.
5 The Office of Regulatory Staff cannot determine
6 whether the utility owns the water tower, or if the
7 man who bought the property in the delinquent tax
8 sale owns the water tower. Because the utility has
9 not proven with certainty, and to ORS's
10 satisfaction, that it owns the water tower, the
11 Office of Regulatory Staff cannot, in good
12 conscience, recommend that the ratepayers pay the
13 company a return on a water tower that it may not
14 own. It's that simple.

15 The management fees: We believe the utility is
16 paying a premium for the management services. We
17 think management services have a value. We think
18 the ratepayers should pay it. But ORS doesn't
19 think the ratepayers should pay the premium.

20 Lastly, I want to apologize that we weren't
21 able to get the settlement agreement to you within
22 your guidelines. We ran short on time. We were
23 working diligently on it. And it makes me feel
24 better to say out loud that we're cognizant of your
25 guidelines. We were able to reach the settlement

1 agreement with all three property owner
2 associations by making one change to our
3 adjustments. That one change was to recalculate
4 our bad-debt expense and adopt the bad-debt expense
5 methodology proposed by the company in its
6 Application. Using that one change, along with our
7 original adjustments, produces a revenue increase
8 of \$462,798. That number is in the settlement
9 agreement. It produces a return on equity of 9.28
10 percent and an operating margin of 16.18 percent.

11 We believe that return on equity of 9.28
12 percent and the operating margin of 16.18 percent
13 provides the company the opportunity to earn a fair
14 return. We think it's very fair, and we hope you
15 agree. Thank you.

16 **CHAIRMAN HALL:** Mr. Pringle?

17 **MR. PRINGLE:** I was just going to rise on the
18 point that - and I'm glad Ms. Hudson mentioned
19 this, about the Commission settlement guidelines.
20 Let me just make it clear that any fault for not
21 filing it on time rests with me and not with Ms.
22 Hudson. She continually badgered me about it, and
23 I said, "No. Rules, schmules, no way. I mean,
24 I'll file it when I want to."

25 [Laughter]

1 And so anything that comes along with that
2 just should fall on me.

3 CHAIRMAN HALL: All right. Now, before I
4 invite the parties to present their case, do we
5 have any members of the public that would like to
6 testify?

7 MR. DELANEY: [Indicating.]

8 CHAIRMAN HALL: Did you - come forward, sir.
9 Did you sign up with Mr. Richardson with our
10 office?

11 MR. DELANEY: I don't think I did.

12 CHAIRMAN HALL: Okay, that's fine. Come
13 forward.

14 MR. DELANEY: All right.

15 CHAIRMAN HALL: Just have a seat right here at
16 this table [indicating]. Give us your -

17 MR. DELANEY: Right here [indicating]?

18 CHAIRMAN HALL: - name. Yes, sir, right
19 there.

20 MR. DELANEY: I'm from Georgia, so you have to
21 excuse me.

22 CHAIRMAN HALL: Okay. Are you a customer of
23 the utility?

24 MR. DELANEY: No, I'm actually a property
25 owner.

1 **CHAIRMAN HALL:** Okay. All right. If you can
2 give us your name, and raise your right hand so you
3 can be sworn.

4 **MR. DELANEY:** Okay. Reed Delaney.

5 [Witness affirmed]

6 THEREUPON came,

7 **R E E D D E L A N E Y ,**

8 who, having been first duly affirmed, testified as follows:

9 **CHAIRMAN HALL:** Go ahead, Mr. Delaney.

10 **WITNESS:** I just – I don't know if this is the
11 appropriate time, but one of the attorneys was just
12 talking about that the utility doesn't own two
13 properties, and he mentioned one property. And I'm
14 assuming he was referring to our property for the
15 second one, which he did not address.

16 We purchased 200 acres, which was part of the
17 Bloody Point tract, when they went through
18 bankruptcy, and a waste treatment plant of theirs
19 is sitting on our property. And they do not own
20 the land; we own it. We've been trying to approach
21 them and talk to them for, I think, three years. I
22 had my attorney involved in it. Our attorney spoke
23 with their attorney, went back and forth and never
24 came to a resolution. We were simply saying,
25 "Look, we're happy to deal with you. We just don't

1 want the liability of having this operation on our
2 land, so if you just lease it from us for a nominal
3 fee, I'm happy to do that. I just don't want the
4 liability." They eventually cut off talking to us.
5 They haven't returned my calls in a year and a half
6 or more.

7 We called up the – I think it was maybe DHEC,
8 perhaps, and we spoke – I think maybe it was
9 someone at the PSC. And the conversation went in a
10 circle as they'd say, "Well, they have the permit
11 to operate it." And I said, "Well, but they're
12 operating it on my land." And they said, "Well,
13 that's not our issue; that's a property-rights
14 issue." And I said, "Okay, I understand. So then
15 I'll just kick them off my land." And they said,
16 "No, you can't do that. They have a permit to
17 operate a public utility." And I said, "Well, what
18 am I supposed to do?" And it just went in a big
19 circle. So I felt like the best approach was just
20 to fairly approach them and say, you know, "Look,
21 why don't you guys just sign a nominal-sum lease so
22 that you can operate properly and legally on my
23 property, and I can have some protection from a
24 liability standpoint," and they've never responded.

25 So I am not in favor of them in any way. I

1 don't see how they can apply for a permit or get a
2 rate increase for a utility on a property that they
3 don't own; and, hence, they don't own the physical
4 structures that are on the property, meaning the
5 ponds, the buildings, everything else. They don't
6 own any of it.

7 CHAIRMAN HALL: Okay, Mr. Delaney. I'm not
8 even sure where to start.

9 WITNESS: I don't either.

10 CHAIRMAN HALL: Okay. Just tell me -

11 WITNESS: I have a copy of the fee here, if
12 you'd like it.

13 CHAIRMAN HALL: When was it you purchased the
14 property?

15 WITNESS: I think it was about three and a
16 half, four years ago.

17 CHAIRMAN HALL: Okay. And you said you've
18 tried to contact the company -

19 WITNESS: I've got -

20 CHAIRMAN HALL: - to no avail?

21 WITNESS: I've got e-mails. We contacted Mr.
22 Guastella's office, as well. I've got e-mails,
23 I've got my attorney's records. You know, we ended
24 up - I talked to the owner, or one of the owner's
25 representatives personally, initially, and he was

1 very responsive; and then, all of a sudden, boom,
2 he just quit talking to me, and this was three
3 years ago, probably. So then I got upset, and I
4 got my attorney involved. He got them ginned up
5 again, and they started conversation and we thought
6 we were going to get to a resolution, and then,
7 boom, just they quit talking. So I suspect it's
8 been maybe a year and a half, two years, or
9 something, since we really had any conversations,
10 whatsoever. I don't understand it, at all.

11 CHAIRMAN HALL: Okay. As is our practice, let
12 me invite the parties, too, if they have any
13 questions for Mr. Delaney.

14 WITNESS: Sure.

15 MR. GRESSETTE: Madam Chairman, Commissioners.

16 CROSS EXAMINATION

17 BY MR. GRESSETTE:

18 Q Mr. Delaney, my name is Tom Gressette, and I work at
19 Pratt Thomas Walker.

20 CHAIRMAN HALL: Mr. Gressette, can you go to a
21 microphone?

22 MR. GRESSETTE: Sure, I'll be glad to
23 [indicating]. Sorry, I didn't want to make him
24 have to turn around.

25 <

1 BY MR. GRESSETTE:

2 Q Mr. Delaney, my name is Tom Gressette; I work at Pratt
3 Thomas Walker, and I'm here on behalf of Daufuskie
4 Island Utility Company. Are you familiar with the
5 documents that have been submitted in this case -
6 particularly, those attached to Mr. Guastella's rebuttal
7 testimony? And I'm, specifically, referring to a
8 document submitted as Exhibit 3 called "Indenture Grant
9 of Easement and Bill of Sale for Personal Property"?

10 A I'm not.

11 Q Okay. And I'll just represent to you that Mr. Guastella
12 has provided testimony, along with that document, that
13 indicates that there's a bill of sale referencing the
14 water and sewer infrastructure to which you speak, but,
15 if I understand your testimony correctly, you have not
16 reviewed that document?

17 A I have not. We have documents from Guastella's company
18 saying and agreeing that we own the property and not
19 Guastella. We have those documents.

20 Q Do you have those with you today?

21 A I do not have them with me. I can certainly supply them
22 to the PSC or to you, if you would like.

23 Q Okay. And the only other question I had was, do you, as
24 the owner of this parcel, have an intent or plan to use
25 it for helicopter landing while under agreement with

1 DIUC to be responsible for the liability of that
2 property?

3 A I do not. That was one thing that I talked to them
4 about in the past. The - you're talking about the
5 specific property this utility is on.

6 Q [Nodding head.]

7 A Yes. No. I talked to them in the past; that would be
8 great, but we've got 200 acres. I've got plenty of
9 acreage to land somewhere else.

10 Q Okay.

11 A What I want is a lack of liability for them operating a
12 waste treatment facility - which I'm aware of, because
13 I'm in the chemical business - on my property.

14 Q And in your discussions or your counsel's discussions
15 with regard to how to resolve this issue, has also
16 another firm, beyond our firm, been involved most
17 recently - that of Nexsen Pruitt?

18 A Very possibly. That rings a bell. If it was, it was,
19 what, a year and a half ago or whenever it was, the last
20 conversation.

21 Q I'll represent to you that we worked in conjunction with
22 another firm, and so I have not had personal dealings
23 with the negotiations as of late, so -

24 A That's unfortunate.

25 Q - wanted to make sure you knew that I wasn't

1 intentionally dropping the ball.

2 A Okay.

3 Q The only other question I have is with regard to the
4 document from which you claim title. Does it identify
5 the water infrastructure on the property in any way?

6 A The one that I have here does not. I'm trying to think
7 - because this is an older one that I just printed out
8 this morning. I'm trying to think if the latest one we
9 have does. I'll have to get back to you on that. I
10 think that it might; it might show a border. I don't
11 think it shows the actual infrastructure. I don't think
12 it does.

13 Q Thank you. That's all I have. I appreciate you bearing
14 with me.

15 A Sure.

16 CHAIRMAN HALL: Okay. Thank you. Any other
17 parties have any questions for Mr. Delaney?

18 [No response]

19 Okay. Mr. Delaney - oh, I'm sorry. Ms.
20 Hudson.

21 CROSS EXAMINATION

22 BY MS. HUDSON:

23 Q The document that, Mr. Delaney, you have, is that
24 printed from the Beaufort County website?

25 A No, it was a survey done back, I think, when Melrose

1 owned the whole property.

2 Q Okay. It's just -

3 A Because I have a more -

4 Q - a survey?

5 A - recent one. I just didn't - I was late leaving, so I
6 just grabbed it.

7 MS. HUDSON: Madam Chair, would it help to
8 have that into the record? If that - we would ask
9 that it be moved into the record as a hearing
10 exhibit.

11 CHAIRMAN HALL: Okay. Mr. Delaney, would you
12 like to submit that?

13 WITNESS: Sure.

14 CHAIRMAN HALL: Let me ask you, Mr. Delaney,
15 when you - if you - does it appear on the
16 assessor's map, do you know?

17 WITNESS: No.

18 CHAIRMAN HALL: It does not?

19 WITNESS: I don't - I'm pretty sure it does
20 not.

21 CHAIRMAN HALL: Okay.

22 WITNESS: But I'm not sure. I mean, we just
23 looked - I think the last survey was done prior to
24 us buying it, by Thomas & Hutton. I think that was
25 done, I think, 2009, 2010, something like that.

1 **CHAIRMAN HALL:** Okay. All right, thank you.
2 Mr. Delaney's survey will be Hearing Exhibit No. 4.
3 [WHEREUPON, Hearing Exhibit No. 4 was
4 marked and received in evidence.]
5 Okay. Thank you, so much, Mr. Delaney.
6 **WITNESS:** Absolutely.
7 **CHAIRMAN HALL:** We appreciate you coming here.
8 Oh, I'm sorry, I'm sorry. Commissioners also
9 have the opportunity to ask you any questions, Mr.
10 Delaney. So, Commissioner Elam.

11 **EXAMINATION**

12 **BY COMMISSIONER ELAM:**

13 **Q** Good morning.

14 **A** Good morning.

15 **Q** I'm trying to understand the sequence. Both the
16 wastewater treatment pond and/or the water tower, they
17 were on the properties before you bought them?

18 **A** I don't know anything about the water tower. I believe
19 that's somewhere - that's a whole separate issue with a
20 different piece of property. But this one, yes, it was
21 on the property before we bought it. It's been
22 physically there for, I don't know - when was it built?

23 **MR. WALKER:** I think it was '94, is the date
24 of the easement, so it would've been built then.
25 The easement bill of sale is '94.

1 WITNESS: Yeah.

2 BY COMMISSIONER ELAM:

3 Q And you knew it was there?

4 A I did. I did.

5 Q Thank you.

6 A We didn't know it – to be honest with you, we didn't
7 know that it was actually included. We assumed it
8 wouldn't be. And when the final plat came out, and I
9 think it was about a week before closing, we looked at
10 it and said, "Gosh, that's part of the property." And
11 so then I figured, "Well, we'll just turn around and
12 talk to them and get some sort of a lease structure
13 going, so I can be protected liabilitywise." Never was
14 able to achieve it. It's amazing. I don't understand
15 it.

16 Q Thank you.

17 A Uh-huh.

18 CHAIRMAN HALL: Commissioner Fleming.

19 EXAMINATION

20 BY COMMISSIONER FLEMING:

21 Q Do you pay property taxes?

22 A Yes, ma'am.

23 Q On the plant, as well?

24 A No. I – no, just on the property.

25 Q So the plant is listed in Daufuskie Island Utility's

1 name?

2 A I'm assuming. I don't know. I know that I pay property
3 taxes based on the acreage.

4 Q Okay.

5 A And that is included – that acreage is included in our
6 property taxes.

7 Q And when you bought this, was it because property taxes
8 had not been paid, or it was just –

9 A No, ma'am.

10 Q – for sale?

11 A No, ma'am. I don't – again, I think he was referring to
12 that water tower. This was a straight purchase from a
13 group that had bought the entire Melrose assets, and so
14 we purchased a portion of it. When they went bankrupt,
15 the trustee, I think, sold – he couldn't sell the whole
16 Melrose/Daufuskie/Bloody Point as a single entity, so he
17 split it up, and Melrose was sold to a group; Daufuskie
18 – or, Bloody Point was sold to a group; and then ours
19 was called the Eigelberger tract, and we purchased that.
20 And by the way, for the record, it's under Hatcher
21 Holdings, LLC.

22 Q So, to resolve your issue, all you're asking for is a
23 nominal lease to prevent your being liable for the
24 structure?

25 A That was what I was originally asking for. I'm kind of

1 upset -

2 **Q** [word inaudible to reporter] is getting in the way, huh?

3 **A** Yes, ma'am. I'm not - I don't know if I'm willing to
4 say that, at that point. I need to think about it. I'm
5 pretty upset that the people that I'm assuming are
6 sitting in this room have avoided us for years for no
7 apparent reason. I don't - we offered them a very
8 reasonable idea to settle, and they won't respond to me,
9 and that makes me upset.

10 **Q** So you want a lease, then? What is -

11 **A** Right now, I'm not -

12 **Q** - it that you're asking -

13 **A** - sure I'm -

14 **Q** - for, is what I'm trying -

15 **A** I'm bringing this to your attention from the public.
16 That's why I'm sitting here. I'm not necessarily asking
17 for anything. I think that's between Daufuskie Island
18 Utility and me, when I think about it again. At the
19 time, I will tell you that our last offers - from the
20 beginning - and I think - I can't remember what we first
21 asked for, but the numbers got smaller as we got more
22 frustrated. I want to say at first we asked for like
23 \$10,000 a year, or something like that, but it may have
24 been higher at that time. I don't recall. But I know,
25 at the end of the day, we got down to, "Look, just pay

1 us a little something – you know, \$1000 or something,"
2 and never got a response, and that just makes me upset.
3 So I'm not sure what I'm willing to take at this point.

4 Q Okay. And I understand this is between you and the
5 company. I just was trying to understand what you were
6 – from what you said earlier, what you were hoping to
7 gain out of this.

8 A Yeah. You know, I don't know if I'm hoping – I want
9 fairness and I would like, you know, a reasonable
10 solution to it. The reason I'm here is that I
11 personally don't understand how a company can ask for a
12 rate increase or be paid anything at all to operate a
13 utility on someone else's land. So I thought it was
14 valuable information that the Commission should be made
15 aware of.

16 Q It's complicated, isn't it?

17 A It is complicated, but, in essence, it's not. They
18 don't have the right to operate this. Now, I don't know
19 about the rest of the issues, but right now, they don't
20 – I mean, they have the right to operate it, from a
21 Commission standpoint; but from a real estate
22 standpoint, they don't.

23 Q But you said, on the State level, they do have the
24 right.

25 A They do. They do. But from a real property, you know,

1 federal law standpoint, they don't. So that's where it
2 becomes complicated.

3 Q Thank you.

4 A Yes.

5 CHAIRMAN HALL: All right. Commissioners, any
6 other questions?

7 [No response]

8 Okay. Thank you, Mr. Delaney.

9 WITNESS: Absolutely. Good luck.

10 CHAIRMAN HALL: Good luck to you.

11 [WHEREUPON, the witness was excused.]

12 CHAIRMAN HALL: All right. Mr. Gressette,
13 whenever you're ready, sir.

14 MR. GRESSETTE: Thank you, Madam Commissioner.
15 Pursuant to agreement of the parties, and I believe
16 the Commission's kind indulgence, we would ask that
17 the Hon. Maria Walls be called to testify at this
18 time.

19 [Witness affirmed]

20 THEREUPON came,

21 THE HON. MARIA WALLS,
22 called as a witness on behalf of the Applicant, Daufuskie
23 Island Utility Company, who, having been first duly affirmed,
24 was examined and testified as follows:

25 <

DIRECT EXAMINATION

BY MR. GRESSETTE:

Q Good morning, Ms. Walls. Would you, for purposes of the record, state your name, please?

A My name is Maria Walls.

Q And where are you employed, Ms. Walls?

A I am the elected Beaufort County Treasurer.

Q And did you submit prefiled testimony in this matter?

A I did.

Q Did you have an opportunity to thoroughly review that prefiled testimony before it was submitted?

A Of course.

Q And are you appearing here today as a result of a subpoena for attendance?

A That is correct.

Q And with regard to your prefiled testimony, does that include five pages of testimony, dated October 8th, and including one exhibit marked Exhibit A?

A Yes, that's correct.

Q And if I were to ask you each of the questions contained in that prefiled testimony, would your answers be exactly the same as they appear in the testimony?

A Probably not verbatim, but, yes, generally, exactly.

MR. GRESSETTE: And at this time, Madam Commissioner, I would move that the prefiled

1 testimony of Ms. Walls be read into the record as
2 if given orally from the stand, and that the
3 exhibits attached thereto be incorporated into the
4 record as an exhibit.

5 CHAIRMAN HALL: All right. Ms. Walls'
6 testimony will be entered as if given orally.

7 [See pgs 81-86]

8 Her exhibit will be Hearing Exhibit No. 5.

9 [WHEREUPON, Exhibit No. 5 was marked and
10 received in evidence.]

11 MR. GRESSETTE: Thank you.

12 BY MR. GRESSETTE:

13 Q And, Ms. Walls, we would just like to have you briefly
14 summarize a few points of the testimony, so I'd like to
15 just start generally with: What are your duties as the
16 Beaufort County Treasurer?

17 A My primary function as Treasurer of Beaufort County is
18 to act in a fiduciary capacity on behalf of our Council
19 of Government, as well as the school district. We are
20 the banker for the County. So we collect the taxes that
21 are due, as well as any other funds that are coming to
22 Beaufort County, whether from the public or the State,
23 and then we are to maintain those funds until it is
24 deemed appropriate that they will be expended. So our
25 role is to collect the taxes, collect the dollars that

1 are due, and maintain them.

2 Q Does your office assess taxes?

3 A No, we do not.

4 Q And are you familiar with the taxes collected by
5 Beaufort County from Daufuskie Island Utility Company?

6 A Yes, I am.

7 Q And do those taxes include something that's called a
8 utility property tax?

9 A At this time, yes. But at the time that the tax sale
10 had occurred in regards to the elevated tank site, no,
11 that was not the case. The utility was being taxed as
12 if it was any other piece of real property and was not
13 identified as a utility at that time, which is what
14 resulted and why there was - that tax sale resulted from
15 those taxes not being paid.

16 Q Okay. And so, when Beaufort County sold, and I believe
17 you're referring to what we call the elevated tank site,
18 to Mr. Sabry -

19 A Uh-huh.

20 Q - that is because the records of Beaufort County did not
21 identify that parcel as a utility parcel?

22 A Correct.

23 Q And with regard to utility property taxes assessed to
24 Daufuskie Island Utility, what entity assesses those
25 taxes?

1 A The Department of Revenue establishes a valuation dollar
2 amount and provides that valuation to the County
3 Auditor's office, who assigns that value to the utility,
4 calculates the taxes, and then communicates that dollar
5 amount to our office, and we are tasked with pursuing
6 the collection of those dollars.

7 Q In your testimony, you refer to a December 2011
8 transaction whereby the Beaufort County Treasurer's
9 office conveyed a parcel of property, and you refer to
10 it as the elevated tank site, to a Mr. Mamdouh Sabry
11 Abdelrahman --

12 A Correct.

13 Q -- who we'll refer to for our purposes as Mr. Sabry.
14 What was conveyed to Mr. Sabry?

15 A What was conveyed was based on the property we believed
16 we were taxing at that time, which was a parcel of land.
17 The tax deed, which would have been generated by the
18 Treasurer's Office and filed with the Registrar of
19 Deeds, was as it was listed by the Assessor's Office,
20 who was valuing that property at that time. It did not
21 include the elevated tank itself. The only structure
22 indicated on that site was a utility shed, the contents
23 of which would've been unknown at that time.

24 Q Does the elevated tank remain the property of Daufuskie
25 Island Utility?

1 A I don't believe that I can give an answer to that,
2 because I think that's a legal opinion beyond my role,
3 but I will tell you, just from my experience, that a tax
4 deed is not a full warranty deed. There's protocol and
5 procedures that need to be followed for that, in which
6 case I believe that the utility, if that were pursued by
7 Mr. Sabry, would have the opportunity to protest and it
8 would need to be done in a court of law. So I can tell
9 you that the tax deed did not convey that elevated tank
10 or the infrastructure, besides that utility shed.

11 Q The elevated tank and infrastructure located on this
12 parcel of property, is that infrastructure included
13 within the items that Department of Revenue assesses the
14 utility property tax against Daufuskie?

15 A The Department of Revenue, when they provide a value to
16 the Beaufort County Auditor – any auditor, is my
17 understanding. I will say, I am not the auditor; I'm
18 the treasurer. But it is my understanding that they do
19 not provide a listing of what is included in this
20 valuation or how they have made that valuation
21 determination. But it is my understanding that when DOR
22 provides a valuation on the utility or any other
23 property they are valuing, it is in its entirety, not
24 for portions of it.

25 Q And with regard to the taxes Daufuskie Island Utility

1 Company owes for utility property taxes to Beaufort
2 County, was there – am I correct – a time when those
3 taxes were not paid by the predecessor to Daufuskie
4 Island Utility?

