

STATE OF SOUTH CAROLINA
In the Supreme Court

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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 II of III

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1 will represent to you is an exhibit from your – and I
2 will adjust this and zoom it in, so you can see it. But
3 it's Schedule A(4) from your Application. It was one of
4 the schedules that was filed with the Application, and I
5 can continue – I'm going to be talking about a
6 particular area, but I wanted you to be able to –

7 A [GUASTELLA] I have it.

8 Q Okay, you've got it. Now, there's been a lot of
9 discussion about this, as you characterize it, your
10 arm's length management agreement. On this particular
11 sheet that was attached with your Application, correct
12 me if I'm wrong but isn't the amounts that Guastella &
13 Associates will earn under the management agreement
14 listed in your year-end adjustments, the leftmost column
15 in this document, probably – I don't know – a third of
16 the way through the operating expense, as \$157,650?

17 A [GUASTELLA] Those would be our charges for 2014, I
18 believe.

19 Q Okay. For – in connection with the services that
20 Guastella & Associates provides under this management
21 agreement, correct?

22 A [GUASTELLA] For the management services.

23 Q Okay. Are those management services those services that
24 are provided pursuant to your management agreement with
25 the utility?

- 1 A [GUASTELLA] Yes.
- 2 Q Okay. And just by looking at that particular number, at
- 3 least in that leftmost column, that \$157,650 is, is it
- 4 not, the largest operating expense in that column?
- 5 A [GUASTELLA] Yes.
- 6 Q Okay. Let's turn, then, to the actual management
- 7 agreement. You made some – you made some – you gave
- 8 some testimony about the – and you correct me if I'm
- 9 wrong – about your original management agreement with CK
- 10 Materials being an arm's length transaction. Was that
- 11 your testimony?
- 12 A [GUASTELLA] With the utility and with CK. That
- 13 agreement, I believe, was with the utility, as well as
- 14 the owners.
- 15 Q That's not the current management agreement that you
- 16 operate under, is it?
- 17 A [GUASTELLA] It's similar, but there was a change when
- 18 Melrose was acquired.
- 19 Q So the answer to my question is that it is not the same
- 20 management agreement?
- 21 A [GUASTELLA] It's – I believe it's the same agreement,
- 22 but there was a change in the dollar amounts.
- 23 Q Okay. Let's go through this for a second.
- 24 A [GUASTELLA] The provisions were the same.
- 25 Q Okay, let's look, and give you an opportunity. You can

1 take a look at this, and I can certainly bring you this
2 piece of paper if you want to take a look at it a little
3 bit and see. Can you identify this -

4 CHAIRMAN HALL: Where is that, Mr. Pringle?

5 MR. PRINGLE: I'm sorry?

6 CHAIRMAN HALL: I'm sorry. Just so we can
7 follow along.

8 MR. PRINGLE: Oh, I'll give you some copies of
9 it. This was provided in response to discovery.

10 [Document distributed]

11 CHAIRMAN HALL: Thank you.

12 BY MR. PRINGLE:

13 Q Mr. Guastella, would you like one to follow along with?

14 A [GUATELLA] Probably would be easier if I did, please.

15 Q Sure [indicating].

16 A [GUATELLA] [Indicating.]

17 Q Okay. Can you identify this agreement?

18 A [GUATELLA] Yes, this is our current management
19 agreement.

20 Q Okay. And that agreement is between Guastella &
21 Associates and DIUC, correct?

22 A [GUATELLA] In part. It's also - there are other
23 parties to the agreement.

24 Q Tell me about that.

25 A [GUATELLA] First paragraph, the parent corporation is

1 also a part of this agreement.

2 Q Okay.

3 A [GUASTELLA] And the parent's individual stockholders are
4 also part of this agreement.

5 Q Right. And the date on this agreement is the 18th day
6 of June, 2015, isn't it?

7 A [GUASTELLA] Yes.

8 Q So this is not the agreement that you described that may
9 have involved CK Materials, is it?

10 A [GUASTELLA] No, the parties changed. I said the
11 provisions of the agreement remained the same, but the
12 parties changed because, in order to obtain financing,
13 SunTrust - first Wells Fargo and then SunTrust -
14 required that CK Materials and all of the individual
15 owners of CK Materials be taken out of the picture
16 completely. So part of obtaining the financing was to
17 completely reorganize the ownership of the utility to
18 remove CK Materials and anyone affiliated directly with
19 CK Materials, and form a separate corporation as being
20 the parent of the utility. So the utility would remain
21 the same but the ownership of the utility changed as a
22 requirement of obtaining financing.

23 Q Okay. Let's talk about the ownership of the utility,
24 and I'm talking specifically about DIUC. Who are the
25 shareholders of the company?

- 1 A [GUASTELLA] Daufuskie Island Utility Holding Company
2 owns the stock of Daufuskie Island Utility Company.
- 3 Q Okay. Are there any individual stockholders of DIUC?
- 4 A [GUASTELLA] No, just the holding company, and then
5 there's managing members of the holding company.
- 6 Q Okay. Who are the managing members of the holding
7 company?
- 8 A [GUASTELLA] Terry Lee, Ron Schimanowitz, and David
9 Hutton.
- 10 Q Okay. And you're not a managing member of the holding
11 company?
- 12 A [GUASTELLA] No.
- 13 Q Okay. You are a director of DIUC, are you not?
- 14 A [GUASTELLA] I'm - well, the manager of DIUC, and I'm on
15 the board of directors.
- 16 Q Which makes you a director?
- 17 A [GUASTELLA] Yes.
- 18 Q Okay. Are you an officer of DIUC?
- 19 A [GUASTELLA] No.
- 20 Q Okay. But you characterize yourself as a manager of
21 that company?
- 22 A [GUASTELLA] In accordance with this management
23 agreement.
- 24 Q Okay. All right. Well, let's talk about that a little
25 bit. You can turn a little with me as I get there.

1 Looking specifically – and I'll try to highlight this a
2 little bit [indicating]. And you've talked about this a
3 little bit. Guastella & Associates gets paid a
4 management fee each month, correct?

5 A [GUATELLA] Yes.

6 Q Okay. After all this, I walked up here without my
7 calculator [indicating]. And the management agreement
8 lists the amount of \$13,596.85 per month, correct?

9 A [GUATELLA] Yes.

10 Q Okay. And would you agree with me that that results in
11 a yearly or annual figure of \$163,162 [indicating]?

12 A [GUATELLA] Subject to check, I'll accept your
13 calculation.

14 Q Sure. Sure. So that's – Guastella & Associates
15 receives that every year, pursuant to this arm's length
16 management agreement.

17 A [GUATELLA] We charge it every year – every month. What
18 we receive may be a different situation, depending on
19 cash flow.

20 Q But you're entitled to those amounts pursuant to this
21 contract.

22 A [GUATELLA] That's correct.

23 Q Okay. And in addition – and you made reference to this
24 – there's also an automatic, we could call it, cost-of-
25 living increase, but the agreement increases by 3½

1 percent per year, does it not?

2 A [GUASTELLA] Yes, in –

3 Q Okay.

4 A [GUASTELLA] – part.

5 Q And there's also a provision for customer growth that
6 would allow some additional compensation, in the event
7 that additional customers are added onto the system,
8 correct.

9 A [GUASTELLA] Yes.

10 Q Okay. And that increase is going to take place
11 contractually, according to this management fee, and not
12 as a result of any particular performance or evaluation,
13 correct?

14 A [GUASTELLA] That's correct.

15 Q Okay. There is also mentioned that Guastella &
16 Associates is entitled to a finance fee in certain
17 situations, correct?

18 A [GUASTELLA] Yes.

19 Q Okay. Let's talk through how that might work. I think
20 your report to the Commission, your May 2015 report,
21 mentioned – and you tell me if this is correct –
22 securing financing in the amount of, is it \$3.25 million
23 or \$3.75 million?

24 A [GUASTELLA] The \$3.25 million is the financing we
25 undertook with SunTrust Bank already.

1 Q Okay.

2 A [GUASTELLA] The \$3,750,000 is what we are anticipating
3 refinancing with SunTrust.

4 Q Okay. So for a – on a \$3,250,000 loan, the finance fee
5 allows you to – Guastella & Associates to receive 2
6 percent of that, correct?

7 A [GUASTELLA] No.

8 Q No. All right. Tell me how that works.

9 A [GUASTELLA] Well, if you read the 2 percent, and that's
10 four lines down –

11 Q Yeah.

12 A [GUASTELLA] – that's number one. Or our usual hourly
13 rates for time spent handling any of the processes or
14 long-term financing. So it's either 2 percent or hourly
15 rates, essentially based on what our actual costs would
16 be for undertaking financing.