5 A That is correct. Furthermore, it was more complicated
6 by the fact that DOR did not identify Daufuskie Island
7 Utility as a utility at all. It was quite some time
8 into, I believe, the current owner's ownership that
9 Daufuskie Island Utility became on the radar of DOR, and
10 the Auditor's Office received valuation information for
11 three tax years at one time, resulting in quite a
12 substantial amount of taxes, as you can imagine. The
13 tax ratio for utility is 10½ percent, so it is a
14 substantial amount. Some of you are legal residents of
15 your home; you know you pay 4. So imagine how much that
16 is.

17 So what I believe you're referring to is, the
18 utility received multiple tax bills at the same time.
19 Had things progressed in the way that it would for any
20 other entity, they would've received a tax bill each
21 year and had the opportunity to pay if they were able
22 to.

23 Q And did Beaufort County enter into an agreement with
24 Daufuskie Island Utility, with regard to the multiple
25 tax years noticed simultaneously?

1 A Yes, we did.

2 Q And can you briefly describe the terms of that
3 agreement?

4 A So the terms of that agreement included the back taxes
5 that were due, as well as a projected amount for Tax
6 Year 2015. I'm new to learning about the utility
7 process, so I will tell you that, based on my
8 determination and that of my predecessor at the time -
9 the Treasurer was Douglas Henderson; I was his deputy at
10 that time, which is why I'm familiar with this case -
11 the utility would not have been able to pay \$524,000 at
12 one time. It is the authority of the Treasurer's Office
13 to identify taxes that are not collectible, and we have
14 the authority to remove those taxes. The years - I
15 believe you have a copy of the agreement in evidence,
16 but there were years that were written off, so to speak,
17 or removed. Future years are not included, other than
18 2015. We wanted the utility to have the opportunity to
19 make payments free of penalty, which is why we included
20 Tax Year 2015, which will be billed next month.

21 Q And does the agreement with Daufuskie Island Utility
22 allow a payment over a period of time, to cover the
23 years of 2012, '13, '14, and '15?

24 A Yes, that's correct.

25 Q And how much is that payment each month?

1 A Is at about \$5000? \$5400? Something like that.

2 Q Yes. And is the utility current on its payments,
3 pursuant to that agreement?

4 A Yes.

5 Q And you testified earlier that two of the years were
6 deemed to be uncollectible, and is that based on the
7 County's understanding that the income necessary to
8 cover those tax payments was not included in an approved
9 rate by this Commission and, therefore, the funds could
10 not be collected by the utility?

11 A That is correct. And in addition to that, the process
12 that needed to be in place failed to occur for those tax
13 years that were due, and with the advice of our legal
14 counsel it was determined that it would be within our
15 rights to write off those taxes that were for those two
16 particular years.

17 Q Thank you, very much.

18 A You are welcome.

19

20

21

22

23 [PURSUANT TO PREVIOUS INSTRUCTION, THE
24 PREFILED REBUTTAL TESTIMONY OF THE HON.
25 MARIE WALLS FOLLOWS AT PGS 81-86]

1 DAUFUSKIE ISLAND UTILITY COMPANY, INC.

2 DOCKET NO. 2014-346-W/S

3 **Testimony of The Honorable Maria Walls**

4 Before the South Carolina

5 Public Service Commission

6 Testimony Prepared: October 8, 2015

7 Hearing Date: October, 28, 2015

8

9 **Q. Please state your name and business address.**

10 A. Maria Walls, 100 Ribaut Road, Suite 165, Beaufort, SC 29902.

11 **Q. Briefly describe your education and any certifications?**

12 A. I am a Certified Public Accountant (CPA). I graduated Cum Laude with a
13 Masters of Accounting, with a specialization in International Business, from Rider
14 University.

15 **Q. What is your current employment?**

16 I was elected Beaufort County Treasurer in November 2014 after serving four
17 years as the Deputy Treasurer under Douglas E. Henderson. In July 2015, I was
18 sworn in as Beaufort County Treasurer.

19 **Q. What are your duties as Beaufort County Treasurer?**

20 A. The Treasurer serves as the County's chief banker and investment officer and has
21 the statutory responsibility of collecting all real, personal, and motor vehicle
22 property tax revenues on behalf of the County, school district, municipalities and

1 other taxing authorities within the boundaries of Beaufort County, and manages
2 the disbursement of collections.

3 **Q. Are you familiar with the taxes collected from Daufuskie Island Utility, Inc.**
4 **("DIUC") by Beaufort County?**

5 A. Yes. I have met separately with John Guastella and Mike Guastella who work for
6 DIUC's manager, Guastella Associates. DIUC's attorney, Tom Gressette,
7 attended my meeting with John Guastella. I have also had several phone calls
8 with John Guastella regarding tax issues for DIUC.

9 **Q. Are you familiar with a parcel of real property on Daufuskie Island in**
10 **Beaufort County that is referred to as the Elevated Tank Site?**

11 A. Yes. The Elevated Tank Site is a parcel of real property on which is located an
12 elevated water tank and other water system facilities of DIUC. On December 1,
13 2011, the Office of the Beaufort County Treasurer conveyed the Elevated Tank
14 Site to Mamdouh Sabry Abdelrahman via tax deed. The Tax Deed is recorded at
15 the Office of the Register of Deeds for Beaufort County, State of South Carolina,
16 Book Number 03102, Pages 0169-0170, File Number 2011061014.

17 **Q. Why was the Elevated Tank Site sold?**

18 A. The Elevated Tank Site was sold because ad valorem property taxes were not paid
19 by the previous owner, Haig Point Utility, Inc.

20 **Q. Did Beaufort County convey to Mr. Abdelrahman the elevated tank and**
21 **other DIUC utility facilities located on the Elevated Tank Site?**

1 A. No. The Tax Deed did not include the elevated water tank, the well, the water
2 pump, system pipes, or other DIUC property located on the Elevated Tanks Site.
3 All of those items remain part of the DIUC water system infrastructure.

4 **Q. Is DIUC required to pay taxes on its water system infrastructure?**

5 A. Yes. DIUC must pay an annual Utility Tax, which includes taxation for the DIUC
6 water system infrastructure.

7 **Q. Is Mr. Abdelrahman taxed for the elevated water tank, the well, the water
8 pump, and system pipes located on the Elevated Tank Site?**

9 A. No.

10 **Q. Does Beaufort County have an arrangement in place with DIUC that
11 addresses payment of DIUC's Utility Tax?**

12 A. Yes. Because DIUC's rates as approved July 10, 2012, did not provide DIUC
13 with sufficient revenue to pay the due and upcoming annual Utility Tax
14 assessments for the years 2012, 2013, 2014, 2015, the Beaufort County
15 Treasurer's Office entered into an agreement whereby the total amount due for
16 those tax years could be paid in monthly payments of \$5,487.95. Basically, the
17 Agreement amortizes the taxes for these years over an eight-year period so as to
18 allow DIUC to make a predictable payment. No interest is charged. A copy of
19 the Agreement with Addendum is attached hereto as Exhibit A.

20 **Q. Is DIUC making its required payments according to the Agreement?**

21 A. Yes. DIUC has timely made its required payments pursuant to the Agreement.

22 **Q. Were any arrangements made with DIUC for the Utility Tax due for 2016 or
23 for the following years?**

1 A. No.

2 **Q. Can you briefly explain how those taxes will be noticed and when they will be**
3 **due?**

4 A. Yes. Annual tax notices are mailed the beginning of each November. Taxes
5 are due by January 15th of the subsequent year. For example, taxes billed
6 November 1, 2015 are due January 15, 2016. .

7 **Q. When is DIUC's next Utility Tax payment due?**

8 A. In addition to the monthly payments for the years covered by the Agreement,
9 DIUC's next regular Utility Tax payment will be due January 15, 2017.

10 **Q. Do you have any concerns about DIUC's ability to pay its upcoming taxes?**

11 A. Yes. In working with DIUC I have come to understand that DIUC's rates are set
12 by the Public Service Commission. If the rates are not sufficient to allow DIUC
13 to collect enough money prior to January 15th of a given year to pay the tax bill
14 due on that date, then DIUC will not be able to pay its taxes. Of particular
15 concern to me is the payment that will be due January 15, 2017, and whether
16 DIUC will be allowed to charge rates sufficient to collect the funds necessary to
17 make that payment in 2017.

18 **Q. What will happen if DIUC does not pay the taxes due on January 15, 2017?**

19 A. If DIUC misses a payment on January 15th of 2017 (or any subsequent year), a
20 3% penalty on the total taxes due would be assessed. If the taxes are not paid by
21 February 1st, an additional 7% penalty is assessed. If the taxes are still not paid
22 by March 15th, an additional 5% penalty is assessed. So, in total DIUC would
23 incur a 15% delinquency penalty by not paying the taxes on time. Since Beaufort

1 County cannot offer DIUC an installment payment option for these upcoming
2 taxes, I am concerned that if DIUC is not able to collect sufficient revenues in
3 2016 for the taxes due in January 2017 then DIUC will begin a cycle of incurring
4 15% penalty every year. Plus, if DIUC's taxes are not timely paid then DIUC
5 will suffer the other ramifications of nonpayment of taxes.

6 **Q. Does this conclude your testimony at this time?**

7 **A. Yes.**

DAUFUSKIE ISLAND UTILITY COMPANY, INC.

DOCKET NO. 2014-346-W/S

Testimony of The Honorable Maria Walls

Before the South Carolina

Public Service Commission

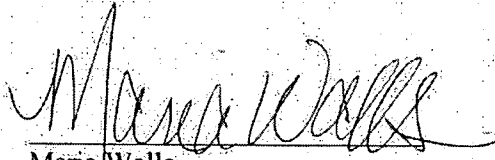
Testimony Prepared: October 8, 2015

Hearing Date: October, 28, 2015

STATE OF SOUTH CAROLINA)
COUNTY OF BEAUFORT)

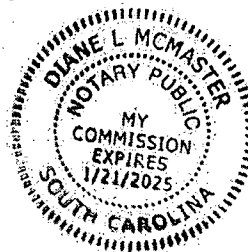
AFFIRMATION OF TESTIMONY

PERSONALLY appeared before me, Maria Walls, who, being duly sworn, deposes and says that she has read and does hereby affirm the foregoing Testimony and that said Testimony is true and correct of her own knowledge.


Maria Walls

SWORN to before me this 8 day of October 2015


Notary Public for South Carolina
My Commission Expires: _____



1 CHAIRMAN HALL: All right. Mr. Pringle.

2 MR. PRINGLE: Thank you, Madam Chair.

3 CROSS EXAMINATION

4 BY MR. PRINGLE:

5 Q Good morning, Ms. Walls.

6 A Good morning.

7 Q Is this your first time testifying before the Public
8 Service Commission?

9 A Before any commission, anywhere, so how about that?

10 [Laughter]

11 Q It's all very, very exciting.

12 A Great practice.

13 Q Yeah. You haven't been up to the Administrative Law
14 Court?

15 A No.

16 Q I had a matter up there with Beaufort County a couple of
17 years ago, but I don't guess you were there, and I'm
18 glad you don't know what it is.

19 [Laughter]

20 A No, me too.

21 Q Let's talk a little bit, first, about the tax sale. You
22 mentioned it in your testimony. Are you aware of Mr.
23 Guastella's contention in this case that the notices
24 involved with the delinquency on that particular piece
25 of property were sent to the wrong address?

1 A I am aware of that, yes.

2 Q Okay. And what is your Office's response to the
3 allegation, in this case or other cases, that notices
4 were sent to the wrong property?

5 A First of all, as of May 1st, the Treasurer's Office -

6 CHAIRMAN HALL: Ms. Walls, if you could still
7 speak -

8 WITNESS: Oh [indicating].

9 CHAIRMAN HALL: - into the microphone, so
10 everybody can hear you, please.

11 WITNESS: The Treasurer's Office assumed the
12 responsibility of updating addresses at the
13 taxpayers' request on May 1st of this year.
14 Previously, it was the Assessor's Office's
15 responsibility to maintain addresses, especially
16 changes that were made at the request of the
17 taxpayer. We are required by law to send the tax
18 notice to the address of record. I don't agree
19 with it, personally, but whether we know it's
20 correct or not, that is the address we are required
21 to send the notice, and that's where it was sent.

22 BY MR. PRINGLE:

23 Q And that was done?

24 A Yes.

25 Q And Beaufort County followed all processes and

1 requirements under Municipal and State law in taking
2 that deed to tax sale?

3 A Although I was not an employee of the Treasurer's Office
4 at that time, it is my understanding that that is
5 correct, yes.

6 Q Okay. Tell me a little bit about - I'm interested in
7 learning a little bit more about utility tax assessments
8 and how that works. And you mentioned, I think, the 10%
9 percent assessment. Is it your understanding that that
10 is - I think you made reference to it - that that is,
11 generally speaking, the commercial tax rate?

12 A Yes.

13 Q And separate from and different from, for example, the
14 primary residence assessment, which is, I think,
15 somewhere between 3 and 4 percent?

16 A It's 4 percent, yes.

17 Q Four percent. And then there may be something else
18 that's -

19 A There are many different assessment rates, yes.

20 Q Okay. But this is the one we're talking about?

21 A That is correct.

22 Q So, based upon your understanding, that number is 10%
23 percent of what?

24 A Of a value.

25 Q Okay. And what is your understanding of how that value

1 is obtained or derived?

2 A I can't speak to that. You would have to either ask the
3 Department of Revenue or the Beaufort County Auditor.

4 Q Okay. So, well, tell me what happens – what you know
5 about what happens before it gets to you, or how it gets
6 to you.

7 A As I previously stated, the Department of Revenue
8 assigns a value –

9 Q Okay.

10 A – to the assets that they're attempting to value.

11 Q Okay.

12 A And they send a list of those properties or accounts to
13 the Beaufort County Auditor's Office –

14 Q Okay.

15 A – who then applies that value to the asset in our
16 software system. They then apply the ratio, any
17 exemptions – which, in this case, don't apply.

18 Q Okay.

19 A Apply the millage, and you get your tax dollars.

20 Q Okay. So, then, how was that being done – well, when
21 did Beaufort County discover that, for lack of a better
22 term, taxes were owed that had not been paid?

23 A I can't answer that. You would have to ask the
24 Auditor's Office. And the Auditor at that time is no
25 longer the Beaufort County Auditor.

1 Q Okay.

2 A However, I can't say that there was a discovery. It's
3 my understanding of how that office operated at the time
4 that when they'd get something from DOR, they would put
5 it in. I don't think they even – they would question
6 it. There's taxes. Calculate them. And now it's the
7 Treasurer's problem.

8 Q Okay. When did you learn that there was a different
9 rubric or different framework for taxes for this
10 property?

11 A I believe it would have been the summer of last year.
12 You're going to have to forgive me on my recollection.

13 Q Okay. So, in the summer of – you learned in the summer
14 of 2014 that something had happened, through which or as
15 a result of which the value of this real property needed
16 to be taxed at a different rate and a higher rate?

17 A It's not being taxed at a different rate; it was never
18 being taxed at all. You're dealing with two different
19 things.

20 Q Okay.

21 A A real property – we think of things from a real-
22 property perspective and a personal-property
23 perspective.

24 Q Sure.

25 A A utility is going to fall under the personal-property

1 perspective and the authority of the Beaufort County
2 Auditor, so you have an authoritative change there.
3 Real property, it is the Assessor's Office's authority
4 to assign a value for the purposes of *ad valorem*
5 taxation. The Auditor, in this case, because now it has
6 become personal property, now has that authority. The
7 Assessor no longer has that authority.

8 So, in my realm, from my perspective, for the
9 purposes of collection, first of all, the authority of
10 valuation has completely changed. And then, two, the
11 method that I would pursue collection has completely
12 changed. Specifically, that elevated tank site, if that
13 had occurred – if that tax sale had occurred under my
14 predecessor or my watch, Daufuskie Island Utility's
15 property would never have gone to tax sale, because we
16 do not auction, at our annual tax sale, personal
17 property – especially a utility.

18 Q Okay. Do you have any knowledge of whether there were
19 any real-property taxes being assessed in connection
20 with the property that bears these tax map numbers for
21 DIUC?

22 A Yes.

23 Q Okay.

24 A There would have been – on all real property, there is
25 an assessment, and these would be no different.

1 Q Okay. So there were real-property assessments that took
2 place for some period of time, and then a discovery that
3 these personal-property taxes should have been applied?

4 A Yes. Think of it like a change in category.

5 Q Right. Right. And so what did – and what did your
6 office do, if anything, with that information?

7 A At that juncture, one, because we received notification
8 all at once of multiple years, first of all, at that
9 juncture it would have been – even if we had wanted to
10 auction it at the annual tax sale, we would have missed
11 the opportunity for those statutory requirements to sell
12 the property at tax sale. And, two, I am not a resident
13 of Daufuskie Island, but I am a resident of Beaufort
14 County, and I want people to continue to have service,
15 and I did not think it was appropriate that the utility
16 be punished, so to speak, in the form of a significant
17 amount of unexpected taxes because of a failure of
18 valuation or communication, wherever that occurred –
19 DOR, somewhere else, I can't speak to that. But the
20 fact of the matter is, there was a significant amount of
21 dollars dues, and I have a responsibility to collect.
22 However, when I looked at the dollars that were due, the
23 timeframe that was provided, I just did not think it was
24 realistic to be paid.

25 Q Okay. As part of your discussions – and I believe the

1 settlement agreement may have been an exhibit to your
2 testimony.

3 A Uh-huh.

4 Q As part of those settlements discussions, did the
5 company – to your knowledge, did the company file any
6 revised annual reports that adjusted the value of their
7 utility?

8 A Yes, with the Department of Revenue.

9 Q Okay.

10 A It was my understanding that the Department of Revenue
11 had assigned a valuation that was in excess of the value
12 of the rate base – and forgive my terminology, but there
13 was a disagreement between the valuation, and DOR was
14 significantly higher. And we incorporated into our
15 agreement, which I believe to be a fair agreement, their
16 opportunity to adjust the dollars due each month, if the
17 appeal had been granted, and DOR decided to grant that
18 appeal.

19 Q Okay. And consistent with the testimony you've given
20 about especially what you did in recognizing that
21 taxpayers – if you want taxpayers to continue to be on
22 the rolls, and you don't want to put them in – and you
23 tell me if I'm categorizing this wrong – you don't want
24 to put them in unfair circumstances, and you determined
25 that this was uncollectible. As part of that process,

1 you have the authority to consider things like revised
2 annual reports, revised amounts that may affect that
3 value?

4 A I do not.

5 Q You don't.

6 A I have no role in valuation.

7 Q Okay.

8 A That is the Beaufort County Auditor.

9 Q Sure.

10 A It's my determination, if delinquent tax is due, whether
11 they are uncollectible.

12 Q Yeah.

13 A But I will tell you that, one, my policy as a Treasurer
14 will not be to – this is the only negotiation and
15 contract I am ever aware of, in the Beaufort County
16 Treasurer's Office.

17 Q Okay.

18 A This is not a practice that we will continue. However,
19 in the interest of getting the taxes paid, on behalf of
20 Beaufort County government as well as the agencies we
21 represent, we believed it was in the best interest of
22 Beaufort County at that time to enter into an agreement
23 with Daufuskie Island.

24 Q Okay. And to be clear, the settlement agreement that
25 you entered into reflected revised amounts that were

1 filed on amended annual reports to the Department of
2 Revenue, or that ended up at the Department of Revenue,
3 correct?

4 **A** I believe the amendment to our agreement reflected that,
5 yes.

6 **MR. PRINGLE:** Okay. All right. That's all I
7 have. Thanks very much.

8 **CHAIRMAN HALL:** Okay. Thank you, Mr. Pringle.
9 Ms. Fox?

10 **MS. FOX:** No, thank you.

11 **CHAIRMAN HALL:** Okay. Ms. Hudson.

12 **CROSS EXAMINATION**

13 **BY MS. HUDSON:**

14 **Q** Good morning, Ms. Walls.

15 **A** Good morning.

16 **Q** How long have you lived in Beaufort County?

17 **A** Almost eight years.

18 **Q** Do you live on Daufuskie Island?

19 **A** No. As I said, I do not.

20 **Q** How did you become familiar with the utility here today?

21 **A** Sometime last summer, like I said. I don't remember who
22 – I believe it was Mr. John Guastella, somehow – I do
23 not know how I ended up speaking to him, but I got a
24 very concerned phone call stating that there had been
25 multiple attempts to contact the Beaufort County Auditor

1 to ask what these taxes were, because they had never -
2 they were never on the books, they had never been
3 received, the tax notices. "What is this?" And I will
4 tell you, not surprisingly, the Beaufort County Auditor
5 did not respond. She didn't respond to a lot of things.
6 And I'm not a person who doesn't respond. So when he
7 called me, that is how I became aware of it. I let him
8 know I would call him back, and that - and it just kind
9 of went from there, how I identified what had occurred.

10 Q Okay. You testified earlier that Daufuskie could not
11 pay the level of taxes at once?

12 A Uh-huh.

13 Q How do you know that?

14 A By reviewing the documents that they had provided to DOR
15 and, I believe, to this Commission - some rate-base
16 commission.

17 Q Is everything in your testimony still correct?

18 A Yes.

19 Q All right. You have a really good website.

20 A Thank you.

21 Q One of the items on the website is the opportunity to
22 apply to pay taxes in installments, and I think it's
23 property taxes.

24 A Yes.

25 Q Will you tell us how that works?

1 A So, again, everything we do is governed by State law.
2 This is no different. You can – a citizen can apply to
3 participate in an installment program. It's a pay-in-
4 advance program. So the only way is dictated by statute
5 that you are requi- – you are able or permitted to
6 participate is, first, that you own the property; two,
7 you cannot use a mortgage escrow to pay; three, you need
8 to have – you cannot have any delinquent property taxes;
9 and you need to be current. So if there are six
10 payments that need to be made, if you miss one, you are
11 no longer eligible and you need to reapply for the next
12 year.

13 Q I read that it applies to both commercial and
14 residential property. Is that right?

15 A Yes, that's correct. However, it would not apply to
16 Daufuskie Island Utility.

17 Q Why is that?

18 A Because that is personal property. This is not real
19 property. The classification would be on – if you're
20 familiar with our website, you've looked at the taxes
21 we've collected in our account. So the fact that the
22 statute implies that it can be utilized by an individual
23 or commercial property, this is neither; this is a
24 utility. What they are inferring is – my understanding,
25 based on discussion with our legal counsel, is that they

1 are implying that the ownership of that real property
2 may be an individual or a business.

3 Q I'm confused. You're saying that the utility -
4 Daufuskie Island Utility - cannot apply to pay property
5 taxes -

6 A Correct.

7 Q - in installments?

8 A We have - no utility, corporate, merchant, furniture and
9 fixtures. They're all different types of properties
10 being taxed.

11 Q What about for land the utility owns?

12 A The land? The taxation on the land that is owned by the
13 utility, it's my understanding - again, I'm not a member
14 of DOR and I'm not the Beaufort County Auditor - the
15 land that's owned by Daufuskie Island Utility, the
16 valuation or taxes are included in what they are paying,
17 ultimately. It's included in DOR's valuation. So they
18 would not be eligible for the installment program,
19 first, but even if they were, they would need to have
20 paid in full the taxes that were due before applying.

21 Q You say in your testimony that the tax deed does not
22 include the elevated water tank. How are you certain
23 about that?