17 Q Okay. And the provision is the greater of those two,
18 correct?

19 A [GUASTELLA] I believe it is, yes.

20 Q Okay. So using my \$3.25 million example, and if you
21 accept subject to check that 2 percent of \$3.25 million
22 is \$65,000, with respect to that financing, did you
23 receive \$65,000 or did Guastella & Associates receive
24 \$65,000 or your usual hourly rates?

25 A [GUASTELLA] Our usual hourly rates and the time devoted

1 to this exceeded the 2 percent of the total financing,
2 so our charges – and I'm not talking about what we
3 received, because Daufuskie Island Utility Company owes
4 us a lot of money. But what we charged would have been
5 our actual costs, based on hourly rates.

6 Q And what were those costs?

7 A [GUASTELLA] I believe for that financing, it was
8 something in the neighborhood of \$156-\$157,000.

9 Q Okay. And was that in 2013?

10 A [GUASTELLA] No, it probably spanned a number of years.

11 Q Okay. All right. So, in addition to the management fee
12 that we've already discussed that, at least in the
13 current contract, pays you \$163,000 a year, with respect
14 to the financing that we've just discussed, this
15 contract gives you the right to be paid \$156,000 over
16 and on top of – over and above that, correct?

17 A [GUASTELLA] Well, it gives us the right to charge hourly
18 rates if it exceeds 2 percent. It doesn't have to be
19 the exact number of \$156,000. It would depend on what
20 it takes to obtain financing for the utility.

21 Obviously, in this case, it took three years or so,
22 three banks, not counting individuals that we tried to
23 get money from. So there was an effort that resulted in
24 our fees being at that level, based on this agreement.

25 Q So your answer to my question is yes?

1 A [GUASTELLA] Well, I think when you said \$156,000, it's
2 not strictly \$156,000. It's based on a formula. So we
3 will charge based on what the formula produces, and in
4 this case, that's what we billed.

5 Q Okay. Are you saying it's something different – you
6 told me the \$156,000 number. Is it a different number
7 other than \$156,000?

8 A [GUASTELLA] For the \$3,250,000 financing –

9 Q Yeah.

10 A [GUASTELLA] – but I thought your question was more
11 general that –

12 Q No, I'm specifically talking about the \$3,250,000
13 financing.

14 A [GUASTELLA] Yes, that was what we billed.

15 Q So you billed \$156,000, more or less, in connection with
16 that financing, as part of your finance fee under this
17 arm's length management agreement.

18 A [GUASTELLA] That's right.

19 Q Okay. All right. Let's, then, move to the capital fee.
20 You made some reference to this. And that agreement or
21 the obligation entitles Guastella & Associates to get –
22 and you tell me if this is correct – \$10,000 for the
23 first \$50,000 of construction costs, and 8 percent for
24 amounts in excess of \$50,000 in construction costs; is
25 that correct?

1 A [GUASTELLA] I think you said \$10,000 for the first
2 \$50,000. That's not correct.

3 Q Ten percent. I may have made a mistake. Is 10 percent
4 the number?

5 A [GUASTELLA] Yes.

6 Q Okay. So take me through that. Your May 2015 report to
7 the Commission mentioned a number of capital
8 expenditures that totaled \$755,658.33. Would those
9 expenditures be subject to the calculation of a capital
10 fee in that paragraph we're discussing?

11 A [GUASTELLA] Yes.

12 Q Okay. Well, let's go through that, then, real quick.
13 The first \$50,000 of that would entitle you to 10
14 percent of \$50,000, which is \$5000, correct?

15 A [GUASTELLA] Yes.

16 Q Okay. For the next \$750,658, that would entitle you to
17 8 percent of seven hundred fifty thousand six hundred
18 fifty- - excuse me, I made the wrong - 705,658 times
19 .08. So would you accept, subject to check, that that's
20 \$56,452?

21 A [GUASTELLA] Yes.

22 Q Okay. So if you add those two numbers together, that's
23 roughly \$61,000 that you would've received in capital
24 fees?

25 A [GUASTELLA] I'll have to check that, because I believe

1 the number did not reach \$60,000, so I'm not sure of
2 your arithmetic.

3 Q Okay. Well let's just assume, for purposes – let's say
4 it's 50. Is 50 a reasonable number?

5 A [GUASTELLA] I believe it's about \$56,000.

6 Q Fifty-six thousand dollars [\$56,000], okay. So in
7 addition to the \$163,000 you make for your management
8 fee and the \$156,000 that you make for the finance fee,
9 now we've got \$56,000 for the capital fee, correct?

10 A [GUASTELLA] Approximately, yes.

11 Q Okay. And, again, my arithmetic may be wrong, but I add
12 that all up and that comes up somewhere in the
13 neighborhood of \$375,000, in connection with your
14 management fee, your finance fee, and your capital fee.
15 Does that sound about right?

16 A [GUASTELLA] I think it'd be more accurate if you
17 recognize that the management fee, the day-to-day
18 management, is an annual fee. The capital fees spans
19 the time period for which there is capital, so it may be
20 more than a year. And the finance fee spans a time
21 period that would be more than a year, as well. So it's
22 not an annual amount, but it's, in total, our fees for
23 those three items spread over a period of time, but
24 you're leaving out the annual management fee for two
25 years, I believe, if you want to span – our finance fee

1 does span over three years.

2 Q Oh, so you want me to add \$163,000 to this?

3 A [GUASTELLA] No, I don't want you to do anything. I'll
4 let you do what you wanted to.

5 [Laughter]

6 Q And the agreement does provide that the capital fees,
7 for example, are to be - you're going to bill the
8 utility from time to time, as construction costs are
9 incurred and paid. So it's, you know, on an ongoing
10 basis, right?

11 A [GUASTELLA] Yes, what's happening is we do calculate it
12 from time to time, based on the formulas and the
13 provisions of this agreement.

14 Q Okay. All right. Fair enough. And then there's also -
15 we'll get to the last one. There's an incentive fee
16 that would allow or provide that Guastella & Associates
17 would receive additional payments in the event that the
18 company is sold for amounts over and above a certain
19 adjusted purchase price, correct?

20 A [GUASTELLA] That's part of the incentive fee.

21 Q Okay. And we don't necessarily - I don't know that we
22 necessarily need to do a calculation there, because,
23 obviously, that hasn't happened, has it?

24 A [GUASTELLA] The utility has not been sold, that's right.

25 Q Right. But it's fair to say, isn't it, that the higher

1 the purchase price, the more Guastella would receive as
2 an incentive fee?

3 A [GUATELLA] That's correct.

4 Q Okay. And so it sort of tiers its way up. You get 8
5 percent of the first \$3 million over and above the
6 adjusted sale purchase price of a little over \$2
7 million, correct?

8 A [GUATELLA] Yes.

9 Q And then you get 12 percent of the next \$5 million above
10 that adjusted purchase price?

11 A [GUATELLA] That's what would be applied under the
12 contract in the case of a sale, yes.

13 Q Okay. And, certainly, that provision certainly stands
14 to, you know, might stand to benefit Guastella &
15 Associates in the event of a sale at a particular price,
16 correct?

17 A [GUATELLA] Yes, of course.

18 Q Okay. All right. You gave some testimony about
19 mentioning that your May 2015 report extended an olive
20 branch – my words, but offered to meet with my clients
21 to discuss some of these issues and the challenges that
22 were facing the utility, correct?

23 A [GUATELLA] I believe for the last – partly correct. In
24 the last rate case, the customers said we wanted to –
25 they wanted us to have a better interaction with them.

1 Q Sure.

2 A [GUASTELLA] And when I prepared this report, I sent it
3 to John Beach, who was the attorney for the three
4 property owners.

5 Q My partner.

6 A [GUASTELLA] Your partner. I sent him a copy, and three
7 copies, and offered to conduct a little rate seminar
8 that I would discuss what the ratemaking process is, so
9 they could understand why we would have rates that we
10 have, and also discuss what our costs were with that,
11 and did not hear back from him.

12 Q Sure. And you mentioned in your May 2015 report, didn't
13 you, that any such meeting wouldn't be able to take
14 place until after you'd filed this rate case, correct?