24 A I've read it.

25 Q All right. Do you have a copy of ORS Morgan Exhibit -7?

1 A No, I do not.

2 MS. HUDSON: Madam Chair, may I approach the
3 witness?

4 CHAIRMAN HALL: Please.

5 MS. HUDSON: [Indicating.]

6 WITNESS: [Indicating.]

7 MS. HUDSON: Madam Chair, I'd like the record
8 to reflect that what I handed to the witness is ORS
9 Witness Morgan's Exhibit -7 that was prefiled in
10 this case.

11 BY MS. HUDSON:

12 Q Ms. Walls, is this document what you're calling the tax
13 deed?

14 A It appears so, yes. I think it is. I think it is
15 blanked out here by the Registrar of Deeds' Office's
16 printing, but it should say "Tax Title."

17 Q Okay. That was going to be my next question, what that
18 hidden word is.

19 A I think that's what it should say.

20 Q Will you turn to the second page with me?

21 A Uh-huh.

22 Q And I'm sorry that the writing is small. I wish I could
23 make it bigger. But will you read the first three lines
24 out loud, so the court reporter can hear you, and stop
25 after you get to the word "acres"?

1 A "All those certain pieces, parcels, or lots of land
2 situate, lying, and being in Haig Point, Daufuskie
3 Island, Beaufort County, South Carolina, shown as
4 'Elevated Tank Site,'" in quotations, "having and
5 containing 0.337 acres, more or less, as depicted on
6 that certain plat entitled '9.691 Acre Tract known as
7 Equestrian Center, being...' - oh, that's where you
8 wanted me to stop.

9 Q You can stop. Thank you. You read the portion. I'm
10 going to ask you to read two other paragraphs: the one
11 that has the word "TOGETHER" in bold, and the paragraph
12 beneath it that has in bold "TO HAVE AND TO HOLD."

13 A Uh-huh?

14 Q Would you read those out loud, as well?

15 A "TOGETHER with all and singular, the Rights, Members,
16 Hereditaments and Appurtenances to the said Premises
17 belonging, or in any wise incident or appertaining,
18 "TO HAVING AND TO HOLD, all and singular, the said
19 Premises hereby granted, and with the appurtenances,
20 unto the said Mamdouh Sabry Abdelrahman, his Heirs and
21 Assigns forever, according to the form, force and effect
22 of the laws and usages of the State of South Carolina,
23 in such cases made provided."

24 Q Is the water tower an appurtenance?

25 A I don't believe I can answer that.

1 Q Whose job is it to determine that?

2 A I don't know if I can answer that. I know it is not our
3 department's responsibility. What we would - if I may,
4 what we would traditionally do is we would identify,
5 after a soft title search - so this is not in as much
6 detail as can possibly be done, but in a soft title
7 search we would identify the descriptors of the property
8 or its contents as identified in the deeds held by the
9 Registrar of Deeds' Office, as well as the land
10 description identified by the Beaufort County Assessor's
11 Office.

12 Q But your testimony is, you don't know who makes the
13 determination of what is an appurtenance or not?

14 A That is correct.

15 MS. HUDSON: Madam Chair, may I approach the
16 witness again?

17 CHAIRMAN HALL: Yes, ma'am.

18 MS. HUDSON: [Indicating.]

19 WITNESS: [Indicating.]

20 MS. HUDSON: Madam Chair, I'd like the record
21 to reflect that what I've distributed to the
22 witness is pages two to four, the remaining parts
23 of ORS Morgan Exhibit -7.

24 BY MS. HUDSON:

25 Q Ms. Walls, would you agree that that property ID number

1 on the document I just distributed to you matches the
2 tax title?

3 A Yes, I would.

4 Q And will you say the owner's name out loud?

5 A Mr. Abdelrahman, Mamdouh Sabry.

6 Q Would you agree with me that there is a building listed
7 here?

8 A A residential shed or small utility, yes.

9 Q You see that on the second page, right?

10 A Yes.

11 Q And under the word "Type," what do those letters stand
12 for?

13 A I would imagine "utility shed," but you would have to
14 ask the Assessor's Office.

15 Q Would you agree that it's confusing that Mr. Sabry seems
16 to be taxed for a utility shed, on one hand, but not for
17 a water tower, on the other hand?

18 A I can't answer that.

19 MS. HUDSON: Thank you, Madam Chairman. I
20 have no further questions.

21 CHAIRMAN HALL: All right. Commissioners.
22 Commissioner Whitfield.

23 VICE CHAIRMAN WHITFIELD: Thank you, Madam
24 Chairman.

25 <

EXAMINATION**BY VICE CHAIRMAN WHITFIELD:**

Q Thank you, Ms. Walls, for taking the time to be here. Your testimony and information has been crucial, and I think most of the questions have been asked of you, but I do have one or two more. I realize that you are not the elected Auditor, that you're the elected Treasurer. And I realize you're not the Tax Assessor, and I realize you're not the Department of Revenue. And I realize you have PT-100 Business Personal Property Return, and you have utility taxes. Those are assessed by the Assessor, I guess, and the Auditor, in conjunction with South Carolina Department of Revenue. I get that all that is outside your scope. It would've been helpful to maybe have had the Auditor and the Assessor up here, and others who could've provided information. But that being said, the questions that Ms. Hudson just asked you there at the end about a shed, I realize that we're dealing with a building, and sometimes you have to pay - you deal with the contents of that building, or other personal property, as you refer to, or commercial property, and I realize that that is in a different category. But I realize the shed lends a little bit of confusion, as Ms. Hudson just said, because it does appear to be a building or dwelling, different from the

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PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

1 contents or any utilities or any other items that might
2 be on that property.

3 A Uh-huh?

4 Q That being said, in your testimony you state that your -
5 and I realize you've got the agreement, going forward.
6 I realize your payment plan of \$5487 a month, and I get
7 all that, going forward. But in your testimony,
8 somewhere - I think on page three - you say is Mr.
9 Abdelrahman - and I apologize about not saying his name
10 right - being taxed for the site? I realize you're
11 taxed in - the company is being taxed the utility tax on
12 the tank and the appurtenances, if you will, on the
13 property. But is Mr. Abdelrahman being taxed, going
14 forward, on the piece of land, on the real property?
15 Mr. Pringle almost asked you that, but he didn't quite
16 ask you that, and that's what I want to know: Going
17 forward, how is Mr. Abdelrahman being taxed on this
18 parcel of land, going forward?

19 A I do not know if he will be. And I can provide an
20 answer definitively when I return to Beaufort County,
21 and I will explain to you why. If this parcel is not in
22 the name of Daufuskie Island Utility - as you can see,
23 based on the date of this printout, it was not - what
24 occurs is DOR sends a letter to the Assessor's Office
25 that states, "You do not have the authority to value

1 this parcel," and therefore the Assessor will not value,
2 and the Auditor's Office will need to generate a bill
3 for the utility. Being that this is a very unique
4 circumstance – and I'm not aware that anyone has
5 encountered in our County before – I can't exactly tell
6 you whether Mr. Abdelrahman will be taxed on the dirt
7 and utility shed that is presented in this exhibit, but
8 I can tell you that it would be my assumption that the
9 Department of Revenue is taxing the infrastructure owned
10 by Daufuskie Island Utility on that parcel.

11 **Q** So what you're telling me at this time is the Department
12 of Revenue is taxing that, but you're not sure if the
13 Assessor has assigned a value to the parcel of land –
14 the dirt, if you will, and the shed. In other words,
15 he's not being taxed, is what you're telling me.

16 **A** He – and, again, I can let you know definitively, but
17 I'm going to speculate now, based on the date of this
18 document. If, last summer, the Beaufort County
19 Auditor's Office received notification that they needed
20 to assign a value for Daufuskie Island Utility – and for
21 us, a brand-new utility, even though it's not brand-new
22 – the Assessor's Office would've received, at the same
23 time, a document stating, "You do not have the authority
24 to value this property." However, this Tax Year 2014
25 being listed here and having a valuation –

1 Q Right.

2 A - would indicate to me that the Assessor's Office did
3 not receive this notice. I cannot speak as to whether
4 they truly have the authority to continue assigning a
5 valuation to Mr. Abdelrahman's property or calculating a
6 tax to him on that dirt. I cannot speak to that,
7 because I believe it is a legal opinion. But, based on
8 the process that I'm aware of, unless that document is -
9 we have hundreds of thousands of properties in Beaufort
10 County, and it is a very automated process. So, simply
11 not receiving that letter from DOR by the Assessor's
12 Office, this parcel would be treated, in theory, like
13 any other. However, I do - our Assessor has recently
14 retired, but I know he was intimately aware of this
15 parcel and the dealings and conversations that were
16 taking place with Daufuskie Island Utility.

17 So being that we have not finalized or posted our
18 tax roll for 2015, I'll be happy to verify for the
19 Commission and counsel whether Mr. Abdelrahman is
20 expected to receive a tax notice on this property that
21 is listed here.

22 Q So he - so what he's received up through last year, he
23 is current on and doesn't owe Beaufort County any -

24 A He is not delinquent, correct.

25 Q But you haven't produced him a new bill and you don't

1 know if you're going to, is that what you're telling me?

2 Or you don't know what's going to come out –

3 **A** Correct. And I do – again – only make the assumption
4 that the Assessor's Office, because this parcel is not
5 listed in the name of Daufuskie Island Utility, did not
6 receive notification from DOR that they no longer have
7 the authority to assign a value.

8 **Q** Well, it'll be interesting to see how your next bill
9 comes out.

10 **A** Yes.

11 **VICE CHAIRMAN WHITFIELD:** That's all have,
12 Madam Chairman.

13 **CHAIRMAN HALL:** All right. Commissioners, any
14 other questions?

15 [No response]

16 Okay. Mr. Gressette.

17 **MR. GRESSETTE:** No questions, thank you.

18 **CHAIRMAN HALL:** Okay. All right. Thank you,
19 so much, Ms. Walls.

20 **VICE CHAIRMAN WHITFIELD:** Madam Chairman, can
21 I ask for a late-filed exhibit on that new tax bill
22 when it comes out?

23 **CHAIRMAN HALL:** Okay. Ms. Wells, if you'll –
24 yeah – get with Mr. Gressette, and they'll submit
25 it on your behalf, I'm sure. That Late-Filed

1 Exhibit No. 6 will be the new tax bill for Mr.
2 Abdelrahman. Okay?

3 WITNESS: I'll be happy to do that.

4 CHAIRMAN HALL: Oh, I'm sorry. Mr. Pringle.

5 MR. PRINGLE: I don't want to, you know, be a
6 fly in the ointment, here. I guess my question is
7 somewhat about the timing of when that would be and
8 whether or not it could take place, in order to
9 actually have any pertinence in this Docket, but,
10 again, that's -

11 CHAIRMAN HALL: Okay. Well, let me dialogue
12 with Ms. Walls.

13 Ms. Walls, so you're not positive whether you
14 even will generate a bill for Mr. Abdelrahman.

15 WITNESS: No, I'm not.

16 CHAIRMAN HALL: If you were to, when would
17 that be?

18 WITNESS: It would be, we hope, by the second
19 week of November. But it would be up to the
20 Beaufort County Auditor; once he certifies that the
21 tax roll is complete, we can send out our tax
22 notices.

23 CHAIRMAN HALL: So let's do this, Ms. Walls:
24 When you know, if you could just send us a status
25 letter if you decide not to generate a bill, or the

1 bill, if you do generate a bill, as soon as
2 possible, so – are you in agreement with that, Mr.
3 Pringle?

4 MR. PRINGLE: And I wasn't, you know,
5 objecting to the document or what it said itself.

6 CHAIRMAN HALL: Okay.

7 MR. PRINGLE: I just wondered that, given that
8 there will be a timeframe in which proposed orders
9 and the Commission decision –

10 CHAIRMAN HALL: Okay. Yeah. Proposed orders
11 won't be due until November 25th.

12 MR. PRINGLE: Right.

13 CHAIRMAN HALL: So if you're talking the first
14 week in November, it –

15 WITNESS: Or it's helpful to you, I could
16 contact the Beaufort County Assessor, who would let
17 you know what notifications they have received. So
18 what I can do is ask him for a document that states
19 whether he has applied a value, so that, if he has,
20 it will flow through the taxation process.

21 CHAIRMAN HALL: Okay.

22 WITNESS: And that, I can get to you by the
23 end of this week.

24 CHAIRMAN HALL: Okay. That'd be awesome.
25 Thank you, so much, Ms. Walls.

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WITNESS: You're very welcome.

CHAIRMAN HALL: Thank you. Have a safe trip
back.

WITNESS: Thank you.

[WHEREUPON, the witness was excused.]

CHAIRMAN HALL: We'll take a five-minute break
– or let's just go ahead and go to lunch. We'll
start back at 1:10.

[WHEREUPON, a lunch recess was taken from
12:00 to 1:15 p.m.]

A F T E R N O O N P R O C E E D I N G S

CHAIRMAN HALL: Good afternoon, everybody. I hope you enjoyed your lunch.

Mr. Gressette, we are ready whenever you are.

MR. GRESSETTE: Thank you. The court reporter asked for us to conduct the questioning from here [indicating] to make it easier.

CHAIRMAN HALL: Thank you.

[Witnesses affirmed]

MR. GRESSETTE: Madam Chairperson, the Applicant had a panel of three witnesses. One of those witnesses, Eric Johanson, the chief operator for the utility arrived today but needed to return to the island to address some emergency issues. The parties, as I understand it, have agreed to stipulate to his testimony. So, based upon that, and with the Commission's indulgence, I would ask that his direct prefiled testimony, dated September 18, 2015, consisting of four pages, be read into the record as if given orally from the stand, and all exhibits, if any, be entered into evidence.

CHAIRMAN HALL: All right. Mr. Johansen's direct testimony will be read into the record as if given orally. And he has no exhibits.

MR. GRESSETTE: Thank you.

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[PURSUANT TO STIPULATION AND IN LIEU OF
PERSONAL APPEARANCE AND TESTIMONY, THE
PREFILED DIRECT TESTIMONY {VERIFIED} OF
ERIC JOHANSON FOLLOWS AT PGS 114-118]

MERITS HEARING - VOLUME 2 OF 2
10/28/15

PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

1 DAUFUSKIE ISLAND UTILITY COMPANY, INC.

2 DOCKET NO. 2014-346-WS

3 Testimony of Eric Johanson

4 Before the South Carolina Public Service Commission

5 Testimony Prepared: September 18, 2015

6 Hearing Date: October 28, 2015

7

8 **Q. Please state your name and business address.**

9 A. Eric Johanson, P.O. Box 23527 Hilton Head Island, SC 29925

10

11 **Q. By whom are you employed and in what capacity?**

12 A. Daufuskie Island Utility Company ("DIUC"); Chief Operator.

13

14 **Q. How long have you been employed by DIUC?**

15 A. 16 Years.

16

17 **Q. Please state your professional work experience (water and wastewater**
18 **training courses, licenses, previous employment, etc.).**

19 A. I presently hold state certifications for biological wastewater treatment, water
20 treatment and water distribution and have attended numerous educational and
21 training courses to keep my certifications current. My work experience includes:

22

1 W.A.S.T.E. INC. - contracted to perform daily operations and
2 maintenance of privately owned wastewater package plant.

3 Broad Creek Public Service District - Licensed Wastewater Operator at
4 activated sludge, extended aeration treatment plant.

5 Beaufort/Jasper Water & Sewer Authority - Licensed Water Operator at
6 water treatment plant.

7 Daufuskie Island Utility Company - Chief Operator responsible for the
8 operations and maintenance of two wastewater treatment plants (aerated lagoon
9 systems) and their associated collection systems, the operations and maintenance
10 of seven potable water wells and their associated distribution systems.

11

12 **Q. Please describe DIUC's water and wastewater systems and operations.**

13 A. DIUC owns and operates two wastewater treatment plants, their associated
14 collection systems, seven potable water wells and their distribution systems which
15 include an elevated water storage tank. The wastewater plant located in Haig
16 Point serves both the Haig Point and Melrose communities. The plant is an
17 aerated lagoon system and has a design capacity of 640 thousand gallons per day.
18 The maintenance routines performed by the operator include troubleshooting and
19 repair of any malfunctioning equipment, conducting the daily collection and
20 testing of effluent water samples to determine the performance of the plant and
21 the general maintenance of the facility.

22 The wastewater collection system consists of 57 lift stations equipped with
23 either submersible solids or grinder pumps which vary in size from 2.4 to 20

1 horsepower. The lift stations are inspected on a bi-weekly basis and the
2 maintenance routine includes troubleshooting and repair of any motor control
3 problems, repairing or replacing malfunctioning pumps, and general maintenance
4 such as cleaning wet well and control floats. The station would also require
5 landscaping in the growing season.

6 The wastewater plant located in Bloody Point serves the Bloody Point and
7 Beach Field communities. It is an aerated lagoon system with a design capacity of
8 80 thousand gallons per day. Its collection system consists of 4 lift stations which
9 vary in size from 2.4 to 10 horsepower. The maintenance routines performed on
10 this plant and its lift stations would be the same as mentioned above.

11 The two water distribution systems serve the Haig Point, Melrose and
12 Bloody Point communities. The system serving Haig Point consists of two wells
13 with pumping capacity of 400 gallons per minute (GPM) and one well with a
14 capacity of 600 GPM. The system's pressure is maintained by a 125 thousand
15 gallon elevated storage tank. The water system serving Melrose and Bloody Point
16 consists of four wells, two with a 300 GPM capacity and two wells with a 1000
17 GPM capacity. The system pressure is maintained with four hydropneumatic
18 tanks (two-5000 gal and two-10000 gal). Daily routines include inspection of the
19 well site and the recording of data required by state regulations. The chlorine
20 residual is also tested to ensure proper disinfection of the systems. All general
21 maintenance issues are addressed as needed.

22
23 **Q. Have significant improvements been made since the last rate case?**

1 A. Yes, the capital improvements as described in the Report on Capital
2 Improvements were significant in terms of reliability of service. We have also
3 worked closely with Mike Guastella to improve record keeping, operating
4 procedures and communications.

5 **Q. How many operating employees are now working under your direction?**

6 A. Including myself, there are four full-time employees and one part-time employee.
7

8 **Q. Does that conclude your testimony at this time?**

9 A. Yes.

DAUFUSKIE ISLAND UTILITY COMPANY, INC.

DOCKET NO. 2014-346-W/S

Testimony of Eric Johanson

Before the South Carolina

Public Service Commission

Testimony Prepared: September 18, 2015

Hearing Date: October, 28, 2015

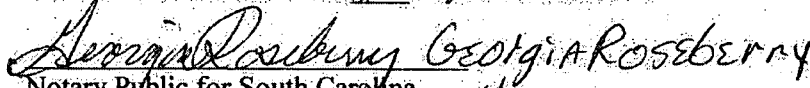
STATE OF SOUTH CAROLINA)
)
 COUNTY OF BEAUFORT)

AFFIRMATION OF TESTIMONY

PERSONALLY appeared before me, Eric Johanson, who, being duly sworn, deposes and says that he has read and does hereby affirm the foregoing Testimony and that said Testimony is true and correct of his own knowledge.


 Eric Johanson

SWORN to before me this 29 day of October 2015


 Notary Public for South Carolina
 My Commission Expires: Sept 25, 2018

1 THEREUPON came,

2 J O H N F . G U A S T E L L A ,

3 G A R Y C . W H I T E ,

4 called as witnesses on behalf of the Applicant, Daufuskie
5 Island Utility Company, who, having been first duly affirmed,
6 were examined and testified as follows:

7 MR. GRESSETTE: At this time, with the
8 Commission's indulgence, we would like to talk to
9 Mr. Gary C. White.

10 DIRECT EXAMINATION

11 BY MR. GRESSETTE:

12 Q For purposes of the record, would you please state your
13 name?

14 A [WHITE] Yes, it's Gary C. White.

15 Q And where are you employed, Mr. White?

16 A [WHITE] I'm the vice president of Guastella Associates.

17 Q And do you have personal knowledge of the operations of
18 Daufuskie Island Utility?

19 A [WHITE] Yes, I do.

20 Q And do you have personal knowledge of the pending
21 Application for rate increase that has initiated this
22 hearing?

23 A [WHITE] I do.

24 Q And did you submit prefiled testimony in this matter?

25 A [WHITE] Yes, I did.

1 Q And did you have an opportunity to thoroughly review
2 that prefiled testimony before it was submitted?

3 A [WHITE] I have.

4 Q And did that prefiled testimony include 11 pages, dated
5 September 17, 2015?

6 A [WHITE] Yes.

7 Q If I were to ask you each of the questions included in
8 that prefiled testimony, would your answers be the same
9 as they appear there?

10 A [WHITE] Yes.

11 MR. GRESSETTE: At this time, I would move the
12 prefiled direct testimony of Gary C. White be read
13 into the record as if given orally from the stand
14 and that it be entered into evidence.

15 CHAIRMAN HALL: All right. Mr. White's
16 testimony will be read into the record as if given
17 orally.

18 [See pgs 124-134]

19 MR. GRESSETTE: Thank you.

20 BY MR. GRESSETTE:

21 Q Mr. White, it would be helpful for the Commission if you
22 could summarize your testimony, but maybe we should
23 start with a summary of the tasks that you perform for
24 Daufuskie Island, with regard to this proceeding.

25 A [WHITE] Yes. Basically, I perform all of the

1 calculations and put together all of the spreadsheets
2 and schedules that are presented as exhibits, supporting
3 the Application.

4 Q And to the best of your knowledge, are all the
5 calculations you provided in those spreadsheets
6 accurate?

7 A [WHITE] Yes.

8 Q In the course of your work with Daufuskie Island Utility
9 Company, have you become familiar with the utility's
10 financial condition?

11 A [WHITE] I have.

12 Q And, generally, how would you describe that condition?

13 A [WHITE] I would say that it is improving, but it's not,
14 certainly, where it needs to be.

15 Q And in the course of preparing the spreadsheets and
16 exhibits you referenced earlier, did you have an
17 opportunity to come to any conclusions about the total
18 revenue increase sought by the Applicant?

19 A [WHITE] I think - certainly, I think it's a fair and
20 reasonable request. I know it's a large request, but
21 it's something that's needed by the utility.

22 Q And what is the total revenue increase sought by the
23 Application?

24 A [WHITE] The total increase in revenue was \$1,182,300.

25 Q There's been some discussion about a revenue increase of

1 \$462,798. Is that amount sufficient to allow Daufuskie
2 Island Utility to maintain its infrastructure?

3 A [WHITE] No.

4 Q And is the increase you described, the \$1,182,301,
5 necessary for Daufuskie Island Utility Company to
6 maintain its operation?

7 A [WHITE] Yes.

8 Q Before I ask Mr. Guastella to summarize his testimony
9 for us, is there anything else you'd like to add?

10 A [WHITE] No.

11 Q Keep it moving?

12 A [WHITE] Keep it moving.

13

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23 [PURSUANT TO PREVIOUS INSTRUCTION, THE

24 PREFILED DIRECT TESTIMONY OF JOHN C.

25 WHITE FOLLOWS AT PGS 123-133]

1 DAUFUSKIE ISLAND UTILITY COMPANY, INC.

2 DOCKET NO. 2014-346-WS

3 Pre-Filed Testimony of Gary C. White

4 Before the South Carolina Public Service Commission

5 Testimony Prepared: September 17, 2015

6 Hearing Date: October 28, 2015

7

8 **Q. Please state your name and business address.**

9 A. Gary C. White, 17369 S.E. 111th Court, Summerfield, Florida.

10

11 **Q. What is your occupation?**

12 A. I am Vice President and the Director of Accounting with Guastella Associates,
13 LLC a firm that provides utility consulting services primarily for municipal and
14 investor-owned water and wastewater utilities.