15 A [GUASTELLA] I don't recall that.

16 Q Okay. Well, let me just see if I can refresh your
17 recollection.

18 MR. PRINGLE: I beg the Commission's
19 indulgence.

20 BY MR. PRINGLE

21 Q If I can just get you to - oh, do you have a copy of it
22 in front of you?

23 A [GUASTELLA] I do.

24 Q Okay. Super. Look at page 18.

25 A [GUASTELLA] I have it.

1 Q Probably six lines from the bottom, with the sentence
2 that begins, "We..." If you could read that?

3 A [GUASTELLA] "We will also review..." - is that what you
4 want?

5 Q Yes, please.

6 A [GUASTELLA] "We will also review the improvements that
7 have been made, as well as explain the specific cost
8 basis for the rate increase, which will have been filed
9 by the time this meeting could be arranged."

10 Q Okay.

11 A [GUASTELLA] So by the time I finished this, I
12 anticipated that we probably could be in a position to
13 file the rate increase and I could review, specifically,
14 what the rate increase would be.

15 Q The text says - and this is in the context of the
16 presentation that you proposed to give - that you will
17 "...explain the specific cost basis for the rate
18 increase, which will have been filed by the time this
19 meeting could be arranged," correct, those are your
20 words?

21 A [GUASTELLA] Yes.

22 Q So no meeting with my clients was going to be able to
23 take place until after this rate case was filed.

24 A [GUASTELLA] No, that's not what the meaning is. The
25 meaning was, at the time of this report, which was May

1 of 2015, I was anticipating a rate filing soon.

2 Q Sure, right.

3 A [GUASTELLA] So I anticipated that, by the time Mr. Beach
4 would get back to me, we probably would have made the
5 rate filing.

6 Q Okay. And that a meeting would take place after you
7 made the rate filing.

8 A [GUASTELLA] Well, I offered to have the meeting with
9 him. I didn't know whether or not it would take place,
10 but I offered to have a meeting with him.

11 Q But, in any event, this document that you wrote and is
12 filed with the Commission indicated that any such
13 meeting would take place after the rate case had been
14 filed.

15 A [GUASTELLA] By the time the meeting could be arranged,
16 is what I said.

17 Q Okay.

18 A [GUASTELLA] I didn't say after the filing was made, but
19 at that point I was anticipating we would have had a
20 filing. So I anticipated that, by the time the filing
21 was made, we would have that rate case done, or filed.

22 Q Right. And so -

23 A [GUASTELLA] It wasn't some provision of meeting with
24 him; it was just the reality of what I thought the
25 timing would be.

1 Q All right. I'm not suggesting anything different. But
2 before – you anticipated that, before you sat down with
3 them, what you wanted in this rate case, and the rates
4 that are in it, would be on file with the Commission,
5 and my clients would not have any input as to what
6 actually went into that Application.

7 A [GUASTELLA] Well, with all due respect to your clients,
8 they weren't going to have any input as to what I put in
9 the Application. My Application is going to be based on
10 the cost of providing service to the customers. Now, if
11 – I'm not going to the customers and asking them, "What
12 are our costs of providing service." I've never met a
13 customer that knows how to do that. So we were going to
14 put together our cost of providing service, and I was
15 then, once we knew what that was going to be and what
16 the impact on the customers would be, I then offered to
17 meet with them to explain how we developed the cost of
18 providing service. I was not anticipating that the
19 customers were going to help me put together a rate
20 filing.

21 Q Or have any input as to the way that your proposed rate
22 filing might affect them, either individually or in
23 customer classes.

24 A [GUASTELLA] No, because that's not the basis for setting
25 rates. Rates are set in accordance with the cost of

1 providing service, so whether it – the impact on
2 individual customers doesn't adjust what the cost of
3 providing service is going to be. So I would be
4 misleading customers if I said, "If you give me input
5 that you don't like the rate increase, I'll change the
6 rate increase." The rate increase is going to be what I
7 think is going to be the cost of providing service to
8 the customers.

9 MR. PRINGLE: That's all I have, Madam Chair.

10 CHAIRMAN HALL: All right. Ms. Hudson.

11 MS. HUDSON: Thank you, Madam Chair.

12 CHAIRMAN HALL: Ms. Fox, I'm sorry, I forgot
13 to ask you.

14 MS. FOX: That's okay. No questions.

15 CHAIRMAN HALL: Okay.

16 CROSS EXAMINATION

17 BY MS. HUDSON:

18 Q Flipping the management agreement back to one prior
19 page, Mr. Guastella, the way I read the paragraph
20 beginning with the words, "The above scope of
21 services..." does not –

22 A [GUASTELLA] I'm sorry, I don't know what page you're on.

23 Q They're not numbered, so it was – it's on the same page
24 that has "Management Fee" in bold with an underline.

25 A [GUASTELLA] Okay.

- 1 **Q** And I'm in the paragraph below the one marked number 10.
- 2 **A** [GUASTELLA] I have it.
- 3 **Q** Good. The way I read that paragraph is that rate-case
- 4 expenses are separate from the fees that Mr. Pringle
- 5 identified earlier? Is that correct??
- 6 **A** [GUASTELLA] Yes, as well as any formal proceedings that
- 7 would require work that is not anticipated for day-to-
- 8 day management or the other provisions of the agreement.
- 9 **Q** Continuing down to the management-fee section, in the
- 10 second line of the management-fee section, are travel
- 11 expenses separate, as well?
- 12 **A** [GUASTELLA] Yes.
- 13 **Q** You mentioned managing some 400 utilities in your
- 14 testimony, or the report - I can't recall. Is that how
- 15 many utilities you've -
- 16 **A** [GUASTELLA] No, that's not - I didn't manage 400
- 17 companies; I regulated 400 companies..
- 18 **Q** I see.
- 19 **A** [GUASTELLA] And I don't know - I also consulted for 5-
- 20 600, but -
- 21 **Q** How -
- 22 **A** [GUASTELLA] - did not manage them.
- 23 **Q** Thank you for correcting me on that. Do you know how
- 24 many utilities Guastella & Associates is managing?
- 25 **A** [GUASTELLA] This is the only one we're managing, right

1 now.

2 Q The interest rate expense – I'm sorry, strike that. The
3 interest rate that you are seeking coverage for, is that
4 number 6.2 percent?

5 A [GUASTELLA] You're not referring to our management
6 agreement; you're on cost of debt?

7 Q Yes.

8 A [GUASTELLA] Yes.

9 Q Does that include some of the Guastella & Associates
10 finance fee?

11 A [GUASTELLA] No, not – the finance fee that's already
12 been billed was for the previous financing. I don't
13 know what the interest rate is going to be on the
14 refinancing, or what the costs are going to be for
15 undertaking the financing. So the 6.2 percent was used
16 because that was the effective interest rate for the
17 last financing. So, because I had some unknowns, I
18 don't know what the interest rate is going to be, and I
19 don't know what the cost of undertaking that financing
20 will be, we used the same effective interest rate as in
21 the last financing.

22 Q Okay. And in that last financing, did that effective
23 interest rate include some of the finance fee of
24 Guastella & Associates?

25 A [GUASTELLA] I believe in the last – yes. I believe it's

1 - I'm trying to remember the number. Our costs were
2 \$156,000, and I think the attorneys' fees were about
3 \$180-190,000. I think the total cost of undertaking
4 that financing was approaching \$400,000 - I think it was
5 367, 387, something like that.

6 Q Do you recall if the gross receipts payment for
7 Daufuskie Island Utility was paid timely this year?

8 A [GUASTELLA] No. I recall getting a call, saying, "Pay
9 your gross-receipts." And I don't know if that's
10 because we were late, and I think ORS gave us a courtesy
11 call saying, "You've got to get that paid," but it may
12 have been late, yes.

13 MS. HUDSON: Thank you. Madam Chair, I have
14 no other questions.

15 CHAIRMAN HALL: Okay, thank you.

16 Commissioners, questions? Commissioner
17 Fleming.

18 EXAMINATION

19 BY COMMISSIONER FLEMING:

20 Q Good afternoon.

21 A [GUASTELLA] Good afternoon.

22 Q I wanted to go back to the refinancing of the existing
23 loan.

24 A [GUASTELLA] Yes.

25 Q And as you've talked about today, the 2011 rate case

1 focused on the company's ability to obtain refinancing.
2 And in your testimony on page six, you describe the
3 current situation, whereby the company will refinance
4 the existing loan of \$2.75 million and a short-term line
5 of credit of \$500,000, correct?

6 A [GUASTELLA] Correct.

7 Q Why is it necessary for the company to refinance this
8 debt?

9 A [GUASTELLA] Well, we do not have to refinance the
10 \$2,750,000. We do have to finance the \$500,000 line of
11 credit. That's part of the loan requirements on the
12 line of credit, the \$500,000, is it must be refinanced.
13 Right now, we're only paying interest on that. We're
14 paying principal and interest on the \$2,750,000. But I
15 - the way I discussed with SunTrust, in order to pay the
16 \$500,000, rather than borrowing a separate loan
17 instrument, I would like to refinance the entire amount
18 with one loan, and also refinance more than the
19 \$2,750,000 and the \$500,000, because we need some
20 additional cash for further improvements and for
21 accounts payable. And by increasing the amount of that
22 loan from \$3,250,000 to \$3,750,000, I then convert more
23 equity into debt so that the interest rate is going to
24 be lower than the debt rates. So the impact on the rate
25 of return, by financing more, is going to tend to reduce

1 the level of the rate increase we need, plus the
2 additional interest is going to give us a higher tax
3 deduction, so our tax allowance built into the revenue
4 requirement will be lower than if we don't finance
5 additional money. So there is a combined benefit. One
6 is, the utility then has additional funding for
7 additional improvements and accounts payable, and the
8 customers essentially get the benefit of a lower rate of
9 return because we're going to use a lower interest rate
10 – 6.2 – instead of my 10.5 or whatever return on equity
11 the Commission allows. And we'll have a tax deduction.

12 **Q** And according to your management fees, you would also
13 get that certain percentage and hourly reimbursement,
14 that you got for the other?

15 **A** [GUASTELLA] If the financing – it depends on the
16 financing. If the financing is \$3,750,000, then we
17 would get either 2 percent, or more, if our costs for
18 undertaking the financing were greater than 2 percent of
19 the financing.

20 **Q** So you would get –

21 **A** [GUASTELLA] Guastella would be – the utility would have
22 an obligation to pay Guastella according to this
23 agreement, so Guastella would charge additional amounts
24 for the additional financing.

25 **Q** Only the amount up and above the amount you had from

1 last time? Or you're saying for all of it?

2 A [GUASTELLA] Well, it would be the whole – the way this
3 agreement reads, it would be the whole financing.

4 Q Okay. So you received that percentage last time, and
5 you will receive it again when you're refinancing?

6 A [GUASTELLA] I'm going to say yes, but keep in mind, we
7 didn't receive it yet. The utility's had cash-flow
8 problems, so Daufuskie Island Utility owes Guastella
9 Associates a lot of money that we've been using to
10 service our customers rather than to reimburse Guastella
11 according to the management agreement.

12 Q But they owe it to you.

13 A [GUASTELLA] But they owe it to me. So, either the –
14 well, for all of the back amounts, really, the
15 stockholders are going to have to pay for that, because
16 we're not going to be getting retroactive ratemaking for
17 the past amounts that the utility did not pay us. So,
18 the way that stockholders are going to pay us is by
19 converting equity into debt, which reduces the rate
20 impact on the customers, and then basically what I'm
21 doing is I'm telling the stockholders, "Reduce the rates
22 by borrowing money, and then use some of that money to
23 pay me." So I'm taking that money out of the
24 stockholders, not out of the customers. That's the same
25 for the incentive fee.

1 Q And one of the reasons for financing in 2011 was to pay
2 off existing accounts payable?

3 A [GUASTELLA] There was a – yes. Part of that was for
4 that, and if you want, I'll explain what the other parts
5 were for, but part of that was for paying off some
6 accounts payable. There were other obligations that had
7 to be paid first. The CK Materials – when CK Materials
8 – if you want me to continue, I will; if you want me to
9 stop, I will.

10 Q That's fine.

11 A [GUASTELLA] When CK Materials acquired the utility from
12 International Paper, CK Materials borrowed, I believe
13 it's \$1,750,000 from Coastal States Bank. In order to
14 borrow that money, CK Materials had to pledge its own
15 requirements, as well as the assets of the utility, to
16 secure that loan. So the assets of the utility were
17 part of the collateral provided by CK Materials to
18 Coastal States Bank. Because of the shortfall in
19 revenues when we lost 25 percent of our revenues,
20 starting from day one when CK Materials acquired the
21 utility, there came a point where CK Materials was not
22 fully paying Coastal States Bank. By the time we
23 refinanced, the utility owed Coastal States Bank
24 something on the magnitude of \$1,600,000. So the
25 financing for the term loan of \$2,750,000, approximately

1 \$1,600,000 was used to pay for CK Materials to release
2 the collateral that Coastal States Bank – because now
3 SunTrust wanted the collateral, and in order for
4 SunTrust to have the collateral, Coastal States Bank had
5 to be taken out of the picture.

6 There were also fees for attorneys from the last
7 rate case. As I indicated before, the rate case was
8 about \$370,000. We requested \$1,800,200. The
9 settlement agreement didn't give us the \$1,800,200, in
10 terms of cash flow. So we owed attorneys; we owed the
11 attorney who undertook the financing. Our legal fees
12 were about \$187,000 to get that financing, maybe more.
13 And then there were closing costs of some \$315,000. So
14 the money from – the proceeds from that financing were
15 used to pay legal fees, Coastal States Bank, and reserve
16 enough to establish the capital reserve of \$700,000 that
17 was required in the rate order. Coastal States – not
18 Coastal States. SunTrust actually set up a reserve of
19 \$750,000. They thought it was 750, which I didn't mind.
20 As long as I was going to get the money, I was ready to
21 do just about anything SunTrust wanted us to do, because
22 otherwise I wasn't going to be able to serve the
23 customers. It turned out that we spent even more than
24 the \$750,000. It turned out that the president of the
25 company and one of the owners – Terry Lee – has a

1 construction company. We still owe him. We still owe
2 him money for some of the capital improvements he made.
3 So this utility has been limping along, trying to make
4 the improvements. We made the improvements. We
5 satisfied DHEC. There's more improvements we need to
6 make. And that's why I want to refinance the \$3,250,000
7 with a new borrowing of \$3,750,000, because that's going
8 to get us on our feet. I want to get this utility to
9 the point where it's got enough cash flow to make more
10 improvements that are needed, and to pay off past
11 accounts payable, and have enough cash to pay for the
12 new principal-and-debt portion of the new loan. And if
13 I may, I'll take 30 seconds. The rate-setting process
14 gives us depreciation, which is a recovery of the cost
15 over the average life of the property. The loan is a
16 15-year term loan, and we have to be making principal
17 payments over 15 years, not even the average life of the
18 property. So the depreciation is not giving us enough
19 money to make the principal payments, so our cash flow
20 is stretched even worse because we have to make
21 principal payments on the loan that are greater than the
22 cash flow we're getting from depreciation. Just to give
23 you a sense of the magnitude, the stockholders are going
24 to have to pay me out of proceeds – not the customers –
25 by converting equity into debt. But at this stage of

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1 the game, the utility – we haven't charged – Guastella
2 has not charged the utility for over six months of
3 management fees not because I don't want to get paid for
4 the work I do but because the priority that I and the
5 owners have is to serve the customers.

6 Q So how much would you say you owe right now in accounts
7 payable?

8 A [GUATELLA] Probably \$600,000.

9 Q And is that up and above the 500 from last time?

10 A [GUATELLA] No, no, the \$500,000 was used for all those
11 purposes, plus additional capital improvements and some
12 payment towards attorneys, Terry Lee's construction
13 company, and some towards Guastella Associates. So the
14 previous financing covered some of the costs. We're now
15 back up to – I believe it's about \$600,000 that the
16 utility/owners owe Guastella & Associates.

17 By the way, it sounds like a lot of money. It's
18 not reflected in the rates. Rates are based on – we
19 went through those costs. As I indicated in my summary,
20 the management fee is competitive, and the cost of
21 operations, with other utilities. The capital fee is
22 half of what typical fees are for administrating and
23 supervising capital. I don't work for nothing,
24 basically, but I'm working for half of what I usually
25 work for, for this utility, and I'm willing to give up

1 getting paid on time to make sure the customers get
2 service.

3 The incentive fee is not being paid by the
4 customers, ever. Not current and not in the future.
5 The incentive fee is being paid only by the
6 stockholders, because it's being taken out of whatever
7 profit the utility makes in terms of equity return. So
8 the great – the profit of the company is net operating
9 income that you calculate by multiplying rate base times
10 rate of return. That gives you the net operating
11 income. That gives the utility the return on investment
12 necessary to serve the customers. Once you get that net
13 operating income in cash, you have to pay your debt
14 first. What's left goes to the stockholder in the form
15 of equity. My incentive fee tells the stockholders, if
16 I'm going to keep you surviving here – and it's been a
17 struggle – I want a percentage of what you would
18 otherwise take as a profit. So the stockholders are
19 going to be paying the incentive fee, not the customers.