15

16 **Q. Please state your educational background and professional experience.**

17 A. I received a Bachelor of Science in Business Administration from Valparaiso
18 University in 1972. I graduated with an Accounting major and Finance minor. I
19 have also completed a course in utility rate regulation sponsored by the National
20 Association of Regulatory Utility Commissioners ("NARUC"), the Florida Public
21 Service Commission and the University of Utah.
22 I was employed in the unregulated, private industry sector between 1972 and
23 1984 with responsibilities in various areas of business management, accounting

1 and finance. Since 1984, my experience has been concentrated in the areas of
2 management, valuation and rate setting for water and sewer utilities. During this
3 period, I was responsible for the rate regulation department of General
4 Development Utilities, Inc. which was the largest investor-owned water and sewer
5 utility in Florida. I was subsequently employed as General Manager of Country
6 Knolls Water Works, an investor-owned utility in upstate New York. I managed
7 all of the utility's regulatory, accounting and operations activities on a day-to-day
8 basis. I began my employment with Guastella Associates in 1992.

9 My experience in utility matters includes the preparation of cost of service and
10 revenue requirement analyses for both private and municipal utilities. I have
11 prepared cost allocation, connection charge, and rate design studies; revenue
12 requirement forecasts; population growth and system capacity projections; market
13 value analyses; and various operations and management evaluations. I have
14 provided rate, regulatory and system valuation services for clients in Alaska,
15 Arizona, California, Connecticut, Florida, Georgia, Illinois, Indiana, Maine,
16 Maryland, Massachusetts, Montana, Nevada, New Hampshire, New Jersey, New
17 Mexico, New York, Ohio, Pennsylvania, Rhode Island, and South Carolina. I
18 have served as an instructor at several seminars for developer-related water and
19 sewer utilities sponsored by Florida State University and the University of Florida
20 and at a utility rate seminar conducted by the New England Chapter of the
21 National Association of Water Companies.
22

1 **Q. How long have you practiced in the area of utility management and rate**
2 **regulation?**

3 A. I have been involved in the utility industry for over thirty years.
4

5 **Q. In what jurisdictions have you presented expert testimony?**

6 A. I have testified as an expert witness in regulatory hearings in Connecticut, Florida,
7 Maryland, New Jersey, New York, Pennsylvania and South Carolina.
8

9 **Q. Are you a member of any professional associations?**

10 A. I am a member of the American Water Works Association.
11

12 **Q. Please describe the nature of your assignment in connection with this**
13 **proceeding.**

14 A. Guastella Associates was retained as consultants to Daufuskie Island Utility
15 Company, Inc. ("Company"). My assignment in conjunction with preparing a
16 rate study was to examine the financial information and operating data of the
17 utility, and to coordinate my work with that of John F. Guastella to prepare an
18 analysis of the Company's revenue requirement for both its water and wastewater
19 operations.

20 Throughout the process of preparing the rate study, which supports the
21 Company's application for the rate increase, I have worked closely with the
22 Company's management, accounting, financial, billing, and operations personnel

1 so that the application accurately depicts the Company's financial position and
2 contains the information necessary to establish its cost of providing service.
3

4 **Q. What test periods do you use?**

5 A. Our analyses are based on the historical test year ended December 31, 2014
6 financial information and a pro forma rate year adjusted for known and
7 measurable changes through the period ending December 31, 2015.
8

9 **Q. Would you briefly describe the results of your rate study?**

10 A. Yes. The study produced a total revenue requirement of \$1,137,531 for the water
11 system and \$1,130,190 for the wastewater system filing which covers the pro
12 forma cost of providing service based on the projected December 31, 2015
13 operations. The revenue requirement reflects a \$590,454 increase over existing
14 water rates or a 107.9% increase in water revenues, and a \$591,847 or 109.9%
15 increase in sewer revenues. The \$2,267,721 of total revenue would cover pro
16 forma operating expenses of \$1,649,127 and provide net operating income of
17 \$618,595 or an 8.73% rate of return on the Company's \$7,085,475 rate base
18 investment.
19

20 **Q. Have you prepared schedules that summarize your rate analysis?**

21 A. Yes, I will briefly describe all of the schedules submitted in support of the rate
22 increase. Mr. Guastella's testimony addresses some of the schedules and certain
23 issues within this rate application.

1

2 **Q. Please explain Schedule A-1**

3 A. Schedule A-1 shows the Company's water and wastewater comparative balance
4 sheets as of December 31, for years 2009 through 2014. This schedule reflects
5 the assets, liabilities and equity balances as recorded to show the Company's
6 financial position.

7

8 **Q. Please describe the contents of Schedule A-2.**

9 A. This schedule contains the individual water and wastewater system's comparative
10 annual income statements for the calendar years 2009 through 2014. The
11 amounts shown on Schedule A-2 reflect the actual level of income generated by
12 the water and wastewater operations of the Company.

13

14 **Q. Please explain Schedule A-3.**

15 A. Schedule A-3 shows the Company's capital structure and rate of return. The
16 schedule shows a pro forma capital structure based on a \$3.75 million proposed
17 debt issuance and the actual balance of equity capital shown on the Company's
18 year-end balance sheet. A cost rate for debt of 6.2% and a cost rate for equity of
19 10.5% results in an overall weighted cost of 8.73%.

20

1 **Q. Would you please describe Schedule A-4?**

2 **A.**Schedule A-4 presents the overall operating statement for the combined water and
3 wastewater systems. It simply reflects the combined results of Schedule W-C, the
4 water operating statement, and Schedule S-C, the sewer operating statement.

5
6 **Q. Please describe Schedule B?**

7 **A.**I will provide a generic description of the remaining schedules as each lettered
8 schedule represents similar information applicable to both the water and the sewer
9 rate filings. In other words, Schedules W-B and S-B sets forth the computation of
10 the water and sewer rate base, respectively. These schedules show the rate base
11 components for the test year ended December 31, 2014, adjustments and pro
12 forma year-end December 31, 2015 rate year balances that are used to develop the
13 Company's revenue requirement.

14
15 **Q. Would you please describe Schedule B.1, B.2, B.3 and B.4?**

16 **A.**Schedule B.1 summarizes and describes the pro forma adjustments made to the
17 rate base calculation shown on Schedule B.

18 Schedule B.2 shows the detail of Plant in Service by primary plant account. It
19 begins with the original cost of plant in service as of test-year ended 2014 and
20 brings the accounts forward through pro forma December 31, 2015 balances.

21 Schedule B.3 contains Accumulated Depreciation by primary plant account, along
22 with the adjustments necessary to formulate the pro forma rate-year ending 2015
23 balances. The development of annual depreciation accruals for the pro forma

1 period are supported and detailed on Schedules W-C.3 (water) and S-C.3 (sewer).

2 Schedule B-4 shows the balances for Contributions-in-Aid-of-Construction

3 (CIAC) and the accumulated amortization of CIAC as of December 31, 2014 and

4 rolled-forward to reflect the Tap Fee (CIAC) related to projected customer growth

5 through the December 31, 2015 rate year.

6 The balances from Schedule B.2, B.3, and B.4 are brought forward to the rate

7 base, Schedule B.1.

8
9 **Q. Please describe the working capital allowance and average unamortized**
10 **balance on Schedule B.1.**

11 A. The working capital allowance is based on a modified lead/lag study applicable to
12 the Company's quarterly billing, in arrears. The level of allowance reflects an
13 average of 75 days (1/5th of a year) of lag time representing the mid-point of the
14 90 day period (or 45 days) over which service is provided prior to billing and an
15 average of 30 days to receive payment from the customers after the end of the
16 period. This lag represents a capital requirement placed on the Company and is a
17 positive rate base adjustment.

18 The average unamortized balance represents the Company's average balance of
19 unrecovered rate case expense. Because the expense is an "up-front" or prepaid
20 cost, the amortization creates a delay in the recovery of the full amount, therefore,
21 the unrecovered portion of the expense becomes a capital requirement of the
22 utility, and a positive rate base adjustment in order to recognize the associated
23 carrying cost.

1 **Q. Would you please describe Schedule W-C and S-C?**

2 A. Yes, these schedules contain the pro forma operating statements or income
3 statements for water and sewer, respectively. Schedule C shows the Company's
4 operating results for the historical twelve months ended December 31, 2014, and
5 also shows the pro forma adjustments and operating results for the pro forma rate
6 period ending December 31, 2015 under present and proposed rates. These
7 schedules summarize the Company's cost of operations, resultant net operating
8 income and rate of return on the Company's rate base investment.
9 The numbered adjustments on Schedules W-C and S-C reference the explanations
10 of those adjustments provided on Schedules W-C.1 and S-C.1.

11

12 **Q. Would you briefly describe the adjustments on Schedule C.1?**

13 A. Yes. Adjustments 1(a) through 1(j) for water and adjustments 1 (a) through 1(h)
14 for sewer reflect the pro forma changes made to operating revenue, by customer
15 class, under present rate and proposed rates. The revenue adjustments are
16 supported by the billing analyses contained on Schedules E, E.1 and E.2.
17 Adjustments (2) through (13) reflect the pro forma changes made to operation and
18 maintenance expenses. An explanation is provided for each adjustment.
19 Adjustment (14) reflects the annual depreciation accrual, determined by applying
20 depreciation rates to the pro forma levels of plant in service.
21 Adjustment (15) reflects the four-year amortization of the unrecovered current
22 rate case costs, and the eight-year amortization of property taxes in accordance
23 with an agreement with Beaufort County.

1 Adjustment (16) reflects the revenue tax applicable to pro forma revenues under
2 present rates.

3 Adjustment (17) reflects the annual level of property taxes calculated in
4 accordance with the Department of Revenue's methodology for determining
5 assessment values.

6 Adjustment (18) reflects the payroll tax expense associated with pro forma wages.

7 Adjustment (19) calculates the state and federal income tax on pro forma taxable
8 income under present rates.

9 Adjustment (20) shows the impacts of the increased revenue, under proposed
10 rates, on the bad debt expense component.

11 Adjustment (21) increases revenue taxes to reflect pro forma revenue levels under
12 the proposed rates.

13 Adjustment (22) calculates the state and federal income tax on pro forma taxable
14 income under the proposed rates.

15

16 **Q. Please describe Schedule C.2.**

17 A. This schedule reflects the individual operating expense items by account as
18 recorded per books for the twelve months of year-end 2013, 2014 and forecasted
19 for pro forma 2015.

20

21 **Q. Please describe Schedule C.3.**

22 A. Schedule C.3 reflects the annual depreciation expense by individual plant
23 accounts. This schedule shows the pro forma rate year depreciation expense. It

1 should be noted that the depreciation methodology used on this schedule complies
2 with the methodology approved in the Company's last rate Order.

3

4 **Q. Please describe Schedule D.**

5 A. This schedule shows the Capital Structure, including debt and equity cost rates
6 and rates of return for each of the utility systems. The capital ratios developed for
7 the pro forma capital structure on Schedule A-3 are applied and synchronized to
8 the water rate base and sewer rate base as reflected on Schedules W-D and S-D,
9 respectively.

10

11 **Q. Please explain the billing analyses presented on Schedules E, E.1 and E.2.**

12 A. Schedule E sets forth the billing analysis for the historical twelve-month period
13 ended December 31, 2014.

14 Schedule E.1 sets forth the pro forma billing analysis under present rates and
15 includes the projection of rate year customer growth.

16 Schedule E.2 applies the proposed rates to the same billing data as appears on
17 Schedule E.1, thus producing revenue equal to the pro forma revenue
18 requirement.

19 The billing analyses provide the detailed billing data for the revenues presented
20 on Schedule W-C and Schedule S-C.

21

22 **Q. Briefly explain each of the Schedules F.1 and F.2.**

- 1 A. Schedule F.1 reflects the water and sewer revenue requirement calculations. It
2 shows the revenue requirement components for the pro forma rate year analysis.
3 Schedule F.2 contains the water and sewer rate design schedules. The proposed
4 rates are designed to reflect a prorate increase by customer class and single tariff
5 pricing. The rates developed on this schedule, when applied to the billing units,
6 will generate the proposed revenue requirement as demonstrated on Schedule E.2.
7
- 8 **Q. Does this conclude your testimony?**
- 9 A. Yes.

1 BY MR. GRESSETTE:

2 Q Mr. Guastella, you ready?

3 A [GUASTELLA] I'm ready.

4 Q All right. Can you state your name for the record,
5 please?

6 A [GUASTELLA] John F. Guastella.

7 Q And, Mr. Guastella, where are you currently employed?

8 A [GUASTELLA] President of Guastella Associates.

9 Q Do you have personal knowledge of the operations of
10 Daufuskie Island -

11 A [GUASTELLA] I do.

12 Q - Utility Company? And do you have personal knowledge
13 of the pending Application for rate increase that
14 initiated the present matter?

15 A [GUASTELLA] Yes.

16 Q And did you submit prefiled testimony in this matter?

17 A [GUASTELLA] Yes.

18 Q And did you have an opportunity to thoroughly review
19 that testimony prior to its submission?

20 A [GUASTELLA] Yes.

21 Q So, for purposes of the record, as I understand it, you
22 have provided direct testimony consisting of 10 pages,
23 with Exhibits A and B; is that correct?

24 A [GUASTELLA] Yes.

25 Q And you have also submitted rebuttal testimony

1 consisting of 24 pages, with Exhibits 1 through 5; is
2 that correct?

3 A [GUASTELLA] Yes.

4 Q And if I were to ask you each of the questions contained
5 in both of those prefiled testimonies, would your
6 answers today be the same as they appear in the
7 testimony?

8 A [GUASTELLA] Yes. I have one typo to point out.

9 Q Would you point that out for the Commission, please?

10 A [GUASTELLA] In the rebuttal testimony on page 12, line
11 11, the first word is "overstated"; it should be
12 "understated."

13 Q Any other changes?

14 A [GUASTELLA] No.

15 MR. GRESSETTE: Subject to that short
16 qualification, at this time, I would move the
17 prefiled direct and prefiled rebuttal testimony of
18 Mr. Guastella be read into the record as if given
19 orally from the stand, and that all exhibits
20 thereto to be entered into evidence.

21 CHAIRMAN HALL: All right. Mr. Guastella's
22 direct and rebuttal testimony will be entered into
23 the record as if given orally.

24 [See pgs 188-197 - Direct]

25 [See pgs 199-222 - Rebuttal]

1 His exhibits will be Hearing Exhibit Nos. 7
2 and 8.

3 [WHEREUPON, Exhibit Nos. 7 and 8 were
4 marked and received in evidence.]

5 MR. GRESSETTE: Thank you.

6 BY MR. GRESSETTE:

7 Q Mr. Guastella, before we proceed to summarizing some of
8 the contested issues that we'll be discussing today, I
9 thought it might be helpful for you to explain to the
10 Commission which, if any, adjustments suggested by ORS
11 the utility has accepted for purposes of this case.

12 A [GUASTELLA] Yes. On page two of my rebuttal testimony,
13 I list 20 separate adjustments or positions by ORS that
14 we are accepting for rate-setting purposes.

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

18 A [GUASTELLA] Yes.

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

21 A [GUASTELLA] Yes. Our bad-debt expense per books, which
22 went to 2014, was over \$100,000. When we prepared our
23 filing, we took a conservative approach and allowed only
24 \$30-\$40,000, I believe. When I saw ORS's testimony,
25 they used a percentage applied to revenues, and they

1 came up with \$100,000, which was consistent with our
2 2014 level. I then looked at our latest 12 months of
3 revenues, compared to a previous similar period of 12
4 months of revenue, and I found that our bad debts'
5 expense were still up over the \$100,000. So I accept
6 their adjustments. It favors the company, but it's the
7 reality of what we've been facing. Our bad debts were
8 at a level of \$100,000, before we filed the case and
9 subsequent to filing the case, and ORS's adjustment was
10 reasonable and I accepted it.

11 **Q** Along with your testimony, you filed a document called
12 "Report on Capital Improvements." Can you generally
13 summarize those capital improvements discussed in that
14 document, and why you thought it was important for the
15 Commission to see that?

16 **A** [GUASTELLA] Yes. In the last rate case, the company was
17 required to set aside \$750,000 in a capital reserve from
18 the borrowing that was anticipated at the time of the
19 last case. When we borrowed the money from SunTrust
20 Bank, we did, in fact, set up a reserve. Actually, we
21 set up a reserve for \$750,000 instead of the 700 that
22 was required. And we actually spent more than the
23 \$750,000. So whatever we needed to provide service to
24 our customers – and there were some significant
25 improvements that were needed – we were able to spend

1 that money, and we were required to submit a report to
2 the Commission about the use of the funds in the
3 \$700,000.

4 And I might just interject that, during the time of
5 this whole process in getting the loan, we had a major
6 failure of the lagoon liner at our wastewater treatment
7 plant, the cost of which was \$500,000. So we were
8 fortunate enough to have an owner who has a construction
9 company that put in temporary repairs until we could get
10 permanent financing and permanent repairs. Were it not
11 for that, we would not have been able to repair, on a
12 temporary basis even, that lagoon liner. And then, once
13 we got the loan, then we were able to start making
14 payments.

15 We still owe that owner some money for some of the
16 capital improvements that are made, because, despite the
17 rate increase, we've had cash flow shortages. But the
18 report itself gave me an opportunity, I thought, to -
19 for a small company - in the last case, I promised this
20 Commission that I was going to do all that I can to keep
21 rates as low as possible and provide safe and adequate
22 service to these customers. That report gave me an
23 opportunity to lay out what has been happening with
24 Daufuskie Island Utility.

25 And if you have had an opportunity to read the

1 report, or take the opportunity to read the report, you
2 see I go into the history of the development of the
3 utility, and some of the very unusual problems that
4 small water companies face. I regulated 400 of them; I
5 consulted for 600. I don't think I've ever seen a small
6 utility face the kinds of problems that this utility
7 faced, and I thought I wanted to bring that information
8 to the Commission, so you could understand really what's
9 going on with how a small company has to meet incredible
10 challenges. And this utility has challenges that I
11 never expected.

12 For example, property taxes – a property tax bill
13 that almost exceeded our annual level of revenues, in
14 total, once we got them. We had challenges with the
15 lagoon liner failures, where we had to spend \$½ million
16 worth of plant – which is a significant part of our
17 total overall rate base.

18 I go through some of the other challenges where we
19 had the County send tax bills to the wrong address.
20 When we took over the management of this company, we
21 sent a letter notifying Beaufort County of what our
22 address was and where to send the bills. They sent us
23 bills for a number of parcels of land, so we were
24 expecting that we were getting bills from the County
25 sent to the address that we told them to send it to. I

1 don't know how this one bill was not sent to the address
2 they were sending all the other bills to, but we were
3 unaware of this. We did not get the notices that this
4 property was up for sale. And the notice that was
5 posted was posted on the wrong piece of property. It
6 was not posted on the site of the tank, which our
7 operators visit every day. So it came as a surprise to
8 me that we were - that this land was sold. At the time,
9 we took legal action to reverse the tax sale, but what
10 happened was, even though we got a rate increase, we had
11 to go to financing, and we did not get financing for
12 about 15 months after the rate increase. I thought we
13 would have financing in place within months. CoBank
14 backed out of the loan because they were afraid the
15 whole island would be wiped out by a hurricane and there
16 would be nobody left. Wells Fargo backed out of the
17 loan, and did not give a reason. SunTrust was willing
18 to talk to me because the owner had a construction
19 business and he had a bank account with SunTrust, so I
20 met with SunTrust people, and I had to provide various
21 schedules, projections, and convince them that this
22 utility would be able to get a rate increase that would
23 support the loan. Indeed, I appreciate the Commission
24 giving us enough of a rate increase in the settlement
25 from the last case, and SunTrust then was willing to go

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1 along and support the loan. However, we had to generate
2 more documents proving that we had easements – ownership
3 and, if not ownership, easements, of every single piece
4 of property. We had to redo every survey we had. I had
5 to provide many financial statements and evidence that
6 we would be able to have a cash flow to pay the loan.
7 It took us 15 months before we actually closed on the
8 loan, after the rate increase.

9 During that 15 months, as I said, we had a lagoon
10 liner failure and we were really hanging on by a string.
11 And I pointed out that when we first took over the
12 utility, Melrose stopped paying its share of the
13 wastewater treatment plant, so we lost 25 percent of our
14 revenues. So I began managing a company with 25 percent
15 of its revenues short, so we didn't have the cash,
16 really, to go through with that. The way we compensated
17 for that was I told the dividends_[sic] there'd be no
18 stockholders_[sic], and indeed there were no dividends.
19 Until this day, there are no dividends, because every
20 penny of cash flow we get is to provide service to the
21 customers. Guastella Associates is owed a large amount
22 of money because, rather than take money out of the
23 utility to pay Guastella Associates, we're using the
24 cash flow to provide safe and adequate service to the
25 utility.

1 To give you a little sense of the impact of the
2 last rate increase, you gave us an opportunity to earn a
3 return, I believe, of around 7 to 8 percent, or about
4 \$176,000 a year, in net income. Over the course of the
5 four years, we have lost about \$485,000. This is the
6 reality of a small company. When certain expenses
7 increase beyond our control, it has an enormous impact
8 on our ability to earn a return. We were conservative
9 in the return on equity that we requested, because
10 that's the reality of what rate regulation is. I really
11 don't expect the regulatory agency to give us a level of
12 return on equity that would really assure that we have a
13 reasonable opportunity to attract capital. But we did
14 all that we can.

15 I thought I would lay out an explanation of the
16 Sabry situation, the condemnation situation. When we
17 found out that we had to go through this proceeding to
18 reverse the tax sale, our attorneys pointed out that
19 this may take a very long time, which means it would
20 have delayed the borrowing for a very long time. The
21 easiest way out was to do a condemnation of the land.
22 We did not have to condemn the land, but the bank had a
23 requirement – SunTrust had a requirement that we go to
24 condemnation. And because we would go to condemnation,
25 the bank was then satisfied that, even though we did not

1 own the land, we had the storage tank and facilities in
2 place and we had the facilities that we could earn a
3 return on, because all of those facilities, I might add,
4 have a cost that was paid for by the utility, they are
5 used and useful in providing service, and I was able to
6 convince the bank that rate-setting is a process of
7 having the utility cover its operating expenses and the
8 capital costs of the business. I even cited to the bank
9 the Federal Power Commission versus Hope Natural Gas
10 Company 320 US Supreme Court decision, where it says
11 that utilities must be given enough revenue to cover
12 operating expenses and the capital costs of the
13 business. And the way the capital costs of the business
14 are determined for rate-setting purposes is you take the
15 costs of the person first devoting it to public use – in
16 this case, it's the utility – and because that cost is
17 incurred, the utility is entitled to earn a return on
18 that cost if the utility facilities are used and useful
19 in providing service.

20 So the bank understood that, believed it – because
21 I believe it, and because I think it's the fact, and the
22 Supreme Court believes it – and then they were able to
23 go forward, knowing the Sabry situation, knowing the
24 condemnation situation, and provide us money to borrow
25 the money. And you will note from the records that we

1 first asked – during the rate case we looked to CoBank.
2 We filed for a petition to approve a financing with
3 Wells Fargo. And you wound up approving a financing
4 with SunTrust. You could imagine three years' worth of
5 work getting this utility to attract capital, without
6 which we would not have been able to serve the
7 customers.