20 Q What do you – what would be the cost of refinancing, the
21 cost to Daufuskie Island Utility, including all of the
22 separate fees?

23 A [GUASTELLA] Yeah, I can tell what the cost of the last
24 case was, and it was pretty high. But we take that cost
25 and we amortize it over a 15-year period.

1 Q So what was it last time?

2 A [GUASTELLA] Last time, it was about \$390,000, the cost
3 of undertaking the financing. We divided it by 15, to
4 come up with an amount – an annual amount over the life
5 of the term of the loan. And then we take that annual
6 amount and add it to the interest that we have to pay,
7 and we come up with an effective interest rate. The
8 nominal rate applies the 5.29 percent nominal rate to
9 the \$2,750,000, but you have to add, then, the
10 amortization of the cost of undertaking the financing,
11 and that increases the 5.29 percent in the last case to
12 6.19 percent.

13 I don't know what the interest rate is going to be
14 on the next loan. I'm expecting that the costs of
15 undertaking the financing are going to be considerably
16 less. I don't think – I'm not going to go through
17 another three years of costs in order to get financing.
18 We've already gone through identifying all of our
19 property, all the easements, and all the legal documents
20 of dissolving CK Materials, dissolving another
21 corporation that was part of CK Materials – JJ Payne
22 Utilities – dissolving all the operating agreements for
23 each of the owners, establishing guarantees from each of
24 the owners, putting up their assets for each of the
25 owners, in order to do – it was an awful amount of work

1 that I had to do, in putting together financing.

2 What I'm a little more worried about is, the bank
3 is looking at our operations now, and they are seeing us
4 with a shortfall in meeting their coverage requirements.
5 I'm hoping that they don't increase the interest rate
6 from 5.29 percent to something higher. So while I
7 expect the costs of undertaking the financing to be
8 lower, I'm expecting the interest rate to be higher. I
9 don't know what amount that's going to be. And I am,
10 therefore, estimating that the effective interest rate
11 for the financing is going to be the same as in the last
12 case.

13 And just as a point of information, in the last
14 rate case, we included an effective interest rate of 6.5
15 percent. I was able to get that, despite the \$390,000
16 worth of costs; the effective interest rate turned out
17 to be only 6.2 percent. So, for a small company, the 6½
18 looked reasonable. Despite the costs we had to go
19 through to get the financing, it turned out to be less.
20 It turned out to be 6.2 percent.

21 We struggle to get our financing and the cost of
22 our financing down as low as we can, and the effective
23 interest rate, if you look around the country for small
24 companies – and even some big companies – interest rates
25 are – this is a pretty competitive interest rate for a

1 small company. What's most important is, if we don't
2 pay them, we don't get financing. This is a little
3 company. I mean, banks are turning us down. We had to
4 really deal with SunTrust in order to get any financing
5 whatsoever.

6 Q Is the utility company in danger of being overleveraged
7 with too much debt?

8 A [GUASTELLA] No. No, because – well, if you kind people
9 accept ORS's adjustments, our rate base is going to be
10 wiped out, essentially. So then maybe we'll be
11 overleveraged, but that's not the problem. Being
12 overleveraged is not the problem. We are then not going
13 to get the rate of return that ORS told you in that
14 proposed settlement between those two parties. We're
15 not going to have any return on equity, and we're not
16 going to be able to make our debt service payments of
17 principal and interest. It would put us right into
18 bankruptcy. We need to have a real decision based on
19 our real costs.

20 So, \$3,750,000 is not overleveraged. That's – as a
21 matter of fact, the ORS cost-of-capital witness is
22 saying that we have too much equity, I believe. They're
23 saying we have 58 percent equity. Our proposed
24 financing is only 42 percent equity, and they're saying
25 we should have more debt and not equity. Debt. So

1 under the proposed financing, we'll have approximately
2 42 percent debt and 58 percent equity, which is a little
3 - it's on the higher range of the nine companies in the
4 proxy group, but it's within the range. There are some
5 that have 60 percent equity. Small companies need that
6 bigger amount of equity because of the cash flow that I
7 mentioned to you. So, I mean, it's a good question,
8 because we need to keep our equity a little bit higher
9 than typical - and it's not higher than typical of the
10 large utilities, but we have to keep it higher, not
11 lower. And that's what the premium incentive does;
12 we're not going to be overleveraged.

13 Q And you said, if you don't get the revenue you want,
14 you'll be forced into bankruptcy?

15 A [GUASTELLA] Well, I don't know if it's going to be
16 forced into bankruptcy. I don't know what the bank is
17 going to do, because I don't know if the bank wants to
18 take over a utility. But if we are violating our loan
19 agreement -

20 Q I'm talking about Daufuskie Island Utility.

21 A [GUASTELLA] Yeah, Daufuskie Island Utility. The bank -
22 I mean, the loan is to Daufuskie Island Utility, so
23 Daufuskie Island Utility has an obligation to SunTrust
24 Bank. And with our rate increase, we're going to be in
25 shape to continue to serve the customers and move along

1 without the danger that we are in now, with -

2 Q With the rate increase you're asking?

3 A [GUASTELLA] - with the rate increase we're asking for.

4 But the rate increase of the proposed settlement, that

5 \$462,000, we're not going to be able to make debt

6 service payments, stockholders get no return on equity

7 at all. To me, it's a confiscation of property.

8 Q I wanted to go back to - I asked a question at the

9 public hearing, after, I think, two or three people

10 suggested they'd like to see progressive rates go into

11 practice. And I asked if there had been any meetings

12 with the company to talk about some of the issues, and

13 there was just a laugh that there had been attempts to

14 have meetings, with no response. And we kind of heard

15 that a couple of other times today, even, that people

16 have not had a response back. What is your line of

17 communication? Why are we hearing these issues that

18 there is no open line of communication?

19 A [GUASTELLA] Commissioner, as I indicated, we offered - I

20 offered to meet and put on a presentation to all three

21 homeowners' through the attorneys. After we did that

22 and we didn't hear from them, I -

23 Q Well, I know I read that in your testimony and I've

24 heard your testimony according to that. But this was in

25 reference to what was being implied, or as I understood

1 was being implied that there had been attempts in the
2 past to have meetings. And I just wondered, what is
3 your – are you open to meetings with your customers to
4 discuss issues? And –

5 A [GUASTELLA] We would discuss any issues with any
6 customer at any time, or their attorneys. We even
7 offered –

8 Q It's on the record, then.

9 A [GUASTELLA] Yes, yes.

10 Q All right.

11 A [GUASTELLA] And we even offered, during the course of
12 the examination of this rate case.

13 Q Well, I know you told –

14 A [GUASTELLA] We asked the attorneys, you know, "You
15 didn't respond to my report. How about meeting again?"
16 And they said no.

17 Q All right. Yeah, I know you – we've discussed that.
18 I'm not –

19 A [GUASTELLA] I'm open.

20 Q – talking about the rate case –

21 A [GUASTELLA] I would meet with the customers anytime,
22 anyplace. They just have to give us a call and set a
23 schedule.

24 Q And where do you keep the books and records of the
25 company?

1 A [GUASTELLA] The books and records of the company, right
2 now, with permission, are in our computers in Boston and
3 in Florida, and sometimes in New York when Mr. White is
4 in New York, and sometimes in Florida when he's in
5 Florida. We have our records on computer so they're
6 accessible to us. And when we first took over, we asked
7 permission if we could do that, because we did not have
8 an office in South Carolina.

9 Q And what processes do you have in place to make sure
10 that all of the company's expenses are paid and properly
11 recorded in the accounting books? Because we've heard
12 some instances of -

13 A [GUASTELLA] Well, we have a bookkeeper that keeps the
14 books. We have someone - someone called Mike Guastella,
15 who monitors the costs of the operations and the
16 operations, and then we have an accountant called Gary
17 White, who reviews all the books to make sure that the
18 accounting is proper.

19 Q And where are they based?

20 A [GUASTELLA] Mr. White is either in New York or in
21 Florida. I'm in Florida. Mike Guastella is in Florida.
22 And the accounting and billing is done out of our Boston
23 office.

24 Q So you think you have all the proper processes in place
25 to make sure that things are accounted for in a timely

1 manner?

2 A [GUASTELLA] Yes, we've got - with SunTrust - we used to
3 do business with Coastal States Bank, but once they got
4 paid out and we got the loan from SunTrust, we now have
5 an account with SunTrust that SunTrust - we
6 automatically deposit money from our offices into the
7 SunTrust account. So the whole billing and accounting
8 and payments are all automatic and done by computer,
9 essentially. And we also developed a website where the
10 customers could pay bills through the website, as well
11 as sending us checks or other methods of payment. So
12 we're all - we're all keeping pretty close track of
13 everything, and we pretty much have to because our cash
14 flow is a problem.

15 Q And are you open to different tariffs for, like, a
16 progressive rate system?

17 A [GUASTELLA] Yes, as long as it's generating our revenue
18 requirement, we're open to that. But, you know, a large
19 part of our customers and revenue is availability
20 customers, so there's really not much that could change
21 for that. We also are now proposing common rates for
22 both the Haig Point and the Melrose customers, because
23 basically our operations' cost of providing either ours
24 or Haig Point customers is about the same. We did a
25 little bit of an allocation internally to make sure

1 that, if we had common rates, they would all be common.

2 We now have a rate structure that has a step-up
3 rate for irrigation use, I believe, so that we're trying
4 to encourage water conservation. And the rates for
5 household use are fairly steady, so we don't need the
6 conservation rate. So we have an irrigation, for
7 customers who use more water and have a separate
8 irrigation meter. Those customers' in-house use is
9 being billed separately. So we've got rates in place
10 that are step-up for encouraging conservation, and if
11 people want to spend more water or more money to do more
12 irrigation outside, they're going to be paying a higher
13 rate than the customers who choose to conserve water.
14 So I think we have a pretty good rate structure, in
15 comparison to other utilities. And we have a fixed
16 service charge with no water allowance, so that the
17 customers who want to save can save for every gallon of
18 water that they buy. There's no minimum charge that
19 they're going to be charged for. So we have a pretty
20 common and good rate structure now.

21 Q Okay, thank you.

22 A [GUASTELLA] Thank you.

23 CHAIRMAN HALL: Commissioner Howard.

24 <

25 <

EXAMINATION**BY COMMISSIONER HOWARD:****Q** Good afternoon, Mr. Guastella.**A** [GUASTELLA] Good afternoon.**Q** Do you have – do you use the accrual method of accounting?**A** [GUASTELLA] Yes.**Q** Well, was any accrual entries made for the property tax in prior years?

A [GUASTELLA] No, because – and the – we didn't know about that level of property taxes, you know, the big amount that we got. Our property taxes were less than \$10,000 a year, and we were billed for a number of pieces of property. So we were accruing money for that. However, after the rate increase, which went into effect on August 15, 2012, as Ms. Walls indicated, we got a property tax bill for 2010, 2011, and 2012. I think it was something in the magnitude of \$500,000. It was half our revenue. And that's when I started the process of trying to negotiate that out. So we certainly were not accruing for that.

However, as we move forward, our property taxes for 2016 are not going to be known until November of 2016. They will not be due until January 15, 2017. So once these rates go into effect, which I'm assuming is going

1 to be somewhere around the beginning of this year, we
2 need to begin accruing taxes in order to pay the
3 property tax in 2016. Otherwise, we won't have the
4 money and we'll start to be getting, effectively, a 15
5 percent penalty. That's about \$30,000 or \$37,000, and
6 it's going to be repeating because, if we don't have the
7 money accruing during 2016, then in 2017, we're going to
8 have to start accruing again, so we'll always be paying
9 a penalty of some \$33-\$37,000. Beaufort County
10 Treasurer Maria Walls worked it out so that we could
11 survive as a utility. She understood the rate-setting
12 properties. Amazingly to me, because she grasped it
13 very quickly.

14 Q I probably know the answer to this question and what
15 you're going to say, but have you checked with the
16 Department of Revenue? Are you sure – have you got
17 confidence that they're figuring your tax base
18 correctly?

19 A [GUASTELLA] Yes, because I checked with how they're
20 doing it with Kiawah Island Utilities. So I wanted to
21 make sure that other water and sewer utilities are being
22 treated the same. I did not believe the tax bill when
23 we got those three bills. I mean, I just couldn't
24 believe it. We're getting tax bills – and this is since
25 1985, by the way. We've got tax bills for like \$10,000

1 a year; all of a sudden, we get these tax bills that are
2 going to be \$140,000 a year, increasing to \$170,000 a
3 year, back taxes of \$353,000. I simply did not believe
4 it; I thought there was a mistake someplace.

5 And so I worked very carefully to find out what was
6 going on. Maria Walls, she - God bless her - she
7 forgave 2010 and 2011. She had to make sure it was
8 legal to do that. But we negotiated - Tom Gressette and
9 I went up there, we met with them, we explained the
10 problem. She grasped the problem; she understood how it
11 would impact our customers. And she was the one who
12 suggested let's spread this out. She first wanted to
13 spread it out only over the period of years, like, three
14 years from the back taxes. And then I asked her, "Can
15 we get 10?" And she negotiated it to eight. And by
16 spreading those taxes over eight years, if the customers
17 paid them on a current basis, the present value cost to
18 the customers would've been about \$100,000 more than by
19 spreading them over eight years.

20 Q On a different subject, do you anticipate a growth
21 factor on Daufuskie? And there's been some decline in,
22 I think, residents. What do you see as the future of
23 Daufuskie Island?

24 A [GUASTELLA] Right now, we see a little growth, but it's
25 relatively small. We built some of that growth to

1 anticipate additional revenues, and we also assume some
2 of the growth to anticipate additional expenses. ORS
3 reversed those growth numbers. And they're small; it
4 wasn't a big concern to me. I don't see anything – and
5 you're better at predicting the economy than I am. I
6 don't know what's going to happen down the road. There
7 are some owners of large amounts of property on
8 Daufuskie Island that are interested in some
9 development, but I don't – I just don't know, with
10 today's economy, whether a developer is really going to
11 be successful in doing a big expansion, so I'm not
12 expecting any big expansion right now. I think if the
13 economy turns around – it's a beautiful island. I mean,
14 it's, you know, for people who like that kind of living
15 and could afford those kinds of properties, it will
16 happen again. But, unfortunately, we can only go six
17 months forward and known-and-measurable changes, so...

18 Q Thank you, very much.

19 A [GUASTELLA] Thank you, Commissioner.

20 CHAIRMAN HALL: Commissioner Whitfield.

21 VICE CHAIRMAN WHITFIELD: Thank you, Madam
22 Chairman.

23 EXAMINATION

24 BY VICE CHAIRMAN WHITFIELD:

25 Q Mr. Guastella, I've just got just a few questions for

1 you. I'm not going to go back into the management fee.
2 I think that's been covered. And I think the ownership
3 of Daufuskie Island Utility, you've explained that and
4 it's in the testimony, and also in your management
5 agreement, as well. And I think you explained your role
6 with the stockholders of Daufuskie Island Utility
7 Company. But at this point, you've stated several times
8 that the company owes you for management fees and other
9 fees. I guess, is it fair to say that you would
10 consider yourself a creditor of the company, at this
11 point? I mean, obviously, you're doing work for free.
12 You're extending them credit, right?

13 A [GUASTELLA] I am, but, if I may, it's a good credit to
14 have because I'm also aware that we - I made a
15 commitment to you and made a commitment to the owners
16 that we were going to make this a utility that can stand
17 on its own feet. I'm a creditor that's not going to put
18 the utility - well, first of all, it would be foolish of
19 me to enforce what they owe me, because they don't have
20 the money to pay me anyway, so I'm not that magnanimous,
21 but I'm going to find a way to convert equity into debt,
22 which is going to save the customers money in terms of
23 rate increase, but take some of the stockholder money,
24 conversion of equity into debt, rather than giving it to
25 them or spend it someplace else. So I'm basically going

1 to have -

2 Q You're not a hostile creditor.

3 A [GUASTELLA] No. And I don't charge - I'm not charging
4 interest on what they owe me. So it's - it's to do
5 what's in the best interest for our customers. That's
6 our goal.

7 Q Yes, sir. I've got one more question for you, going a
8 little bit down one of the lines Commissioner Howard
9 just did. You told him you accrue, in the past, certain
10 amounts for the taxes that were to be owed. And so,
11 obviously, in years past and now, you've prepared a
12 budget for Daufuskie Island Utility Company, correct?