8 That's why I submitted – and I'm sorry for taking a
9 long time. That's why I submitted that report. I
10 wanted this Commission to know exactly what this utility
11 is going through. And I might add, at this point,
12 percentage increases don't determine whether or not the
13 rates are reasonable. What determines whether or not
14 rates are reasonable is what is the cost of providing
15 service. I taught 7000 students the rate-setting
16 basics. The cost of providing service is the operating
17 expenses and a return on the investment for the utility
18 property used and useful for providing service. And
19 that's exactly what our rate filing reflects.

20 Q Mr. Guastella, did you send anyone else copies of the
21 Report on Capital Improvements?

22 A [GUASTELLA] I did. I sent copies of that report to
23 DHEC, who we'd be working very closely with. I sent
24 copies of the report to SunTrust. I sent copies of the
25 report to the attorneys for the property owners'

1 associations who were Intervenor in the last case – the
2 same property owners' associations that are Intervenor
3 in this case. I offered to meet with the property
4 owners to present a rate-setting presentation, in
5 general, and also explain the need for the rate
6 increase. I didn't hear back from them. During the
7 course of this proceeding and investigation, we again
8 offered to the attorneys that I would make a
9 presentation to the homeowners' associations, and they
10 did not want us to do that.

11 Q With regard to the rebuttal testimony you provided,
12 there are about five or six headings or sections of that
13 testimony that I thought we might highlight for the
14 Commission. The first is under "Rate Base," and we've
15 referred to it as the utility plant-in-service. Can you
16 summarize the issues for the Commission related to the
17 utility plant-in-service?

18 A [GUASTELLA] Yes. There are a number of issues. The
19 biggest one, you've already heard about; that is, the
20 cost of the storage tank, well, and facilities on what
21 is known as the Sabry parcel of land.

22 I should give you a little background, which I
23 didn't in my report, but when this development was first
24 started back in 1985 by International Paper, there was,
25 in the covenants and restrictions that all the

1 homeowners became a party to, that the utility had the
2 right to build and construct utility facilities on any
3 piece of property within the 1000-plus acres that were
4 being developed. They could build any utility facility,
5 whether it's a tank, well, mains, storage facilities, on
6 a piece of property, whether it was common area or
7 whether the property was owned by an individual, as long
8 as there was no existing structure or plans for
9 structure on some individual's property. So this
10 utility has had and it has this perpetual easement to
11 construct facilities anyplace on the island for Haig
12 Point Development. There's also a similar - there's
13 also a similar easement with respect to Melrose Utility,
14 with respect to their development.

15 With that as background, we are using the -

16 **CHAIRMAN HALL:** I'm sorry Mr. Guastella.

17 Mr. Pringle?

18 **MR. PRINGLE:** Madam Chair, I think Mr.

19 Guastella has had a lot of leeway, but I think his
20 testimony about what may or may not have been in
21 original documents goes beyond the scope of his
22 direct and rebuttal. Those things - it may very
23 well be that those things are in documents, and I
24 might stand corrected, but I do believe that he
25 went beyond where his direct and rebuttal went to.

1 CHAIRMAN HALL: I would agree with you.

2 Mr. Gressette, if they are in documents, point
3 them to us, please?

4 MR. GRESSETTE: Yes.

5 CHAIRMAN HALL: If not, then Mr. Guastella
6 would have to stay within the four corners of the
7 documents we have.

8 MR. GRESSETTE: I believe the declarations are
9 Exhibit 2 to the rebuttal testimony -

10 WITNESS GUASTELLA: That's correct.

11 MR. GRESSETTE: - attached to the assignment
12 of rights, which relates thereto. So what's
13 attached as Exhibit 2 to the rebuttal testimony is
14 a series of documents that relates to this point.
15 So there was - for purposes of proffer - about five
16 pages in, a document called "Declaration of Rights
17 and Restrictions," and then the document preceding
18 it within the same Exhibit 2 is an "Assignment of
19 Rights," whereby the rights under that declaration
20 were assigned.

21 CHAIRMAN HALL: Okay. Give us a second to get
22 to that.

23 MR. GRESSETTE: Sure.

24 CHAIRMAN HALL: I'm sorry. So Exhibit 2, four
25 or five pages in. The page number?

1 COMMISSIONER ELAM: What's the page number on
2 the bottom?

3 CHAIRMAN HALL: Yeah, the page number -

4 MR. GRESSETTE: The page number is JFG_125.

5 CHAIRMAN HALL: -125?

6 MR. GRESSETTE: Yes, ma'am.

7 CHAIRMAN HALL: Mine have -146, -145, -144.
8 Did you find it?

9 COMMISSIONER ELAM: No.

10 CHAIRMAN HALL: Okay. We're still looking.
11 Our page numbers are JFG_000144, sequential.

12 MR. GRESSETTE: Mine are different. So here
13 we go. -144. Prior to those pages should be -143,
14 -142 -

15 CHAIRMAN HALL: Yes?

16 MR. GRESSETTE: - all the way back to -119,
17 which begins the exhibit.

18 CHAIRMAN HALL: No. Our begins at -141.

19 MR. GRESSETTE: Well, that might be the
20 problem.

21 CHAIRMAN HALL: Therein lies the problem.

22 MR. GRESSETTE: Yes. Exhibit 2 should have
23 borne Bates Numbers -119 - beginning at -119.

24 CHAIRMAN HALL: Yeah, ours starts with -141.
25 Okay, let us check with Ms. Wheat and see what she

1 has.

2 [WHEREUPON, there was discussion off the
3 record, followed by a short recess.]

4 CHAIRMAN HALL: Mr. Gressette, this is taking
5 longer maybe than I anticipated. Is there - can
6 you go to a different line of questioning, and
7 we'll come back when we have that full document?

8 MR. GRESSETTE: Absolutely.

9 CHAIRMAN HALL: Okay. All right. So, let's
10 do that. Let's get back on the record, and when we
11 get the document, you can go back - Mr. Guastella,
12 you can go back to that area. All right.

13 MR. GRESSETTE: Thank you.

14 BY MR. GRESSETTE:

15 Q Mr. Guastella, we were talking about the five or six
16 points raised in your rebuttal testimony, utility plant-
17 in-service, and without going right back to where we
18 were, if you could again pick up with the original costs
19 of the storage tank, well, and other facilities at issue
20 in that adjustment.

21 A [GUASTELLA] Yes. As I explained, the utility paid for
22 the costs; it's a cost on the utility's books. The
23 facilities are used and useful for providing service,
24 and there is no possible way that anyone could prevent
25 the utility from continuing to operate and control those

1 facilities that provide service to the customers. And
2 we own the facilities.

3 I say the cost is ours and they're used and useful
4 in providing service because, even if there were a
5 question about land ownership, aside from the easement
6 that we'll get into later, the costs in setting rates is
7 what does it cost the utility to provide service to the
8 customers. The question of ownership of land, if we can
9 continue to use those facilities and have a right to use
10 them, operate them, and replace them, that's the cost of
11 providing service to the utilities. However, we have
12 established that we own the utility facilities. We've
13 got bill-of-sales for the utilities, we've got the
14 testimony of Ms. Walls, so those facilities are used and
15 useful and should be included in rate base.

16 Q Mr. Guastella, has there been some discussion in this
17 case about what is referred to, I believe, in the ORS
18 testimony as undocumented costs?

19 A [GUATELLA] Yes.

20 Q Can you explain the utility's position with regard to
21 those?

22 A [GUATELLA] Yes. I would start off by saying the only
23 reason I could find in ORS's testimony and exhibits for
24 eliminating certain levels of costs – and in the
25 exhibits, they don't identify what those levels of costs

1 are, by the way; we were able to figure that out from
2 work papers that were provided to us by ORS - is that
3 they are undocumented expenses. They also refer to
4 undocumented expenses that ORS looked at from the last
5 case.

6 Those are expenses that are documented. We gave
7 ORS information that shows, by primary plant account,
8 line items of costs of plant, about 200 lines of line
9 items of specific plant, the cost of the 200 line items
10 of plant, the year the plant was placed into service,
11 and the date that the plant was in service. So we
12 provided documentation from our books and records as to
13 the cost of plant and identification of the plant.

14 The issue is that there were invoices that we could
15 not produce to ORS in their examination. A large part
16 of those invoices have to do with Melrose Utility
17 Company. Melrose went bankrupt. It abandoned its
18 systems. It had no records. It stopped operating. We
19 stepped in and began operating Melrose - that's in my
20 Report on Capital Improvements - without additional
21 compensation, simply because I was not going to let,
22 even though they were not our customers, I wasn't going
23 to let customers on the island go without water and
24 sewer service because of Melrose abandoning the system,
25 and I had an ability with our operators and with my

1 management to continue to provide service to those
2 customers by helping out the trustee. The owners also
3 put money into making repairs that were needed for the
4 Melrose system. But they didn't have books and records.
5 I point out here and I might note that I believe it's
6 Mr. Lanier - or Mr. Loy, I think, that points out that,
7 when you don't have records for costs, the NARUC System
8 of Accounts says estimate the costs. Do a study to
9 estimate the costs so that you can give the utility
10 enough money to cover the cost of providing service and
11 the cost of the assets. The assets are there. We know
12 what was paid for the assets. They're used and useful.
13 They are visible. They don't have zero costs. A lack
14 of invoices is not a lack of documentation, and it's
15 certainly not a lack of providing the utility with a
16 return on the cost of providing service with respect to
17 these invoices.

18 So as far as my position is concerned, it's my
19 opinion that a lack of invoices for some of the costs of
20 plant - certainly, not the large part of the cost of
21 plant - is not a basis for eliminating what's a real
22 cost for plant that was used and useful, remains used
23 and useful, and is serving the customers, and has been
24 recognized, by the way, when we provided support to the
25 banks in order to get financing.

1 Q Mr. Guastella, does the ORS, in this case, propose
2 adjustments with regard to the use of certain
3 capitalized legal and consulting fees with regard to
4 rate base?

5 A [GUASTELLA] Yes. I'm going to address our management
6 agreement with Daufuskie Island Utility and its owners
7 in a little more detail later, but part of the
8 management agreement we have – we have a management
9 agreement with Daufuskie and its owners, and I might
10 point out that when CK Materials and Haig Point, Inc.,
11 the developer – formerly International Paper –
12 petitioned the Commission to have CK Materials acquire
13 the stock of the utility, Haig Point Utility Company,
14 part of that agreement indicated that I would –
15 Guastella Associates – would be doing the management of
16 that utility. The homeowners' association – I think it
17 was the Haig Point Club & Community, Inc. – intervened
18 in that case and their attorney prepared a settlement
19 agreement. Within that settlement agreement, the
20 Intervenor notes that Guastella should be managing the
21 utility. And I think during the course of those
22 negotiations, which I was a part of that settlement,
23 they wanted to make sure that this utility was going to
24 be run by competent management. So it's part of the
25 settlement that was part of what the Commission approved

1 in approving the stock sale from Haig Point Utility
2 stock to CK Materials.

3 As part of that management agreement, aside from
4 our monthly management fee, there's a cost for Guastella
5 Associates to undertake the administration and
6 supervision of improvements. Improvements don't happen
7 by themselves. Contractors don't show up at our doors
8 to install facilities when we've never spoken to them.
9 We have to undertake work aside from day-to-day
10 management when it comes to additional facilities,
11 that's apart from what the day-to-day operations
12 require, to identify what improvements need to be made,
13 prioritize those improvements, see what kind of finance
14 would be available and a part of our priority, contact
15 contractors, obtain the lowest costs, then hire the
16 contractors and work with the contractors, supervise the
17 construction and make sure all of the construction is
18 done to the satisfaction of our inspections. That all
19 requires a cost. Guastella Associates charges 10
20 percent for the first \$50,000 worth of cost and 8
21 percent for the remainder of the cost of the
22 improvements. The typical cost for such administrative
23 supervision is 15 to 20 percent, so our charges for that
24 – "ours" being Guastella Associates – as part of the
25 arm's length management agreement, is less than half of

1 what is typical for these construction-cost components.

2 Q Mr. Guastella, you made mention of the last rate case.
3 In the last rate case, as a preliminary question to you,
4 was there a discussion about the utility undertaking
5 future efforts to deal with title issues as to certain
6 property?

7 A [GUATELLA] Yes. As part of the last rate case, I
8 believe it was Dr. Carlisle, he indicated a requirement
9 that the utility must secure either ownership or title
10 to or easements with respect to all of the land. That
11 was all part of the costs that Guastella Associates had
12 to undertake to make sure all of that work was being
13 done, so that was part of the financing cost which is
14 another provision in the Guastella Associates
15 management. There's a provision in the agreement where
16 we would manage – we would obtain for the utility
17 financing. No small effort. I remind you again CoBank
18 turned us down, Wells Fargo's turned us down. Before
19 they turned us down, I had to generate volumes of
20 information to show them that we could afford the
21 financing with a rate increase. Then we had to go
22 through a series of new surveys, closing documents that
23 comprise that folder [indicating] right there, legal
24 fees, closing fees, all the typical costs you go through
25 to undertake a financing. So there was a significant

1 amount of work involved in generating and accomplishing
2 a financing for the utility.

3 Q In conjunction with the suggestion that the utility
4 clarify issues with regard to the title of certain real
5 property, did the utility undertake a condemnation
6 action with regard to the Sabry parcel?

7 A [GUASTELLA] We did. And that was a requirement of -
8 really a requirement of, originally, Wells Fargo, and
9 then SunTrust. When SunTrust considered giving us a
10 loan, SunTrust also wanted to include a requirement that
11 we acquire the Sabry parcel of land. So even though we
12 did not own the land, SunTrust recognized that, if we
13 went through a condemnation, then we would be - we would
14 satisfy their requirement.

15 As I indicated before, however, we've got a
16 perpetual easement where we could use those facilities -
17 we've had those facilities now for five years Sabry's
18 owned the land. There's no way he can stop us from
19 using those facilities. In his documents opposing
20 DIUC's right to condemn the property, he even told the
21 court to have us remove our facilities and then he
22 withdrew that request. But he recognized those as our
23 facilities at least in that filing document.

24 Q How does the utility propose that the legal fees
25 incurred in conjunction with that recommended

1 condemnation action be addressed?

2 A [GUASTELLA] We included those as part of the cost of
3 land. In the last case, I believe there was no amount
4 included in ORS's filing. The case was settled, so the
5 Commission didn't really make a decision on this in the
6 last case, except they agreed to a settlement that was
7 reached among the parties. But there was no amount of
8 land. In the last case, we had estimated market values
9 of about – I forget what it was – \$200,000 worth of
10 land, or more. In this case, in connection with the
11 condemnation proceeding, we hired a land appraiser, and
12 the land appraiser came out with a market value of land
13 of 25 cents a square foot. We then applied that 25
14 cents a square foot to the acreage of the parcels of
15 land that we owned, and we included that amount as part
16 of our cost of land, based on an independent appraisal.
17 We also included the legal fees necessary to condemn the
18 property, the Sabry property, as part of our cost of
19 land. So those costs of land are included. I believe
20 ORS's position does not include anything for the cost of
21 land.

22 Q With regard to ORS's position excluding any value for
23 the land, was there a reason provided by ORS to the
24 utility?

25 A [GUASTELLA] No. All of ORS's adjustments to the cost of

1 facilities, if you look at its schedule – I think it's
2 Adjustment 10, maybe 10(b), the entire reason they give
3 for eliminating \$1.6 million, or a little more than
4 that, but \$1.6 million of cost of plant is "undocumented
5 expenses." They don't present in their testimony – for
6 you – what the breakdown of the million-six is, except
7 what's water and what's sewer. They don't say what is
8 the cost of the storage facilities. They don't say
9 what's the cost of the invoices. They don't say what's
10 the cost of the land they're excluding. They don't say
11 that they're excluding Guastella's capital fee. We know
12 that information from work papers from the last case and
13 from the current case.

14 Q With regard to another category of adjustments that we
15 could refer to, I suppose, as accumulated depreciation,
16 your testimony makes reference to something called the
17 fallout of the utility plant adjustments. Can you
18 explain that to the Commission?

19 A [GUATELLA] Yes. I don't address ORS's accumulated
20 depreciation or depreciation expense number, for that
21 matter, because whatever you allow as the cost of plant,
22 you apply depreciation rates to it. We use a
23 utilization factor, and so does ORS – or at least they
24 don't disagree with our utilization factor. So you
25 apply a depreciation rate to the cost of plant. If

1 you're eliminating the cost of plant, you're reducing
2 the depreciation. So depreciation expense and
3 accumulated depreciation is why I call that a fallout
4 number. Whatever decisions is made with regard to the
5 cost of plant, that's going to affect both accumulated
6 depreciation and depreciation expense.

7 **Q** Did Mr. Loy, on behalf of ORS, prefile some testimony
8 that, for lack of a better word, took issue with the
9 system utilization factor?

10 **A** [GUASTELLA] Yes.

11 **Q** Can you explain why –

12 **MS. HUDSON:** Madam Chair, did counsel just say
13 that Mr. Loy filed testimony on behalf of ORS?

14 **MR. GRESSETTE:** Sorry, on behalf of the
15 Intervenors.

16 **MS. HUDSON:** Okay.

17 **CHAIRMAN HALL:** All right.

18 **MR. GRESSETTE:** I apologize.

19 **BY MR. GRESSETTE:**

20 **Q** With regard to an assertion by Mr. Loy, on behalf of the
21 POAs, that the system utilization factor for calculating
22 accumulated depreciation and depreciation expense is not
23 appropriate, do you have a response to that assertion?

24 **A** [GUASTELLA] Yes. This utility started out as a brand-
25 new utility, being built by real estate developer. I've

1 regulated 400 of them, and I've found these small
2 utilities wound up with problems of not being able to
3 finance after the developer left. When I became a
4 consultant, I found out that most of my clients who I
5 did not help start their utilities had the same
6 problems. They depreciate the plant for tax purposes,
7 and when the developer leaves, they're left with a book
8 value that doesn't enable the utility to attract
9 capital. The solution to that problem is to take a look
10 at a utility's initial rates and develop what I call the
11 complete system analysis for developer-related utilities
12 that are getting started.

13 The complete system analysis makes sure that the
14 utility customers do not subsidize the cost of the
15 utility operation and that today's customers only pay
16 their fair share of the costs of providing service and
17 don't start paying for depreciation based on a fully
18 utilized plant that's not going to be fully utilized.

19 So I developed a complete system analysis where we
20 adjust the depreciation for the number of customers or
21 the demands on the system for the customers that exist.
22 The benefit to that is, one, the rates are lower, and
23 that's what happened in this case. We're using a
24 utilization factor so that the depreciation expense we
25 are requesting in this case is lower than it would

1 otherwise be, which tends to reduce the rate increase.
2 But it also preserves for the utility the ability down
3 the road, when the system is complete or almost
4 complete, that it will not be one of the sick utilities
5 that you hear about throughout the country for small
6 water companies. When the developer leaves, they're not
7 capable of attracting capital or providing a level of
8 service, and those are the problem small companies that
9 you hear about all the time. The complete system
10 analysis and the utilization factor for depreciation is
11 one of the solutions to that problem.

12 Q And is it the utility's position and your testimony that
13 the method you've just described accounts for the
14 financial contributions of the developer constructing
15 the utility?

16 A [GUASTELLA] Well, that was another issue. When these
17 new utilities are first formed, they're paper
18 corporations. So you form a utility and you're a real
19 estate developer, that utility has no revenues yet.
20 It's a paper corporation. So who has to build the
21 plant? The developer has to construct the plant. This
22 doesn't happen once in a while, this happens every
23 single time for every single newly developed utility.
24 And when the utility starts and gets its first
25 customers, then its first 10 customers, first 100, first

1 200, and it goes for a number of years where they have a
2 period of customer growth. During that period of time,
3 the utility can't attract capital. The developer is
4 subsidizing the costs of the operations. And through my
5 complete system analysis, I make sure that the developer
6 is subsidizing the costs of the operations, because I
7 don't want to have the utility ratepayers bear the risk
8 of the success of the real estate developer in any way.

9 Over that period of time, once the utility is able
10 to generate enough revenues to be able to attract
11 capital and finance, then the accounting entry is made
12 where the utility facilities are turned over from the
13 developer into the utility's books, and on the
14 liabilities side there's some type of open account which
15 recognizes that the developer paid for all the
16 facilities. Usually it's an account commonly known as
17 "advances in aid of construction," but it could be any
18 account that the developer and utility, who don't know
19 utility ratemaking or what the Uniform System of
20 Accounts includes, so that there is not a contribution
21 by the developer but a recognition that the developer
22 financed all of the facilities, turned them over to the
23 utility so that there will now be a utility that owns
24 the facilities, and the costs of facilities are
25 recognized on the books and records, so there was no

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1 contribution.

2 CHAIRMAN HALL: Mr. Guastella, let me just
3 tell you, we now have all the exhibits, so you can
4 go back to that whenever you're ready.

5 BY MR. GRESSETTE:

6 Q Mr. Guastella, I am not quite sure what we were
7 summarizing when we had that document. If you want to
8 circle back to it, we can.

9 A [GUATELLA] I'm going to make this surprisingly short,
10 even for me. I'm sorry for being long sometimes. And
11 you don't have to look at it now. But if you go to, at
12 your leisure, Section 18 of the covenants, and I believe
13 that would be DIUC_JFG_000137, there's a Section 18.
14 There's another section - this deals with individual
15 personal property; there's another section that deals
16 with common property. What this section essentially
17 says is that the utility reserves the right to construct
18 its facilities - and this relates not just to water and
19 sewer, but also electric and cable and everything else.
20 And it makes sense. I mean, you're building a real
21 estate development; you're going to have utility
22 facilities. You may not know immediately where those
23 facilities are going to be, so you establish a covenant
24 where the customers buying land have to understand that,
25 in order for them to get water and sewer service, a

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1 utility's going to have to be formed to install the
2 utility facilities. And this section basically is
3 telling the purchasers of property on Haig Point
4 Plantation that, at any point in time, in order to
5 provide water and sewer service, the utility may have to
6 construct utility facilities on any piece of property,
7 and as long as the customer hasn't already built a house
8 or filed a plan for a house, they would build the
9 utility facilities and have the right to do it on that
10 piece of property – regardless of who owns the property,
11 by the way.

12 So this ownership of property really becomes,
13 rather, an excuse for eliminating a cost, not a real
14 basis for excluding a cost that the utility incurred and
15 is being used and useful to provide service to the
16 customers. This is the way a utility is created; it
17 can't work any other way. And they can go back on the
18 property and maintain and operate and replace the
19 facilities, and they don't need anyone's permission.

20 Mr. Delaney – I am not going to enter into a lease
21 agreement with Mr. Delaney for the Bloody Point
22 treatment plant, for which there is a similar perpetual
23 easement, because I'm not going to spend money for a
24 lease that I don't have to, and pass it on to the
25 customers. So it's interesting that Mr. Delaney somehow

1 bought acreage that he didn't know he was buying, but
2 I'm not going to enter into a lease with him. At least
3 not, from my perspective, that I'm going to then add a
4 cost to providing service for our customers. We have a
5 right to use those facilities, we have a perpetual
6 easement for those facilities, and I'm going to keep the
7 rates to the customers as low as I can. Despite what
8 this rate increase may look like, this rate - DIUC needs
9 this rate increase. The customers need this rate
10 increase, if I'm going to provide them with safe and
11 adequate service.