13 A [GUASTELLA] Yes.

14 Q And you've, obviously, gone through your own methods of
15 determining budgeted amounts for each item, correct?

16 A [GUASTELLA] Yes.

17 Q I guess what I want to probe just a little bit more
18 into, and you partially answered it with Commissioner
19 Howard, to have that jump from \$10,000 in one year to -

20 A [GUASTELLA] \$191,000.

21 Q - the next year -

22 A [GUASTELLA] For 2016.

23 Q Right. And, of course, you stated several times that
24 the County Treasurer, Ms. Walls, has forgiven the two
25 years. Let me ask you: Certainly, I know you think the

1 – because you told Commissioner Howard you accrued
2 \$10,000. Is that figure going all the way back to when
3 it was Haig Point Utility, CK Materials, International
4 Paper? I mean, what – has that been consistent?
5 Because you stated all the way back to 1985. Has that
6 been a consistent amount that you think? And I know
7 we're talking about previous owners. But has that been
8 a consistent amount each and every year, maybe with a
9 slight increase, going back some years, or –

10 A [GUASTELLA] Yes.

11 Q – what kind of history has that had?

12 A [GUASTELLA] We – CK Materials acquired it and became
13 active July 9, 2008, and that's when I began managing
14 it. I think the annual property taxes were less than
15 \$6000. I mean, it was hardly a concern. It was low,
16 just a low number. And then it grew, and we anticipated
17 it was going to be about \$10,000, and then this tax bill
18 happened. See, they were not – they were not charging
19 what's called this utility tax for real property. They
20 were charging us for only the land that we owned. So we
21 were never getting that utility tax, and neither was
22 Melrose and neither was Haig Point Utility, going back
23 to 1985. I think – and I'm trying to recall my
24 discussions with a representative of Department of
25 Revenue – when we started looking at financing, among

1 some of the costs that we had to incur was to satisfy
2 that we were current with Department of Revenue and all
3 of the taxes that they had charged us. When they
4 started to look at that, the financing triggered them
5 looking at this as a utility, because we had to get
6 certified statements from them that we were current. So
7 it's - we - that seemed to have triggered their look at
8 Daufuskie Island Utility, but they didn't trigger it
9 until 2012, and then they went back to 2010 and 2011 and
10 2012.

11 Q Right.

12 A [WHITE] May I add something, just as a point of
13 clarification?

14 Q Go ahead.

15 A [WHITE] Thank you. The taxes charged the company prior
16 to the notice in 2013, '14, '12, were for real estate
17 taxes only, which is what Ms. Walls considered dirt.
18 They were paying taxes - we were paying taxes on the
19 dirt, only, so there was no personal property tax, and
20 that's what amounts to the \$100,000-plus.

21 Q The large - and I recall Ms. Walls testifying to that
22 this morning, that all that was on the books was the
23 dirt and a shed, or a building, a dwelling; in other
24 words, no personal property, no contents, no none of
25 that. So I get that. But is there not - I mean, Mr.

1 Guastella just said that – I think you checked on Kiawah
2 Island Utility when you were having an exchange with
3 Commissioner Howard. How did some of their assets,
4 utility assets, that the Department of Revenue would
5 assess, how did that compare? Can you share that with
6 us?

7 A [GUASTELLA] Yeah. They also were paying a large amount
8 of taxes, because, when you apply the Department of
9 Revenue formula and methodology, they took the annual
10 reports of Kiawah Island, took the cost less
11 depreciation and less contributions, and applied 10.5
12 percent, so that became the assessment. So I checked –
13 and you know Kiawah Island happens to be a client of
14 mine. So I called Becky Dennis at Kiawah Island and I
15 said, "Becky, we got this tax. Are you getting this
16 tax, too?" She says, "Yes, we are." Because I was
17 about to fight Beaufort County saying, "Nobody else gets
18 this tax. Why should we get it," but then we found out
19 that there is this utility tax. So we're – you know, we
20 have to pay this tax, apparently. It's the law.

21 Q Did she have an overnight surprise or did –

22 A [GUASTELLA] No, they have been paying the tax all along,
23 because I guess they were recognized as a utility all
24 along.

25 Q Right. And one other question, and this could go to

1 either one of you. It's come up repeatedly about the
2 tax notices going to the wrong address. Should not
3 somebody at Daufuskie Island Utility somewhere have
4 said, "Hey, why aren't we getting a tax bill? Why
5 aren't we..." - and I get the fact it's going to the
6 wrong address, but we all know we've got to pay taxes.
7 Should there - should there not - is there not some kind
8 of way someone could have called and said, "Where is our
9 tax bill?"

10 A [GUASTELLA] Well, the problem was, we were getting tax
11 bills. For each piece of property, we were getting tax
12 bills. So we were getting multiple tax bills for
13 multiple pieces of property, so, I mean, the last thing
14 I was doing was saying, "Gee, let's see where we can get
15 higher taxes."

16 Q Well -

17 A [GUASTELLA] You know, I didn't go - you know what I
18 mean? So I never - we did give them our new address,
19 where to send the taxes. And, indeed, they were sending
20 property taxes for multiple parcels to us.

21 Q Maybe I've got that slightly wrong. Maybe it was the
22 delinquent tax sale notice that went to the wrong place
23 and not the tax bills themselves.

24 A [GUASTELLA] The bills didn't get to us and the notice
25 didn't get to us either. We just did not know that this

1 was going on. And they're required to post the notice
2 at the property that's going to be up for tax sale,
3 which is our storage tank.

4 **Q** Right.

5 **A** [GUASTELLA] They posted the notice at the equestrian
6 piece of property, so we never even saw the notice. So
7 it was a series of events where whoever handled that
8 property for that tax – and, in fact, when I spoke with
9 Mr. Sabry, he says, "No, I didn't buy the land where the
10 storage tank is. I bought the property next to it."
11 Nobody knew that there was tax for this piece of
12 property.

13 **VICE CHAIRMAN WHITFIELD:** I think you stated
14 that, because you said your employee was on the
15 property every day and he would've seen the sign.
16 I think that has been stated. But, anyway, that's
17 all I have, Mr. Guastella, and that's all I have,
18 Madam Chairman.

19 **CHAIRMAN HALL:** All right, thank you.
20 Commissioner Hamilton.

21 **COMMISSIONER HAMILTON:** Thank you, Madam
22 Chairman.

23 **EXAMINATION**

24 **BY COMMISSIONER HAMILTON:**

25 **Q** Mr. White, I'm going to aim this question at you.

1 You've been quiet for some time. How long have you been
2 associated with Mr. Guastella?

3 A [WHITE] I think we decided today it was over 30 years.
4 Thirty-one years, I believe. It goes back to 1984.

5 Q I assumed that you'd had a long relationship. I just
6 wonder, have you heard him ever answer a question yes or
7 no?

8 [Laughter]

9 A [WHITE] I think once or twice.

10 Q Once or twice.

11 A [GUASTELLA] You really know how to hurt a guy.

12 A [WHITE] Very rarely.

13 Q Then I would have to agree with that.

14 A [GUASTELLA] Sorry, Commissioner.

15 Q Mr. Guastella, you aren't trying to get us to leave here
16 today feeling sorry for your stockholders, are you?

17 A [GUASTELLA] Yes.

18 [Laughter]

19 Q I kind of could see that sub-line as we moved through
20 the meeting this afternoon. But I do have one point
21 that I would like to ask you about, and you can answer
22 this one pretty fast I think. On page five of Mr.
23 Willie Morgan's prefiled testimony - if you have that? -
24 he said that in the Melrose service area that a
25 commodity charge of \$1.95 per 1000 gallons of usage was

1 charged, versus \$1.77 which the Commission had approved
2 in the last rate case. Has that been adjusted?

3 A [GUASTELLA] Yes.

4 Q Are they -

5 A [GUASTELLA] That was an error -

6 Q - refunding?

7 A [GUASTELLA] - on the part of the utility.

8 Q How did you handle it?

9 A [GUASTELLA] I think the total amount came out to be \$27,
10 some such amount of money.

11 Q You gave them a credit?

12 A [GUASTELLA] We're going to credit those customers.

13 Q Okay. I think this was one of the questions that came
14 up earlier.

15 A [GUASTELLA] Yes.

16 Q But I'm enjoyed your testimony, both of you.

17 A [GUASTELLA] Thank you.

18 COMMISSIONER HAMILTON: Thank you, Madam
19 Chair.

20 CHAIRMAN HALL: All right. Thank you.
21 Commissioner Randall.

22 COMMISSIONER RANDALL: Thank you, ma'am.

23 EXAMINATION

24 BY COMMISSIONER RANDALL:

25 Q Mr. Guastella, I just wanted to go back to your Report

1 on Capital Improvements. You discussed it pretty at
2 length earlier today and talked about working with DHEC
3 and that they've been satisfied with what you had done.
4 I wanted to just ask you a question or two about the
5 consent order from May 15th, and it's on page three, I
6 think, where you mentioned about the violations. It
7 says, "a number of deficiencies regarding the
8 maintenance of records, reports, operator's logbook, and
9 operations manual." That sort of generalizes - it's
10 right in the middle.