12 **CHAIRMAN HALL:** Okay. Mr. Pringle.

13 **MR. PRINGLE:** Well, he just kept going through
14 my objection. So I guess that train has left the
15 station. I don't know what the Commission's
16 pleasure is, in terms of witnesses who haven't
17 filed specific testimony to respond to public
18 witnesses. They were certainly subject to cross.
19 I don't know - it's done. But I guess I would just
20 point that out for what it's worth.

21 **CHAIRMAN HALL:** Okay. We'll reserve that.

22 **BY MR. GRESSETTE:**

23 **Q** Mr. Guastella, there was a lot of conversation this
24 morning and there has been a lot of paperwork exchanged
25 in this process, with regard to property taxes. Before

1 you summarize the history, can you succinctly state what
2 DIUC's tax obligation is, with regard to utility
3 property tax, and how the ORS adjustments impact that?

4 **A** [GUASTELLA] In accordance with the agreement that I was
5 able to work out with Beaufort County's Treasurer – and
6 you heard her testimony today, Ms. Walls – the utility,
7 for the back taxes for 2012, '13 and – 2012, '13, '14,
8 and '15, are going to be paid over an eight-year period
9 to the tune of \$65,000 a year. So our rate filing
10 includes, for those periods, \$65,000 a year. ORS
11 includes \$30,000 a year, less than half. What ORS did
12 was it excluded the taxes for 2012 and 2013. They
13 excluded them.

14 **A** [WHITE] '14 and '15.

15 **A** [GUASTELLA] Oh, I'm sorry. They excluded the years '14
16 and '15. Thank you, Gary. In addition to paying the
17 taxes for those years, prospectively, over an eight-year
18 period –

19 **CHAIRMAN HALL:** I'm sorry, Mr. Guastella.

20 **MR. PRINGLE:** Again, I'll just only mention
21 this for a second, but I don't think, even with the
22 panel setup, that it's appropriate for one witness
23 to –

24 **CHAIRMAN HALL:** To confer with another?

25 **MR. PRINGLE:** – to confer during their

1 testimony.

2 CHAIRMAN HALL: Yes, so, Mr. White, if you
3 want to contribute, you have to contribute on the
4 record, but you can't confer with each other, just
5 because it's a panel setting. You wouldn't be able
6 to do that if Mr. Guastella was on the witness
7 stand by himself. So, if you want to contribute,
8 you need to contribute on the record.

9 WITNESS WHITE: Understood. I'm sorry.

10 WITNESS GUASTELLA: In addition to paying for
11 those years of taxes at the rate of \$65,000 a year
12 for eight years, we are going to have an ongoing
13 level of property taxes annually. The way the
14 taxes are going to move forward – and before I do
15 that, ORS allowed \$140,000 for ongoing taxes, so
16 ORS allows \$30,000 instead of \$65,000 for the past
17 taxes, and for ongoing taxes, ORS allows \$140,000.
18 Their total is \$170,000. For ongoing taxes, we are
19 going to have to comply with the method that the
20 Department of Revenue uses to assess the utility's
21 book value of property. The way that assessment
22 works is – and I worked closely with the Department
23 of Revenue to get an adjustment to reduce the way
24 it calculates our property taxes. The way it
25 assesses the property taxes, it takes a look at the

1 annual reports to the PSC. It takes the cost of
2 the plant, less accumulated depreciation, less
3 contributions. And then it applies a 10.5
4 percentage to that amount. That develops the
5 assessment.

6 **CHAIRMAN HALL:** Ms. Hudson?

7 **MS. HUDSON:** Madam Chair, I object. I don't
8 know that -

9 **CHAIRMAN HALL:** If you could go to the
10 microphone? Even I can't hear you.

11 **MS. HUDSON:** [Indicating.] My apologies. I
12 object to this answer in the sense that Mr.
13 Guastella is not a Department of Revenue expert.

14 **MR. GRESSETTE:** If I may respond, Madam Chair?
15 I believe that the witness is testifying as to how
16 his taxes are calculated and how much he has to
17 budget for them. I don't think there's an
18 expertise in that.

19 **MS. HUDSON:** The concern was saying how the
20 Department of Revenue does it.

21 **CHAIRMAN HALL:** So, yeah, Mr. Guastella can
22 testify to his assessment, but not as to how DOR
23 calculates or computes.

24 **WITNESS GUASTELLA:** In order to determine
25 property taxes, I had to directly work with the

1 Department of Revenue to determine its methodology
2 of assessing property. I'm not going to argue
3 expertise as being a tax – but I'm an expert
4 witness that's able to give you testimony as to how
5 the process works, with respect to costs of
6 providing service, and that's what I did with the
7 Department of Revenue. I know exactly how the
8 Department of Revenue does it. We had to submit
9 something called a PT-139 form to the Department of
10 Revenue, which gives them the information they
11 need, as they explained to me, in order to
12 calculate the assessment for property taxes. So
13 the way we developed our property taxes on a *pro*
14 *forma* basis, in our rate filing, is to use that
15 exact same type of form that would be used for the
16 Department of Revenue to assess the taxes. Our
17 number, therefore, becomes \$191,000 a year, not
18 \$140,000 a year, because our assessment is no
19 longer going to be based on the \$5 million rate
20 base that was included – that was given in the last
21 rate case. I was able to convince the Department
22 of Revenue – and Ms. Walls, I actually have to give
23 her credit; she suggested that we get the
24 assessment down, and go meet with the Department of
25 Revenue and try to negotiate a reduced level of

1 property taxes for our customers. And I went to
2 the Department of Revenue and I asked them, "Will
3 you accept the \$5 million rate base allowed in the
4 last rate case instead of the book value that was
5 \$7 million?" And they said, "Submit a revised
6 annual report." I did exactly that. I submitted a
7 revised annual report to the Commission, but I
8 clearly noted at the bottom that page 201 of that
9 annual report is the rate base from the last case;
10 it wasn't the book costs. That enabled me to save
11 the customers another \$100,000 in property taxes.
12 So that was how those property taxes work. The
13 ORS's number is \$30,000 instead of 65, and \$140,000
14 instead of \$190,000. We are going to be paying
15 property taxes at the \$255,000 level. It's going
16 to be our cost. Is not going to be \$170,000.

17 **BY MR. GRESSETTE:**

18 **Q** Mr. Guastella, there has been a proposed adjustment from
19 ORS with regard to the Guastella Associates management
20 fee. Can you summarize the utility's position with
21 regard to that adjustment?

22 **A** [GUASTELLA] Yes. Our management fee was an arm's length
23 negotiation because, when the CK Materials people were
24 thinking about acquiring the utility from International
25 Paper, they came to me and asked if I would help them

1 with that acquisition. They came to me because
2 International Paper recommended that I help them acquire
3 the utility system. In order for me to do - once I
4 helped them with the acquisition, I was asked whether or
5 not I would then manage the utility, because they really
6 didn't know how to do that. So I entered into an arm's
7 length agreement with what was then the Haig Point
8 Utility, which we had to change the name to Daufuskie
9 Island Utility at the request of the homeowners and the
10 owners of Haig Point Utility, and I worked up a
11 management agreement that includes all the duties and
12 functions that Guastella would perform on a day-to-day
13 basis. It included a provision for additional work if I
14 had to enter into a construction program for them. It
15 included additional charges for undertaking financing,
16 because undertaking financing and the cost of
17 undertaking financing is far and above different and
18 more than just the cost of maintaining and managing the
19 system. It also included an incentive fee.

20 So that agreement contained a number of components.
21 If they did not agree to that, I wouldn't be managing
22 the utility. I mentioned before that the homeowners'
23 association, in order to settle that acquisition by CK
24 Materials, required that Guastella Associates manage the
25 utility. In that management agreement, I developed what

1 I thought our best estimate would be of the cost of
2 undertaking the day-to-day management, the cost of
3 capital improvements – which I mentioned to you our
4 costs are about half of what's typical. I also
5 indicated the cost of undertaking financing, because I
6 knew that for a small company this was going to require
7 a massive effort. I didn't realize how massive an
8 effort it would be, because I didn't think we would be
9 rejected by three banks and then have to go through
10 reestablishing ownership and easements for every piece
11 of property. So we spent incredible amounts of time
12 simply trying to get the loan that we needed in order to
13 serve the customers.

14 Looking at our management overall, ORS simply
15 adjusted, saying that our duties didn't change from last
16 case. I'm going to spend a second on that. If someone
17 has a job and they do a good job but their duties don't
18 change over three years and there's cost-of-living
19 increases included, would that employee not get cost-of-
20 living increases because their duties didn't change?
21 With respect to our management fee, we include a 3
22 percent factor in an annual increase and a factor for
23 customer growth – a portion of the customer growth –
24 which I thought was reasonable in terms of moving
25 forward with the agreement. But if you're going to test

1 my management fees, test my performance. Take a look at
2 what we've done for this utility. We've gotten property
3 - we've saved the customer - do you know anyone who
4 saved two years' worth of property taxes and was able to
5 get a county to rescind two years' worth of property
6 taxes, saving the customer something on the magnitude
7 of, I think, \$235,000? We were able to adjust the
8 assessments with DOR, saving the customers \$100,000. We
9 were able to enter into an agreement to pay past taxes
10 over an eight-year period, saving the customers a
11 present value of about \$100,000, if they had to pay
12 those taxes on a current basis. Taxes alone, we saved
13 the customers a bunch of money. Our supervision of the
14 construction projects saved the customers another
15 \$2-\$300,000, maybe \$400,000. We were able to - when the
16 lagoon liner failed, we had to excavate all of the
17 sediment underneath that lagoon liner. If we had to
18 haul that off the island, it would be an enormous amount
19 of money. We worked out something with the fire
20 department -

21 **CHAIRMAN HALL:** Mr. Pringle.

22 **MR. PRINGLE:** I'm hearing testimony about
23 purported customer savings associated with the
24 management agreement and in connection to
25 construction. Again - I've been wrong about this

1 before — I don't see that in any particular
2 testimony.

3 WITNESS GUASTELLA: It's in my testimony.

4 MR. PRINGLE: About customer savings?

5 WITNESS GUASTELLA: Yes.

6 CHAIRMAN HALL: Mr. Gressette.

7 MR. GRESSETTE: I believe it's in the
8 testimony.

9 MR. PRINGLE: Okay.

10 CHAIRMAN HALL: Okay. Tell us where. Do you
11 mean, just generally, the property taxes that were
12 saved, or —

13 MR. GRESSETTE: I believe there's a summary,
14 in the initial testimony, of those numbers.

15 CHAIRMAN HALL: You mean in the direct
16 testimony?

17 MR. GRESSETTE: Yes, ma'am.

18 CHAIRMAN HALL: Mr. Guastella, help your
19 attorney out.

20 WITNESS GUASTELLA: Yes, if I may? On the
21 capital, legal and consulting fees, I have a
22 section on page seven of my rebuttal testimony. On
23 the capital improvements, I have a section on page
24 eight of my rebuttal testimony. On land values,
25 there's a section on page nine. We have some more

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1 on depreciation, and I've got a section on property
2 taxes that begins on page 15. And I have a whole
3 section on page 16 on Guastella management fees;
4 it's on page 16, 17, and 18. I include our working
5 with the Department of Revenue as a part of what we
6 did.

7 **CHAIRMAN HALL:** Okay, we'll allow it.

8 **MR. PRINGLE:** My question was that he made a
9 specific statement that their administration of the
10 construction projects saved customers somewhere in
11 the neighborhood of several hundred thousands of
12 dollars, and I didn't see that.

13 **CHAIRMAN HALL:** Oh, you mean specifically.

14 **MR. PRINGLE:** Yeah.

15 **CHAIRMAN HALL:** Okay. Mr. Guastella, Mr.
16 Gressette?

17 **MR. GRESSETTE:** I think that's probably
18 accurate. I don't think there's a specific
19 reference to savings for the construction.

20 **WITNESS GUASTELLA:** I believe I provided that
21 to ORS in response to discovery. I thought I had
22 included that in here.

23 **CHAIRMAN HALL:** Okay. Well, then let's move
24 on from that, if you're not certain of where that
25 is.

1 WITNESS GUASTELLA: Where was I?

2 BY MR. GRESSETTE:

3 Q I believe you were -

4 A Oh, one of the savings we had was - and this is - it is
5 in the record. It's in my report to the Commission on
6 the capital improvements. It spells out these savings
7 in that report, and that's part of my direct testimony.
8 And if you want, I can find it for you, but I'm telling
9 you it's in there.

10 CHAIRMAN HALL: I think Mr. Pringle would like
11 you to take a second to find that.

12 [WHEREUPON, discussion was had off the
13 record]

14 WITNESS GUASTELLA: It's on page one, capital
15 improvements. "The excavated earth and sludge
16 under the failed lagoon liner will be disposed of
17 by constructing a new helipad at the fire station,
18 in order to save DUIC the cost of removal off-
19 island. The helipad will be constructed in three
20 stages over several months," each with a layer of
21 sludge, which complies with DHEC's approvals. "The
22 use of this fill..." will also help in savings to
23 the fire department in the construction of the
24 helipad.

25 I don't put the dollar amounts in there, I'm

1 sorry. But I certainly do mention that this is
2 going to save us costs for keeping the removal or
3 the disposal of the sludge on the island. It's
4 also going to save the island's customer residents
5 the cost of the fire department incurring -

6 **CHAIRMAN HALL:** Mr. Pringle.

7 **WITNESS GUASTELLA:** - and constructing the
8 helipad.

9 **MR. PRINGLE:** Now he's talking about a
10 separate particular issue. My objection was about
11 that particular one, and he's not supported that
12 with what he read, and he just proceeded to start
13 reading something else.

14 **CHAIRMAN HALL:** Okay.

15 **MR. PRINGLE:** The report is in the record, but
16 it doesn't say what I was talking about, and we can
17 move on. I don't need to belabor this. Sorry.

18 **BY MR. GRESSETTE:**

19 **Q** Mr. Guastella, although -

20 **CHAIRMAN HALL:** I -

21 **BY MR. GRESSETTE:**

22 **Q** - the third page of the report, to which you were just
23 reading an excerpt, makes reference to the assistance of
24 Terry R. Lee, DIUC's president, I don't think it
25 includes an exact amount, but did the utility have the -

1 derive a benefit from Mr. Lee's - and I'm quoting from
2 the report - coming to the rescue with his construction
3 company?

4 **A** [GUASTELLA] Yes.

5 **Q** And was it his construction company that installed a
6 temporary modification of the plant as designed by
7 Thomas & Hutton Engineering, until a permanent
8 replacement of the lagoon liner could be made?

9 **A** [GUASTELLA] Yes.

10 **Q** Undertaking the work without payment?

11 **A** [GUASTELLA] Yes.

12 **Q** So, Mr. Lee, who is president of DIUC and one of its
13 owners, had his company, without payment, repair the
14 lagoon liner when the utility did not have money to pay
15 an outside vendor to do that?

16 **A** [GUASTELLA] That's correct. I worked closely with Mr.
17 Lee. And dealing with the owners - incidentally, I'm
18 dealing with owners that, under my management, I was
19 telling them they're not going to get paid a penny in
20 dividends until we serve our customers; and indeed,
21 that's been the case. So that's part of the performance
22 that I was talking about.

23 Our performance extended into other areas. Because
24 of the lack of money, we had to deal with DHEC in making
25 improvements, as well. And we had to prepare a

1 corrective action plan to submit to DHEC, with respect
2 to a number of items. DHEC was understanding in
3 allowing us to take time to make improvements because
4 they recognized that we need to undertake financing
5 before those could be made. It was exacerbated a little
6 bit because I thought we would be able to start very
7 soon after the last rate increase, but it took 15 months
8 to get any money after the last rate increase, and I had
9 to bear with and DHEC had to bear with us, to do that.
10 We submitted a corrective action plan one Friday, and by
11 that afternoon we got an email from DHEC approving our
12 corrective action plan. There is also a series of
13 meetings of – Michael Guastella met with DHEC on a
14 number of these improvements. I've got emails that I
15 believe I include in – I believe there's a series of
16 emails included in my rebuttal testimony, where a member
17 of DHEC compliments us for taking action on problems
18 that were long-standing, compliments our communication.

19 I say all this because – test my performance,
20 whether it's property taxes, whether it's costs, whether
21 it's leases, whether it's undertaking financing, whether
22 it's saving money on construction projects, whether it's
23 dealing with DHEC. This small utility is getting the
24 benefit of my 50 or more years' worth of experience,
25 knowing what the problems of developer-related utilities

1 have been, as a regulator that I regulated, and also as
2 a consultant for 600 of them. So test – one, test my
3 performance. Don't say that our duties didn't change
4 over three years.

5 Next, test the price. I include in my rebuttal
6 testimony – I took an effort to compare at least seven
7 municipal utilities in South Carolina, and they do not
8 pay property taxes or income taxes, and they finance
9 only with debt and no equity return. So I adjusted our
10 costs as if we were a municipality and didn't pay
11 property taxes and income taxes, so that I could measure
12 our cost of operations with the municipalities of South
13 Carolina. Our costs compare favorably. I think we're
14 less than half of them, in terms of our cost of
15 operations, which is astounding for two reasons. One
16 is, we're on an island where everything is more
17 expensive; there's no road access. Second is we have
18 the fewer number of customers compared to those other
19 utilities, so we have to spread our costs over fewer
20 customers. They spread their costs over many more
21 customers. So us being competitive with those other
22 municipalities is the test of whether or not our
23 management fees are reasonable.

24 So in terms of performance, the quality of
25 management that these customers are getting that some

1 large companies don't get, and the costs that these
2 customers pay compared to comparable costs of other
3 utilities is the kind of test that I would ask you to
4 make, because it's the kind of test that ORS did not
5 make and does not mention.

6 Q Mr. Guastella, there are a couple more topics and then
7 I think we'll be finished, but one I would like you to
8 summarize briefly is the rate-case-expense adjustment
9 and the utility's position with regard to the same.

10 A [GUASTELLA] And I'll be brief with this one, I promise.
11 In the last rate case, we filed for a rate-case expense
12 of \$181,200. By the time we were finished with that
13 case, our costs were about \$370,000. In this case, we
14 filed for \$191,200, \$10,000 more than in the last case.
15 So far we expect our rate-case expenses to be about
16 \$380,000. I'm not asking for the \$380,000, but
17 certainly we would expect that you would give us half of
18 the rate increase, because when we are going through a
19 rate-setting process with a number of interrogatories
20 and examinations, and a process with seven witnesses,
21 that takes money. It's the same kind of process, it
22 seems to me, that a large utility would go through. So
23 we're asking for less than half of what our actual costs
24 will be. It's demonstrated from our last case, our
25 rate-case expense that we requested were half of what

1 they turned out to be. It's the cost of doing business
2 for a small company. Rate regulation is not much lower
3 for a small company than a big company, and if that's
4 what the cost of providing service, then I love the
5 Supreme Court of the United States that you must give
6 the utility enough revenues to cover its operating
7 expenses and the capital costs of the business, so that
8 it can maintain financial viability and attract capital.

9 Q Mr. Guastella, there is some reference in your rebuttal
10 testimony to the cost of capital or rate of return?

11 A [GUASTELLA] Yes.

12 Q Can you summarize the utility's position with regard to
13 that?

14 A [GUASTELLA] Yes. I have never seen a utility's debt
15 rate be based strictly on the nominal interest rate,
16 because there's always a cost that is incurred in order
17 to undertake financing. I think, by now, you recognize
18 there was an enormous cost in order to undertake the
19 financing.

20 What you do with the cost of undertaking the
21 financing is you amortize it over the life or term of
22 the loan, which is what we did. So we took the cost of
23 undertaking the financing, spread it over 15 years, and
24 then you add that annual amount to what the interest
25 would be, and if the nominal interest rate is 5.29

1 percent, when you add the cost of undertaking the
2 financing, it came out to be about 6.29 – about 6.2
3 percent. Six point one nine [6.19] to be exact. We are
4 planning on refinancing the existing loan, because we
5 have to refinance the existing loan.

6 We've got a \$500,000 line of credit that is due
7 November 1st. I was able to have the discussion with
8 SunTrust. They are willing to wait until April 1st
9 before us having to pay off the \$500,000 line of credit,
10 so they're accommodating us once again because the rate-
11 setting expertise of Guastella Associates is able to
12 convince a bank that we're going to be able to move
13 forward, and they are postponing the time that we have
14 to pay off the \$500,000 line of credit.

15 **CHAIRMAN HALL:** Ms. Hudson?

16 **MS. HUDSON:** Madam Chair, I just ask – I'm not
17 aware of the April 1 date being in testimony.

18 **WITNESS GUASTELLA:** It's not. Sorry, it's
19 not. I'm telling you the reality of what I'm
20 facing.

21 **CHAIRMAN HALL:** Okay. Well, yeah, if you can
22 stay limited to the testimony that's been
23 submitted.

24 **WITNESS GUASTELLA:** I guess the impact that
25 concerns me the most is: That loose-leaf binder

1 [indicating] is just the closing documents. We had
2 legal fees that were about \$187,000. We had to
3 redo all of our - prove all of our easements, all
4 of our land, we had to do all surveys. We had to
5 respond to - and maybe at some point, we'll give
6 you the table of contents of what's in there.
7 That's just for the legal fees for one of the
8 firms. The other firms that were involved had to
9 do with submitting applications for approval of the
10 financing with this Commission. All through this
11 three-year period, there were costs that Guastella
12 Associates incurred that's included. Despite that,
13 we're looking at a cost of capital of 6.2 percent,
14 which is pretty darn good for a small utility that
15 can't finance on the strength of its own financial
16 condition. Incidentally, in order for us to
17 finance, the owners have to put up their personal
18 guarantees and their personal assets in order to
19 secure financing.

20 So the interest rate that the staff is
21 allowing is the nominal interest rate of 5.29
22 percent on the last loan. They allowed nothing,
23 zero, for the cost of undertaking the financing.
24 This is a small company that should not be treated
25 worse than the big companies. So that's my problem

1 with the debt part.

2 With respect to the equity part - and I'll try
3 to go through this sooner - the DFC formula uses
4 nine of the largest utilities in the country. The
5 revenues for the utilities average about \$800
6 million, compared to our proposed \$2 million. One
7 of the companies has revenues approaching \$4
8 billion. The lowest annual revenue is \$57 million.
9 We are being compared to those as if we're typical
10 companies in terms of how we can finance. I think
11 you have a sense of what this utility goes through
12 to attract capital. Those utilities don't get
13 turned down by three banks. Those utilities don't
14 have to have personal guarantees from the owners of
15 the utility. Those utilities don't go through the
16 kind of effort that we had to go through to
17 finance, for the purposes of making improvements,
18 to serve our customers. The reality of what it
19 takes to serve our customers, for a small company,
20 is what you see in our rate filing. It troubles me
21 greatly to have the rate of return on debt be
22 excluding any cost of undertaking financing, and to
23 come up with a return on equity of less than 10, or
24 less than 10½ percent, really is not the reality of
25 this utility.

1 Now, I have to admit to you. I used a 10.5
2 percent return on equity. It's way below what it
3 really would mean if we have to attract capital and
4 earn it. The job that the regulators have – and
5 I'm sure you've dealt with this – is you give the
6 utilities a reasonable opportunity, not a
7 guarantee, to earn a reasonable return. Look at
8 what happened from your last rate case. We're
9 supposed to get \$176,000 a year, every year, for
10 the last three years. We're short by over
11 \$400,000.

12 And I have to finish by telling you that the
13 proposed settlement between ORS and the property
14 owners of \$462,000 will give this utility no return
15 on equity. None. And it will not give us enough
16 money to pay our debt service on our existing loan.
17 We will be in default because of all of these
18 adjustments and failure to include what are real
19 costs of providing service in terms of capital and
20 our real cost of providing service in terms of
21 operating the utility.

22
23 [PURSUANT TO PREVIOUS INSTRUCTION, THE
24 PREFILED DIRECT TESTIMONY OF JOHN F.
25 GUASTELLA FOLLOWS AT PGS 187-196]

1 DAUFUSKIE ISLAND UTILITY COMPANY, INC.

2 Testimony of John DOCKET NO. 2014-346-W/S

3 F. Guastella

4 Before the South Carolina

5 Public Service Commission

6 Testimony Prepared: September 18, 2015

7 Hearing Date: October, 28, 2015

8

9 **Q. Please state your name and business address.**

10 A. John F. Guastella, 725 N. Highway A1A, Suite B103, Jupiter, Florida 33477.

11 **Q. What is your occupation?**

12 A. I am president of Guastella Associates, LLC ("GA").

13 **Q. Briefly describe GA?**

14 A. Guastella Associates provides utility rate, valuation and management consulting
15 services.

16 **Q. Have you previously testified before the South Carolina Public Service
17 Commission ("PSC")?**

18 A. Yes.

19 **Q. Have you attached as Exhibit A to this testimony a summary of your
20 qualifications and experience?**

21 A. Yes.

22 **Q. What is your involvement with Daufuskie Island Utility Company, Inc.
23 ("DIUC" or "Company")?**

1 A. GA has been the manager of DIUC since July 9, 2008, when DIUC was acquired
2 by CK Materials, LLC from Haig Point, Inc. (formerly International Paper Realty
3 Corporation of South Carolina). In addition, GA has prepared the rate analysis in
4 support of the proposed rate increase.

5 **Q. Would you describe the changes in the ownership structure since DIUC's last**
6 **rate case, Docket No. 2011-229-WS?**

7 A. Yes. The decision in the last rate case recognized the conversion of equity into
8 debt in order to obtain a \$3.0 million loan. In addition to many other
9 requirements, the lenders required that DIUC divest itself of any connection to
10 CK Materials. As a result, a new company was formed, Daufuskie Island Holding
11 Company, LLC ("DIHC") that is now the parent and stockholder of DIUC; DIHC
12 has no other business activity.

13 **Q. What is the basis for the proposed increase?**

14 A. The rate increase has been determined on the basis of the actual operating costs
15 for the historical test year ended December 31, 2014, adjusted for known and
16 measurable changes through December 31, 2015. The rate analysis is set forth on
17 an exhibit entitled, "Schedules in Support of a Rate Increase" previously
18 submitted to the Public Service Commission as an attachment to DIUC's pending
19 application for rate increase.

20 **Q. Did you prepare the rate analysis?**

21 A. Yes, I coordinated the preparation of the rate analysis with Gary C. White, Vice
22 President of GA, who prepared the specific schedules, under my direction and
23 supervision. Mr. White is also submitting direct testimony in this case, which

1 addresses the contents and calculations in the rate analysis. My testimony
2 explains the circumstances or causes regarding certain significant revenue
3 requirement components.

4 **Q. What are the primary reasons for the proposed overall 108.9% increase in**
5 **DIUC's revenue requirement?**

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

11 **Q. In its order in DIUC's last rate case, Docket No. 2011-229-WS, the PSC**
12 **accepted a settlement agreement which, among other things, required that**
13 **the Company establish a Capital Reserve in the amount of \$700,000, and**
14 **submit a report on the use of those funds to the PSC, the Office of Regulatory**
15 **Staff ("ORS") and Intervenors. Did you submit that report on behalf of**
16 **DIUC to those parties?**

17 A. Yes, copies of the report were also submitted to the Department of Health and
18 Environmental Control ("DHEC"), Beaufort County, SunTrust Bank and others
19 with whom DIUC had interacted since the last rate case. The report contains a
20 service list of the many individuals who were sent a copy of the report. The
21 report is provided in this case as an exhibit. It is entitled, "Report on Capital
22 Improvements" ("Report"). A copy of the Report is attached hereto and
23 incorporated herein as Exhibit B.

1 **Q. Did you provide a copy of the Report to Haig Point Club and Community**
2 **Association, Inc.; Melrose Property Owner's Association, Inc.; and Bloody**
3 **Point Property Owner's Association?**

4 A. Yes. The Report also included the following on page 18:
5 "By providing a copy of this report to the three property owners' associations
6 through their attorney, John Beach, Esq., I am offering to meet informally with
7 the customers to make a PowerPoint slide presentation of the basics of utility rate
8 setting and the regulatory process." The Report also stated that during a meeting
9 with the associations I would "review the improvements that have been made as
10 well as explain the specific cost bases for the rate increase, which will have been
11 filed by the time this meeting could be arranged."

12 **Q. Did anyone from any of those property owners' associations respond to your**
13 **offers to personally meet?**

14 A. No. No one responded to the offers to meet.

15 **Q. After this rate case was filed did you again offer to meet with the property**
16 **owners' associations?**

17 A. Yes. On August 24, 2015, DIUC's attorneys emailed counsel for the three
18 property owners' association and again extended the offers included in the Report.

19 **Q. Did anyone from any of those property owners' associations respond to those**
20 **offers?**

21 A. No. No one responded to the offers to meet.

22 **Q. Why are you submitting the Report as an exhibit in this case?**

1 A. In addition to providing the required information on the use of the Capital
2 Reserve funds, the Report gave me the opportunity to inform DIUC's economic
3 and environmental regulators, customers, local government, bank and others of
4 the financial and operational challenges that this small utility have been
5 overcoming in order to provide adequate water and wastewater service on an
6 island only reachable by boat.

7 **Q. Without repeating the information in the Report, would you briefly discuss**
8 **the issues covered, beginning with the capital improvements?**

9 A. Yes. Instead of a capital reserve of \$700,000, we established a separate reserve
10 with SunTrust in the amount of \$750,000. The Report provides a detailed
11 description of the improvements and attaches pictures of major projects.

12 **Q. Are the costs of the improvements and all existing water and sewer plant and**
13 **facilities included in the rate base as reflected in the schedules in support of**
14 **the rate increase?**

15 A. Yes, and all of the utility plant is used and useful in providing service to the
16 customers.

17 **Q. Why did you include a section entitled "Historical Background" in the**
18 **Report?**

19 A. DIUC is now the merged Haig Point Utility and the Melrose Utility, both of
20 which were newly created in the mid-1980s by different real estate companies. In
21 addition to a matter of interest as to how these utilities developed, I wanted to
22 provide some insight as to the typical circumstances impacting new, small utilities

1 that must independently survive if they are to continue to provide adequate
2 service to their customers after their real estate developers move on.

3 **Q. Please briefly describe the "Finance" section in the Report.**

4 A. The Finance section outlines the extraordinary difficulty we had in obtaining a
5 loan, despite the last rate increase. It outlines how remarkable it was that we were
6 able to persevere in not only actually borrowing \$3.25 million, but at an effective
7 interest rate of only 6.19%. That rate is lower than the anticipated 6.5% at the
8 time of the last rate case.

9 **Q. Does DIUC's rate application reflect another financing?**

10 A. Yes.

11 **Q. Please describe the proposed financing.**

12 A. It is DIUC's intention of refinancing the balance of the existing term loan of
13 \$2,750,000 and short term line of credit of \$500,000 with a \$3,750,000 loan. The
14 basis for the proposed debt financing of \$3,750,000 is a management judgement
15 considering DIUC's need to pay off its short term line of credit in November of
16 this year, the need for additional capital improvements, and the reduction of
17 accounts payable.

18 **Q. What is the rate impact of the proposed refinancing?**

19 A. The refinancing would increase the debt portion of the existing capital structure,
20 essentially converting equity into debt resulting in a lower overall rate of return,
21 lower income taxes and a lower revenue requirement.

22 **Q. How did you determine the effective interest rate on the refinancing?**

1 A. Although we have requested that SunTrust refinance the existing loans with a
2 \$3,750,000 loan, it has not yet provided a proposal, indicating it is waiting for
3 more information regarding the outcome of DIUC's present rate application to the
4 PSC. Accordingly, we have used the effective interest rate of the existing debt,
5 rounded to 6.2%.

6 **Q. What is the pro forma capital structure reflected in the rate application?**

7 A. The pro forma capital structure consists of 41.2% debt and 58.8% equity.

8 **Q. What is DIUC's requested rate of return on equity, and how was it**
9 **determined?**

10 A. The proposed return on equity is 10.5% which is based on my experience and
11 judgement with respect to small water and sewer utilities, not on the typical cost of
12 capital methodologies. Small water and sewer utilities rarely, if ever, obtain
13 financing on the strength of their own financial condition, particularly those as
14 small as DIUC. A guide-post Supreme Court decision holds that the return to the
15 equity holder should be commensurate with risks on investments in other
16 enterprises having corresponding risks and that equity return should be sufficient to
17 assure confidence in the financial integrity of the enterprise, so as to maintain its
18 credit and attract capital. That standard is not satisfied if DIUC's equity return is
19 determined by applying such typical rate of return analyses as the discounted cash
20 flow method or capital asset pricing model. Those methods have value for large
21 utilities but not for DIUC. For example, in the last rate case the settlement included
22 a return on equity of 8.81% which was estimated to produce some \$176,215 in net
23 income. The rate increase went into effect on August, 15, 2012. From August 15,

1 2012 to December 31, 2014, DIUC's net income should have been a total of about
2 \$418,000 if it achieved the 8.81%, but instead its actual net income was less than
3 \$90,000 for that period. For 2015, we project a loss of about \$450,000. These
4 results demonstrate the sensitivity to earnings erosion for DIUC as a small utility, a
5 factor not reflected in the typical cost of capital methodologies. The 10.5% equity
6 rate of return that I have used is conservative and it is most probable that it also
7 would not be fully achieved in the future. As a practical matter, however, I am
8 aware that the regulatory climate would be hard pressed to allow equity rates that
9 might be precedent setting in the context of decisions in other rate cases. On the
10 other hand, while the owners have never received a dividend payment, the time has
11 come when DIUC must be given a fair opportunity to achieve a reasonable rate of
12 return. Moreover, the allowance of a reasonable rate of return is also essential for
13 DIUC to meet coverage requirements with respect to the proposed refinancing and
14 not defaulting on the repayment of its short term debt.

15 **Q. The next section in the Report describes the circumstances regarding the tax**
16 **sale of the "storage tank" parcel and DIUC's actions to condemn the property.**
17 **What is the status of the condemnation?**

18 A. We are waiting a decision by the Court of Appeals of Mr. Sabry's appeal of the
19 court's ruling that DIUC has the right to condemn the subject property, and have
20 been advised that its decision will be made this fall.

21 **Q. Does DIUC own and control the storage tank, wells and other facilities located**
22 **on the subject property?**

1 A. Yes. As confirmed by Beaufort County's Treasurer, the tax sale of the subject
2 parcel of land did not include the storage tank, well and facilities, only the land.
3 DIUC paid for those facilities; it pays property taxes to Beaufort County for those
4 facilities; it has the right to operate, maintain, and replace those facilities on any
5 parcel of land in accordance with the original covenants of the development; and
6 those facilities have always been and continue to be used and useful in providing
7 water service to its customers.

8 **Q. With respect to the property tax issue discussed in the Report, what is the**
9 **impact of those taxes on DIUC's revenue requirement?**

10 A. Although our negotiations with Beaufort County and the Department of Revenue
11 saved some \$356,726 in property taxes that would have had to be included in the
12 revenue requirement, the new annual pro forma level of property taxes is \$192,302.
13 In addition, instead of having to pay past taxes of \$526,843.39 within a year or two,
14 we entered into an agreement with Beaufort County to pay those taxes in
15 installments over an eight year period, or \$65,856 a year. It is noted that the annual
16 amount of the new property taxes is the largest single item cause of the rate
17 increase.

18 **Q. In your opinion, does the proposed rate increase reflect the reasonable cost of**
19 **providing water and wastewater service to DIUC's customers?**

20 A. Yes.

21 **Q. What rate structure does the Company propose for the water and sewer rates?**

1 A. The proposed water and sewer rates are based on single-tariff pricing – the same
2 rates for the previous Haig Point and Melrose Utility operations. With the merged
3 operations, the operations, accounting, billing, management and financing costs
4 are common to all customers, and single-tariff pricing will be more efficient for
5 billing.

6 **Q. Does this conclude your testimony at this time?**

7 A. Yes.

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[PURSUANT TO PREVIOUS INSTRUCTION, THE
PREFILED REBUTTAL TESTIMONY {W/CORRECTION}
OF JOHN F. GUASTELLA FOLLOWS AT PGS 198-221]

MERITS HEARING - VOLUME 2 OF 2
10/28/15

PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

1 DAUFUSKIE ISLAND UTILITY COMPANY, INC.

2 DOCKET NO. 2014-346-W/S

3 Rebuttal Testimony of John F. Guastella

4 Before the South Carolina Public Service Commission

5 Testimony Prepared: October 9, 2015

6 Hearing Date: October, 28, 2015

7

8 **Q. Please state your name and business address.**

9 A. John F. Guastella, 725 N. Highway A1A, Suite B103, Jupiter, Florida 33477.

10 **Q. Did you submit direct testimony in his case?**

11 A. Yes.

12 **Q. Have you reviewed the direct testimonies submitted on behalf of the Office of**
13 **Regulatory Staff (“ORS”) and the Haig point Club and Community**
14 **Association, Inc., Melrose Property Owner’s Association, Inc. and Bloody**
15 **Point Property Owner’s Association (“Intervenors”)?**

16 A. Yes. I reviewed the testimonies of ORS’s witnesses Ivana C. Gearheart, Willie J.
17 Morgan and Dr. Douglas H. Carlisle. I also reviewed Intervenors’ witnesses
18 Tony Simonelli, Doug Egly, Harry Jue, Paul Vogel, Lynn M. Lanier and Charles
19 Loy.

20 **Q. How have you organized your rebuttal testimony?**

21 A. My rebuttal testimony is organized according to those issues for which I disagree
22 with the positions taken by ORS or Intervenors. Gary White will also provide
23 rebuttal testimony with respect to certain issues.

1 **Q. Before addressing those issues, are there any adjustments proposed by ORS**
2 **that you would accept for rate setting purposes in this case?**

3 **A.** Yes, the following is a list of line item revenue requirement components under
4 existing rates for which ORS made adjustments that I accept and also those for
5 which ORS made no adjustments:

- 6 1. Total Revenues;
- 7 2. Wages;
- 8 3. Benefits;
- 9 4. Director's Fees;
- 10 5. Power;
- 11 6. Chemicals;
- 12 7. Supplies & Maintenance;
- 13 8. Outside Services-Engineering;
- 14 9. Outside Services-Accounting;
- 15 10. Outside services-Legal;
- 16 11. Outside Services-Testing;
- 17 12. Outside Services-Other;
- 18 13. Transportation;
- 19 14. Bad Debt;
- 20 15. Insurance;
- 21 16. Regulatory Commission Expense;
- 22 17. Other A&G Expenses;
- 23 18. Revenue Taxes;

1 19. Payroll Taxes; and

2 20. Average Unamortized Balances.

3 **Q. What are the revenue requirement components for which ORS and/or**
4 **Intervenors proposed adjustments and with which you disagree?**

5 A. I disagree with the proposed adjustments and/or issues raised with respect to the
6 following:

7 1. Rate Base

8 A. Utility Plant in Service

- 9 a) The original cost of the storage tank, well and other
10 utility facilities located at the "Sabry" parcel of land;
11 b) The original cost of items of plant for adjustments from
12 the previous case;
13 c) Capitalized legal and consulting fees; and
14 d) Land values.

15 B. Accumulated Depreciation

16 C. Contributions in Aid of Construction

17 2. Property Taxes

18 3. Management fees

19 4. Incentive Fee

20 5. Rate case expenses

21 6. Cost of Capital or Rate of Return

22

23

1 **1. Rate Base**

2 **A. Utility Plant in Service**

3 **a. Original Cost of the Storage Tank, Well and Other Utility Facilities:**

4 **Q. Would you explain the reasons why you disagree with ORS's proposed**
 5 **adjustment to eliminate the cost of the storage tank, well and other utility**
 6 **facilities located on the parcel of land that was transferred by tax deed to a**
 7 **Mr. Mamdouh Sabry Abdelrahman ("Mr. Sabry")?**

8 **A.** DIUC owns those facilities, as reflected in the Special Warranty Deed and Bill of
 9 Sale dated April 1, 2001 by and between Haig Point, Inc. and Haig Point Utility
 10 Company, Inc. See Exhibit 1. DIUC's initial and supplemental response to ORS
 11 Request #1.79 documents that DIUC, as the successor utility to Haig Point Utility
 12 Company, Inc. ("HPUC"), has the right to construct, operate, maintain and
 13 replace utility facilities on any parcel of land on the 1,040 acres of the Haig Point
 14 Plantation being developed by Haig Point, Inc., formerly International Paper
 15 Realty Corporation of South Carolina, provided there were no existing plans for a
 16 building construction. See Exhibit 2. The approved joint application of Haig
 17 Point, Inc. and CK Materials LLC for the sale of the stock of HPUC includes on
 18 Schedule 3.13(a), page 3, the cost of the storage tank and well in the amount of
 19 \$1,303,083.97. The Beaufort County property record reflected in Exhibit WJM-7
 20 does not include any of DIUC's utility facilities. Moreover, the testimony of
 21 Maria Walls, Treasurer of Beaufort County, confirms that Beaufort County did
 22 not sell DIUC's storage tank, well, pump, pipes and other utility facilities in the
 23 tax sale to Mr. Sabry, and that Mr. Sabry is not paying property taxes on those

1 utility facilities. DIUC, however, is paying Utility Taxes for them on the basis of
 2 assessments by the Department of Revenue ("DOR"). The original cost of these
 3 facilities is reflected on DIUC's books and they have continued to be used and
 4 useful, without interruption, in providing water service to DIUC's customers since
 5 they were first placed into service.

6 **Q. Is there also an Indenture Grant of Easement and Bill of Sale for personal**
 7 **property that includes the Bloody point Well #1?**

8 A. Yes, that easement and bill of sale is between Bloody Point Group Limited
 9 Partnership and Melrose Utility Company. See Exhibit 3. Bloody Point Well #1
 10 is also reflected on DIUC's books and it has continued to be used and useful in
 11 providing service to our customers.

12
 13 **b. Original Cost of Items of Plant for "Adjustments from the Previous Case":**

14 **Q. Are the "adjustments from the previous case" reflected in Ms. Gearheart's**
 15 **testimony and exhibits?**

16 A. No, they are not itemized. Only the total amount of the adjustment to utility plant
 17 for water and sewer are provided in Ms. Gearheart's Audit Exhibit ICG-4, Page 5,
 18 which are described as "undocumented expenses from gross plant in service",
 19 without details. Upon review of ORS's testimony and exhibits from the last rate
 20 case, I noted the same statement appears; however, in that case ORS did provide
 21 amounts by type of plant within its testimony. In the instant case, ORS provided
 22 DIUC with work papers as a follow up to our audit exit conference call that
 23 enable us to identify what we think are the specifics of its adjustments. The

1 largest adjustment relates to the storage tank and facilities that I discussed above.

2 The other adjustments shown in the work papers are for items of plant that are
3 specifically identified by plant account and year of installation. Apparently, a
4 lack of invoices is the sole basis for ORS's position that those costs are
5 "undocumented".

6 **Q. In your opinion, is ORS's statement that the costs are undocumented**
7 **correct?**

8 A. No. That statement appears to be ORS's only explanation or justification for the
9 adjustments. In fact, itemized costs at specific amounts, by primary plant account
10 and the year in service, are recorded on the DIUC's books, which certainly
11 constitute "documentation". The ORS does not claim that the assets in question
12 do not exist and are not used and useful, nor does it question the reasonableness of
13 the amounts that it clearly observed from DIUC's records. Some missing
14 invoices for a relative small portion of plant, particularly for the Melrose Utility
15 Company that essentially abandoned its system, does not constitute an absence of
16 evidence of the reasonableness of the utility plant costs for assets that are
17 providing service. Even the Intervenor's expert, Mr. Loy, understands such
18 circumstances. On page 19 of his testimony, he states with respect to trends,

19 "These studies are typically performed when there are no
20 supporting cost records of plant. The NARUC USoA
21 requires an 'estimate' of plant values when there is no
22 supporting documentation available. Original cost studies

1 have been an accepted methodology to establish these
2 values.”

3 Although Mr. Loy applies that statement to his opinion with respect to an issue he
4 raised with which I disagree and will discuss later, he is correct that the cost of
5 plant is not properly disallowed because of a lack of documentation, but instead it
6 is proper and consistent with the NARUC USoA to use estimates. In this case,
7 however, it is not necessary to estimate the costs because the costs are known and
8 recorded, and the assets are used and useful in providing service to our customers.

9
10 **c. Capitalized Legal and Consulting Fees:**

11 **Q. What adjustments did the ORS propose with respect to legal and consulting**
12 **fees that are reflected in DIUC’s utility plant in service?**

13 A. Ms. Gearheart’s testimony and exhibits do not specifically identify the amounts of
14 those adjustments. They are included with Ms. Gearheart’s adjustment to utility
15 plant in service. It is our understanding that Ms. Gearheart proposes to eliminate
16 the legal fees incurred in connection with the condemnation of the Sabry parcel
17 and to eliminate GA consulting fees that were capitalized. I would note that Ms.
18 Gearheart’s statement that the legal costs of \$29,511 were for condemnation of the
19 water tower is incorrect. DIUC is condemning the land, not the water tank that
20 DIUC already owns.

21 **Q. Why was the condemnation action required?**

22 A. When we learned of the tax sale of the storage tank parcel, our first reaction was
23 to reason with Mr. Sabry. When that was unsuccessful, we filed a legal action to

1 reverse the tax sale. Subsequently, however, our attempt to finance with CoBank
2 and then Wells Fargo fell through, and our need to obtain financing for capital
3 improvements had to be our primary objective. It became evident that the
4 proceeding to reverse the tax sale would be drawn out and result in an
5 unacceptable delay in obtaining a loan. The best course of action was to
6 withdraw the law suit and initiate a condemnation, an action that SunTrust would
7 accept -- and made it a requirement of the loan.

8 **Q. Why should the legal fees be included in the cost of providing service?**

9 A. The tax sale was beyond our control. Upon managing DIUC, we notified
10 Beaufort County of the new address, and we received regular property tax bill
11 from Beaufort County at that address. For an unknown reason, Beaufort County
12 sent a tax bill for the storage tank parcel of land to the wrong address without our
13 knowledge, as well as notices of a delinquency and a tax sale. It even posted a
14 notice of the tax sale at the wrong property, and our operators never observed any
15 notice at the storage tank site which they visit daily. The legal fees were,
16 therefore, unavoidable and included in the cost of land.

17 **Q. Why should GA's fees related to capital improvements be included in the**
18 **cost of providing service?**

19 A. GA's management agreement contains a provision under which work performed
20 in connection with capital improvements is not part of the routine day-to-day
21 management of DIUC and, therefore, is to be billed at 10% of the first \$50,000 of
22 improvements and 8% of capital costs over \$50,000. The work involves
23 establishing the improvements that are needed or desirable, establish priorities in

1 terms of their impact on service and available funding cost, solicit and obtain
2 contractors' proposals, select contractors, schedule and coordinate work with
3 DIUC's routine operations, and supervise the construction work.

4 **Q. Did ORS provide any reason for eliminating GA's fees related to capital**
5 **improvements?**

6 A. Not that I could find.

7 **Q. Why should GA's fees related to capital improvement be included in rate**
8 **base as part of the cost of the improvements to utility plant in service?**

9 A. GA's capital fees are not only part of an arms-length management agreement,
10 they are necessary and the cost is reasonable. It is obvious that capital
11 improvements cannot be made without the work I describe above. The 10% and
12 mostly 8% of the construction costs are significantly less than the 15% to 20%
13 typically allowed for this type of administration and supervision of construction
14 work.

15

16 **d. Land Values**

17 **Q. Has the ORS included anything for the cost of land in utility plant in service?**

18 A. No.

19 **Q. Did the ORS give a reason for eliminating any value for land?**

20 A. Not that I could find.

21 **Q. What have you included as the cost of land for the parcels owned by DIUC?**

22 A. We estimated the cost of land at about \$0.25 per square foot on the basis of the
23 appraised value of the storage tank parcel that was performed by an independent

1 appraiser we engaged in connection with the condemnation proceeding. The total
2 estimated cost of land, excluding capitalized legal fees, is \$109,560.

3
4 **B. Accumulated Depreciation**

5 **Q. Do you have any disagreement with ORS's proposed accumulated**
6 **depreciation allowance?**

7 A. The ORS's calculation of accumulated depreciation and depreciation expense is
8 based on the system utilization factor method, which is the same method that we
9 use. The primary difference between ORS and DIUC seems to be the "fallout" of
10 ORS's utility plant adjustments. Accordingly, the determination of allowed cost
11 of utility plant in service will result a revision to accumulated depreciation and
12 depreciation expense.

13 **Q. Does Mr. Loy take issue with the use of a system utilization factor for**
14 **calculating accumulated depreciation and depreciation expense?**

15 A. Yes. On the basis of my review of Mr. Loy's testimony not only with respect to
16 depreciation but also his proposal to treat the cost of plant as developer
17 contributions, it is clear that he is simply unaware of the utility accounting and
18 rate setting that best addresses the characteristics and nature of newly formed
19 developer-related water and sewer utilities that were created as part of a new real
20 estate project.

21 **Q. What leads you to that conclusion?**

22 A. Mr. Loy's first stated reason for recalculating accumulated depreciation is that he
23 believes the utilization factor ("UF") is meant to reflect the fact that the system

1 either has not been completely built out or is not fully utilized in providing
2 service. Both beliefs are incorrect. He then begins to essentially define
3 utilization factor as a “non-utilized” portion of plant. That is incorrect. Without
4 further addressing each statement with which I disagree, Mr. Loy states that he is
5 not aware of any case where this Commission has approved UF adjusted
6 depreciation rates in the past, and later in his testimony acknowledges that he has
7 never seen this methodology used in the 25 years he has been involved in
8 ratemaking and accounting.

9 I do not criticize Mr. Loy for not being aware of this methodology; I find
10 that it is not familiar to many experts because they have rarely --if ever-- focused
11 on solving the problems of small developer-related water and sewer utilities,
12 particularly those that were newly created. Indeed, on page 25 of his testimony,
13 where Mr. Loy is asked if an acquisition should be included in rate base, he
14 answers “No. Troubled utilities usually become ‘troubled’ because they have
15 poor records, poor management and/or limited resources.” It is precisely for those
16 reasons that I personally developed the system utilization factor methodology for
17 depreciation, along with the complete system analysis, in setting water and sewer
18 rates for developer-related utilities. I was motivated to do so about 35 years ago
19 because, before becoming a consultant, I had been regulating some 400 water
20 utilities, mostly small developer-related, and observed the difficulty they
21 invariably had in attracting capital on the strength of their own financial condition
22 once the real estate development was completed. Some of my first consulting
23 clients were developers who were creating new water utilities; they retained me to

1 financially structure the utilities and to establish rates. I developed rates on the
 2 basis of a complete system analysis so that the utility customers would not
 3 subsidize the cost of the real estate project or even bear the risk of the success of
 4 the real estate project. Under the complete system analysis, depreciation is
 5 calculated on the basis of system utilization.

6 **Q. Why is depreciation calculated on the basis of system utilization under the**
 7 **complete system analysis?**

8 **A.** Under the complete system analysis, depreciation is calculated on the basis of
 9 system utilization because during the growth years when there are insufficient
 10 revenues to cover expenses, including depreciation, the book value would not be
 11 understated overstated after completion of the real estate project and the utility would not be
 12 left in a weak financial position.

13 **Q. Mr. Loy states that DIUC's accumulated depreciation does not properly**
 14 **reflect the age and condition of the plant. Would you comment on that**
 15 **opinion?**

16 **A.** Yes. Depreciation rates can be revised over time to reflect a range of average
 17 service lives, and it would not be unreasonable at some point to increase the
 18 depreciation rates. Depreciation, however, is caused not only by wear and tear,
 19 action of the elements and decay (the physical condition) but also changes in art,
 20 obsolescence and changes in regulatory requirements. For a newly formed
 21 developer-related utility, depreciation rates should take into account the
 22 regulatory requirement as to rate setting and full cost recovery. The system

1 utilization method takes those factors into account and helps avoid the problem of
2 limited resources.

3 **Q. Does the existence of availability fees preclude the use of the system**
4 **utilization factor for depreciation?**

5 A. No, the benefit of a preserved book value is appropriate regardless of the rate
6 structure.

7
8 **C. Contribution in Aid of Construction**

9 **Q. Do you agree with Mr. Loy's analysis to support his position that the plant**
10 **should be treated as contributed?**

11 A. No. Mr. Loy's analysis is a fabrication. Mr. Loy begins his analysis by claiming
12 that Haig Point, Inc. treated the utility plant as inventory and expensed these costs
13 as development costs. He provides no support for that statement, and it's rather
14 far-fetched. Under the tax code, one affiliate cannot expense plant for tax
15 purposes and then transfer it to an affiliate who depreciates the cost that was
16 already expensed. On page 14 of his testimony, Mr. Loy states that "Working
17 with Mr. Guastell, (sic), HPUC developed an original cost trending study..." That
18 never happened. On page 19, Mr. Loy states that "Mr. Guastella probably
19 inventoried the plant and identified certain records that helped date the plant. He
20 probably then performed an original cost trending study..." Again, that never
21 happened. GA was retained by HPUC in 2004 only to prepare a rate analysis,
22 which we did on the basis of information provided by HPUC's representatives.

1 HPUC's rate application was examined by the ORS and it prepared a report of its
2 audit, which included the following:

3 "AUDIT EXHIBIT SGS-10; BALANCE SHEET

4 Shown in this exhibit is the balance sheet of HPUC as of June
5 30, 2004. ORS verified the balances contained in this statement
6 to the books and records of HPUC."

7
8 On page 18, Mr. Loy goes on to state that "HPUC hired Mr. Guastella to ready
9 HPUC for sale." This is not true. I never knew there would be a sale until 2008
10 when a member of CK Materials, LLC contacted me to help him purchase HPUC.

11 **Q. When you prepared the last a rate analysis on behalf of DIUC, did you find**
12 **anything unusual in the relationship between Haig Point, Inc. and HPUC as**
13 **reflected on the balance sheet as of December 31 2007, before the acquisition**
14 **by CK Materials?**

15 **A.** No. I found what I have always found for the hundreds of my developer-related
16 utility clients. When a water or sewer utility is created as part of a real estate
17 project, it has no customers and no revenues, because the utility system has not
18 yet been constructed. The developer owner, individual or corporate, funds the
19 construction of the utility system. At some point, sooner or later, the assets are
20 transferred from the developer to the utility at their original cost and a liability is
21 reflected on the utility's books in some form of open account, typically as
22 Advances in Aid of Construction or some other named contributed capital
23 account, which represents the developer's equity investment. In sum, there is
24 absolutely no indication that there were customer contributions in aid of

1 construction as defined in the NARUC USoA, and Mr. Loy's proposal to assume
2 contributions is simply not supported by any substantive analysis.

3
4 **2. Property Taxes**

5 **Q. Do you agree with the ORS allowance for property taxes?**

6 A. No. The Amended Agreement with Beaufort County with respect to the back
7 taxes provides for the annual installment payment of \$65,856 for 8 years, which
8 includes taxes for the years 2012, 2013, 2014 and 2015. ORS only includes the 8
9 year installment of \$30,612 for the back taxes for 2012 and 2013. We estimated
10 the ongoing annual taxes using the assessment formula applied by the Department
11 of Revenue ("DOR") and applying Beaufort County's tax rate, resulting in an
12 annual amount of \$192,301. In total DIUC will need about \$258,157 annually
13 for the next eight years, ignoring possible future tax rate or assessment increases.
14 The ORS includes an estimate of \$140,881 for ongoing property taxes, and adding
15 its \$30,612 for back taxes, ORS's total is \$171,493, or \$20,808 short of just the
16 annual ongoing taxes and effectively no allowance for the \$65,856 installment
17 payments.

18 Because the property tax bills for 2010, 2011 and 2012 were all sent for
19 the first time in August of 2012, we were able to negotiate the elimination of the
20 2010 and 2011 taxes, and reduce the DOR assessment for 2012 to date, and also
21 work out an interest and penalty-free installment plan to recover back taxes over
22 eight years. This result is due in large part to an understanding and very helpful
23 Beaufort County Treasurer, Maria Walls. Had we been able to rush a rate

1 increase with rates effective in July of 2014, the customers would be paying about
2 \$280,000 over the subsequent 2 years. Instead, under this Amended Agreement,
3 the 8-year installment results in a present value savings for the customers of about
4 \$100,000. ORS's proposed property tax allowance is counter-productive and
5 would deny recovery of actual expenses.

6
7 **3. GA Management Fees**

8 **Q. Why do you disagree with the ORS adjustment to GA management fees?**

9 A. As with a number of its other adjustments, ORS provides no analysis in support
10 its adjustment to limit the amount of management fees to the 2011 level. When
11 CK Materials applied to the PSC for approval of its acquisition of Haig Point
12 Utility Company from Haig Point, Inc., Docket No. 2007- 414-W/S, one of the
13 provisions contained in the approved settlement agreement, prepared by the
14 attorney for the Haig Point Club and Community Association, Inc., requires that
15 Guastella Associates "manage HPUC, helping to make strategic decisions on
16 permitting, system management, maintenance, and upgrades." The purpose of
17 that provision was to be certain that there would be qualified management of
18 HPUC. The GA management agreement that was submitted in support of that
19 acquisition remains essentially the same as the current agreement. The
20 qualifications of GA's staff include engineering, accounting, administration, rate
21 setting and valuation expertise that are rarely, if ever, available on a day-to-day
22 basis for small, developer-created water and sewer utilities that typically do not
23 maintain a full or part time staff with all such qualifications. The management

1 fee includes office space, furniture and equipment. With respect to Melrose
2 Utility Company, it was apparent that before merging with DIUC, its management
3 was inadequate, as evidenced by its bankruptcy and actual abandonment of its
4 utility operation in 2009. Even before merging into DIUC in 2010, DIUC began
5 operating MUC's systems, without compensation, in order to avoid major
6 interruption of service to its customers. The merger of MUC into DIUC gave
7 MUC's customers the benefit of the same expert management as DIUC's
8 customers. The challenges of managing DIUC were many and exceptionally
9 difficult, even unusual for a small water and sewer utility, as described in our May
10 2015 Report on Capital Improvements that is now in the record in Docket No.
11 2011-229-WS. Today, however, under GA's management, DIUC has financing
12 in place, essential improvements have been made, it is in compliance with DHEC
13 requirements, and service to its customers has continuously been adequate,
14 without a single interruption, all despite severe cash flow shortfalls.

15 The provision of adequate service to our customers has taken priority over
16 any other consideration. There have been no dividends paid to owners. For rate
17 setting purposes, the rate application in the last case, prepared by GA, used a
18 projected capital structure in which the owners' equity investment was converted
19 into debt in order to finance projected system improvements (even though the cost
20 of the projected capital improvements was not included in rate base). The
21 projection or imputation of debt reduced the overall rate of return and revenue
22 requirement because the debt rate was lower than the rate of return on equity. The
23 revenue requirement was also lower because the projected interest on the debt was

1 used as a deduction to taxable income in the calculation of the income taxes
2 allowance. The cash shortfalls over the years have been dealt with by having the
3 owners pay for some expenses, by delaying payment to the owners for
4 construction of facilities before financing was in place, and delayed payments to
5 GA (in amounts in the hundreds of thousands of dollars for which payment will
6 be out of equity, not current rate revenues). These efforts reflect an unequivocal
7 commitment to provide adequate service to the customers, some of which were
8 achieved because of GA's rate setting expertise that is not typical of other
9 managers.

10 **Q. Has GA worked hard to meet requirements of the Department of**
11 **Environmental Control?**

12 A. The Report on Capital Improvements outlines our effort. I would also share an
13 exchange of emails from Mr. H. Michael Longshore of DHEC. See Exhibit 5.

14 **Q. Have you prepared an analysis comparing DIUC's operating costs to other**
15 **water and sewer utilities in South Carolina?**

16 A. Yes. Assuming monthly bills for residential customers using 11,000 gallons of
17 water, I compared DIUC's proposed rates with the municipal utilities of St. John's
18 County Utility Dept. (2014), Charleston Water System (2015 and 2016), Mt.
19 Pleasant (2015), Folly Beach (2015), Isle of Palms (2015) Sullivans Island (2014)
20 and Seabrook Island. See Exhibit 4. Because these are municipal utilities that do
21 not pay property or income taxes and finance with debt, I adjusted DIUC's
22 revenues to eliminate those costs in order to compare just the rates that reflect
23 DIUC's cost component of its rates on the same basis as the municipals. As

1 shown in Exhibit 4, DIUC is about average and less than 4 of the 8 utilities.
2 Because DIUC is on an island with only boat access and it has the lowest number
3 of customers, its cost per customer should be expected to be measurably higher
4 than utilities with more customer. While rates should not be established on the
5 basis of the costs of other utilities, DIUC compares very favorably in terms of
6 cost per customer. This comparison is an indication that GA's management is
7 competitive with other management.

8 **Q. Having regulated hundreds of small water utilities and provided consulting**
9 **services to hundreds more, would you compare the qualifications and**
10 **experience of GA with the managers and owners of other small utilities?**

11 A. None of the managers or owners of the hundreds of small utilities that I have
12 known have GA's rate, valuation and management experience.
13

14 **4. GA Incentive Fee**

15 **Q. Is it proper for ORS to make an adjustment for GA's incentive fee of 20% of**
16 **net operating income?**

17 A. No. The existing and proposed rates do not include any allowance for GA's
18 incentive fee. The incentive fee is calculated by applying a percentage to the net
19 operating income of DIUC. The net operating income is calculated by applying a
20 rate of return (cost of capital) to rate base. The calculations of the net operating
21 income, rate base and rate of return are not affected by the incentive fee.
22 Accordingly, the owners, not the customers, are responsible for the incentive fee.

1 Indirectly, however, the customers have benefitted by GA's incentive fee,
2 because without it GA would not have agreed to manage DIUC. GA's expertise
3 in management, valuation and rate setting, and its commitment to place the
4 customers' best interests ahead of all other considerations, have been the major
5 factors enabling DIUC to maintain adequate and uninterrupted service to the Haig
6 Point and Melrose customers. Within days of our management of DIUC at the
7 start of a transition from International Paper, MUC was found to be delinquent in
8 payment of its share of the HPWWTP, creating a 25% shortfall in revenues. In
9 less than two years, MUC filed for bankruptcy and abandoned the operation of its
10 utility systems, which GA took over to keep MUC's customers from interruption
11 of service, but it added another cost. Another major obstacle was that Coastal
12 States bank began a formal default action against CK Materials that involved
13 DIUC because its assets were used as collateral. GA prepared projections under
14 an anticipated rate increase, met with Coastal States' representative and
15 successfully negotiated a delay in the legal action for a default – the default action
16 was ultimately withdrawn and Coastal States Bank was fully paid as promised by
17 GA. Without GA's participation, MUC's customers would likely have
18 experienced interruption of service for an unknown duration, and DIUC would be
19 in the hands of a bank that had never managed a utility. The harmful
20 consequences to the customers of either circumstance would have been dramatic
21 and long lasting.

22 Having consulted for some 600 developer-related water and sewer
23 utilities, I am not aware of any that had managers with the regulatory, utility

1 accounting, valuation, or rate setting experience that GA applied in meeting the
2 challenges of managing DIUC. This statement is not meant to be self-serving, but
3 offered to consider whether or not other manager(s) would have been better able
4 to meet the challenges as described in more detail in the Report on Capital
5 Improvements submitted in May of 2015 in Docket No. 2011-229-WS.

6
7 **5. Rate Case Expenses**

8 **Q. Are ORS's adjustments to rate case expenses reasonable?**

9 A. No. DIUC's proposed revenue requirement includes an estimate of rate case
10 expenses in the amount of \$191,200 amortized over 4 years. It was estimated on
11 the basis of the cost of the last rates case. The actual cost to complete this case
12 will likely be significantly higher. ORS proposes to limit the allowance for rate
13 case expenses to the level allowed in DIUC's last rate case or \$75,000 and
14 unamortized rate case expenses from the last rate case, and a 5 year amortization
15 period. The reality is that the extent of the rate proceeding for this small utility
16 seems to be no less than that for other larger utilities. Responding to over 300
17 discovery requests alone required many weeks of work for a number of people,
18 and several weeks of work are added for review of direct testimonies of nine
19 witnesses, 5 major and 4 minor, preparation of rebuttal and then surrebuttal
20 testimony, preparation of cross-examination, hearings and briefs. We would
21 provide an update of actual rate case expenses at the hearing. With respect to the
22 amortization period, the last rate case ended in mid-2012, 3 years ago. In our
23 opinion, 4 years is a more realistic amortization period.

1 **6. Cost of Capital or Rate of Return**

2 **Q. Do you agree with Dr. Carlisle's recommendations regarding capital**
3 **structure, debt rate and equity?**

4 A. No.

5 **Q. Why do you disagree with his proposed capital structure?**

6 A. Dr. Carlisle states that ORS includes known and measurable adjustments.
7 Opining that DIUC's negotiations with banks or lenders is unknown and it may
8 not obtain the outcome indicated in DIUC's proforma adjustments, he
9 recommends that the proposed debt be rejected. He then recommends a
10 debt/equity ratio of 46%/54% on the basis of an average of his proxy group
11 consisting of nine large utilities. That hypothetical debt/equity is no more known
12 and measurable than the rate of 41.2%/58.8% that I proposed. Dr. Carlisle
13 supports the use of a hypothetical capital structure until such time as DIUC begins
14 to approximate that of a company with traded stock. DIUC does not have to wait
15 to approximate the proxy group, its debt ratio is equal to or higher than three of
16 the nine in the proxy group, well within the range.

17 As for adhering to the standard of comparability, DIUC is requesting
18 annual revenues in the magnitude of about \$2 million, the average annual
19 revenues of the proxy group is nearly \$800 million (the lowest is \$57 million and
20 the highest is nearly \$4 Billion). In DIUC's last rate case, the rate increase was
21 approved to generate about \$176,000 of annual net income; however, it actually
22 earned only \$89,000 in total for the last three years since the rate increase. That is

1 a three-year difference of \$439,000. The utilities in the proxy group are
2 obviously nowhere near that standard of sensitivity to earnings erosion.

3 **Q. Do you agree with Dr. Carlisle's use of the nominal interest rate of 5.29% of**
4 **the existing term loan for the projected financing?**

5 A. No. DIUC incurred significant cost to obtain financing, having been rejected by
6 three banks before finally obtaining a loan from SunTrust. As describe in DIUC's
7 responses to discovery, the debt expense or cost of obtaining financing was
8 incurred to find a lending institution, work with the banks, provide financial
9 analyses to support a loan, prepare a market value appraisal in accordance with
10 the Uniform Standards of Professional Appraisal Practice (at a savings by
11 Guastella who is qualified to perform appraisals), undertake legal work to identify
12 all assets, obtain easements, prepare new surveys of all properties, prepare loan
13 documents, reply to bank requests for information, reorganize the ownership
14 structure of the utility, form a new parent corporation and divest all relationship
15 with the previous parent and one of its owners, modify all existing agreements
16 among the owners, obtain title insurance, satisfy bank fees and legal costs,
17 prepare applications to the PSC for approval of the financing, and prepare closing
18 documents then close on the loan. The total cost was \$367,649.81 up to and
19 including closing in 2013, and another \$5,197.90 in follow-up work in 2014.
20 There was no compounding and the amortization of those costs were used to
21 compute the effective interest rate. Contrary to Dr. Carlisle' testimony, Guastella
22 was not paid \$372,879.71, but \$159,357.50 for an effort that spanned about three
23 years.

1 These costs increased the nominal rate to 6.2%, a spread of 91 basis points
 2 above the nominal 5.29%. The spread between nominal or coupon rates and
 3 effective rates ranges for selected large utilities from 110 to 140 basis points.
 4 Accordingly, despite the percentage of transaction fees and costs in relation to the
 5 principal amount of the loan, the 6.2% is reasonable by comparison. What is
 6 most disturbing is that Dr. Carlisle recommends the nominal rate with no attempt
 7 to include any of the costs of undertaking a financing, particularly knowing the
 8 circumstances of this small utility.

9 **Q. Do you agree with Dr. Carlisle's proposed return on equity of 9.1%?**

10 A. No, because he states on page 6 that "Specifically, I used publicly traded
 11 companies since they are I the same line of business as DIUC and share similar
 12 risks." There is simply no analysis that would justify that statement. I have
 13 recommended a rate of return on equity of 10.5%, which after the earnings
 14 erosion experienced by DIUC since its last increase is incredibly conservative.

15
 16 Testimony of Lynn Lanier

17 **Q. Do you have any comments with respect to Mr. Lanier's testimony?**

18 A. Under the Connecticut Public Utilities Regulatory Authority formula for return on
 19 equity for small companies, the rate of return on equity for DIUC in 10.69%.

20
 21 **Q. Does this conclude your testimony at this time?**

22 A. Yes.

1 MR. GRESSETTE: I don't have any further
2 questions. Thank you.

3 CHAIRMAN HALL: All right. We'll take a
4 break. Ten minutes.

5 [WHEREUPON, a recess was taken from 2:42
6 to 2:55 p.m.]

7 CHAIRMAN HALL: Thank you. Be seated. Mr.
8 Pringle, we're ready whenever you are.

9 Mr. Gressette, we need a certification for Mr.
10 Johanson's testimony. Verification. I'm sorry.
11 We stipulated it, so we need that.

12 MR. GRESSETTE: Yes, ma'am, I'll get it for
13 you.

14 CHAIRMAN HALL: Okay, thank you.

15 All right. Mr. Pringle, your witness. Maybe
16 we could be finished before the Benghazi panel's
17 hearings have run?

18 MR. PRINGLE: I'm not making any promises.

19 CHAIRMAN HALL: Okay. All right, that's fine.

20 [Laughter]

21 CROSS EXAMINATION

22 BY MR. PRINGLE:

23 Q Mr. Guastella, good afternoon.

24 A [GUASTELLA] Good afternoon.

25 Q Let's start - I'm going to put up a document here that I