11 A [GUASTELLA] Yes.

12 Q I just wanted to see, what were the root causes of the
13 deficiencies that the consent order was about?

14 A [GUASTELLA] The primary cause was lack of money. But
15 then we also had increased our overview of the
16 operations and of the operators, as well, thanks to
17 somebody called Mike Guastella. And we began to really
18 attend DHEC's inspections, and they were very
19 understanding and they started to point out every single
20 thing you can possibly - like for example, they said,
21 "You don't have a bucket by one of the outflows," so we
22 had to go get - I mean, they got into the nitty-gritty.
23 And the records that our operators - and, you know,
24 these are local operators keeping records the way they
25 keep records. So some of that was just the record-

1 keeping itself. Because of the lagoon liner failure,
2 there was some – our employees made an error in not
3 keeping some records of the effluent. And then there
4 were a number of other things, having spare pumps at
5 every one of the lift stations, which we didn't have
6 money to do. A number of those kinds of items.

7 Once Mike Guastella met with the DHEC people, we
8 put together a corrective action plan, and we reported
9 to DHEC every single Friday on what our progress is
10 going to be. And then we sent in a corrective action
11 plan, which amazed me that they e-mailed us, I think
12 within an hour or two, that they accepted the plan, and
13 they followed it up with a letter the next day. They
14 really – and they were very helpful. I mean, these
15 people know how to really get into every single – you
16 know, dot every i, cross every t, in terms of our
17 operation. So they really helped us, as managers; they
18 helped our operators. And we are now clicking along, in
19 compliance with everything. And they appreciate our – I
20 think I attached some of the e-mails that they were –

21 **Q** So everything is in compliance.

22 **A** [GUASTELLA] Everything is in compliance. And by the
23 way, they never – you know, they never issued – they
24 were going to fine us \$11,000, and we had interchanges
25 with them. They did not do that, because they saw how

1 we reacted and complied with everything that they
2 wanted.

3 Q Is this the only consent order that you're under right
4 now?

5 A [GUASTELLA] Right now, we're not under any consent
6 order.

7 Q Not under any.

8 A [GUASTELLA] Right.

9 COMMISSIONER RANDALL: That's all I have.
10 Thank you.

11 CHAIRMAN HALL: Commissioner Elam.

12 EXAMINATION

13 BY COMMISSIONER ELAM:

14 Q Good afternoon.

15 A [GUASTELLA] Good afternoon.

16 Q Mr. Guastella, on page four of your Report on Capital
17 Improvements, there's a table there -

18 A [GUASTELLA] Yes.

19 Q - capital expenditures by account?

20 A [GUASTELLA] Yes.

21 Q The table contains a \$92,548 line for "Reclaimed Water
22 Pumping Equipment," and there's also a line a few lines
23 down - three lines from that, "Reclaimed Water T&D
24 Equipment." Can you explain to me what reclaimed water
25 is, and why that's a necessary expense?

1 A [GUASTELLA] I think that's at our Haig Point wastewater
2 treatment plant, where our – and I think I provided a
3 picture that went along with this. At the Haig Point
4 wastewater treatment plant, we had to redo the entire
5 pumping system that took the treated effluent and pumped
6 it to the golf course.

7 Q Oh, so they're using that as – what do they call it,
8 gray water, or –

9 A [GUASTELLA] Yes. You know, the treated effluent that's
10 being disposed of at the golf course, and we had to redo
11 that entire – and I think we had to also do one at the
12 Melrose wastewater treatment plant, as well.

13 Q The report also shows a line for \$14,244 – I'm sorry,
14 just a second. Yeah, the first thing under the "Water
15 System Plant Projects," for "Land & Land Rights-source."
16 Do you see that?

17 A [GUASTELLA] Yes.

18 Q Okay. What's included in that amount?

19 A [GUASTELLA] I don't know, off the top of my head.

20 A [WHITE] Let me see [indicating].

21 Q I won't ask you to guess.

22 A [WHITE] I think that was some of the legal fees
23 associated with the condemnation of the – no, it
24 wouldn't be, because that's on the wastewater side,
25 isn't it?

1 A [GUAATELLA] No, that's -

2 A [WHITE] Is that water?

3 A [GUAATELLA] That's water.

4 A [WHITE] I think that's what it is.

5 Q Legal fees?

6 A [WHITE] Condemnation of the storage site and the well,
7 and I think those were legal fees associated with that
8 condemnation action.

9 Q And you capitalized those.

10 A [WHITE] We capitalized it as part of the land costs.

11 Q All right. Why should customers bear that expense, the
12 condemnation?

13 A [GUAATELLA] The taking of land was beyond our control,
14 for one thing, and we just went through the notices.
15 But from the other perspective of it, SunTrust Bank
16 required that we own the land. If it were up to me, we
17 have that perpetual easement; I would let Mr. Sabry keep
18 the land and keep paying taxes on it, because I don't
19 need to own the land. I can operate those facilities;
20 we paid for the facilities, I can replace those
21 facilities. We've got that perpetual easement that goes
22 back to 1985. But if a bank tells me, in order to give
23 me money, I have to - and by the way, instead of doing -
24 it's amazing that they trusted me, because they know I
25 also happen to be an appraiser and I've testified in

1 condemnation proceedings, that that condemnation was
2 going to be successful. So it's one of those things
3 where, in order to obtain financing, we had to continue
4 with this condemnation proceeding.

5 Q You told the bank that there was a less-expensive method
6 you had for securing the use of that property and they
7 told you you had to try to condemn it?

8 A [GUASTELLA] I told them that we didn't have to spend any
9 money to use our facilities. We had the easement
10 agreement for it. And they recognized that, but once a
11 bank puts a provision or a condition for a loan, they
12 just don't go back. They said, "No, we would rather you
13 take the property," so we're going to take the property.

14 Q And that was without any other explanation?

15 A [GUASTELLA] That's right, pretty much. And, you know,
16 at that stage of the game, we needed that money, so if I
17 had to condemn the property, we're going to have to
18 condemn the property. And, you know, when I say "I," I
19 mean the utility.

20 Q Right. The third line, a couple of lines below that, it
21 says, "Extraordinary Expense," 37,945. Do you see that?

22 A [GUASTELLA] Yes.

23 Q What's included in that?

24 A [GUASTELLA] You know, we probably could pull up that
25 information on our computer, but I just don't have it in

1 the top of my head.

2 Do you remember what the \$37,000 was?

3 A [WHITE] Let me see it [indicating].

4 A [GUASTELLA] I can give you a late-filed exhibit on it,
5 if you want.

6 Q It's been my experience that things considered as an
7 extraordinary expense is not considered part of the
8 normal test year. Isn't that your understanding?

9 A [WHITE] I do know what it is. It's a tank painting,
10 \$37,000 for painting a tank.

11 Q Then why is that extraordinary?

12 A [GUASTELLA] Let me answer. Because we do not recover
13 the cost of tank painting in one year. We have to
14 amortize it over a period of years.

15 Q Well, I understand that. I just don't understand why
16 it's labeled - tank painting is a normal expense.

17 A [GUASTELLA] But - it's better language, I agree with
18 you, it should have been nonrecurring expense for tank
19 painting.

20 Q All right.

21 A So we have it included in the account so that it's
22 amortized over a ten-year period, rather than for
23 recovery all at once.

24 Q Okay. And it's been your experience that you repaint
25 tanks every 10 years?

1 A [GUAATELLA] I don't know if - it's probably going to be
2 a little longer now. It used to be every 10 years. I
3 think now it's probably going to be longer than 10
4 years, maybe 15.

5 How much did we amortize it for? May I ask that?

6 MR. BUTLER: I don't think you're supposed to
7 ask.

8 WITNESS GUAATELLA: I'm just trying -

9 WITNESS WHITE: I'm just not sure. I think we
10 used -

11 CHAIRMAN HALL: Y'all are really not supposed
12 to be conferring with each other.

13 WITNESS GUAATELLA: I believe it's 10 years,
14 but I'll correct myself. And if you say it could
15 be longer, then maybe it could be longer. But it's
16 on an island that's exposed. All of our tanks are
17 exposed. So it may very well be, when you're that
18 close to the ocean, that it's going to be 10 years.

19 BY COMMISSIONER ELAM:

20 Q Well, you've consulted for hundreds of utilities.

21 A [GUAATELLA] I have.

22 Q I'm just asking what your experience is for tank
23 painting.

24 A [GUAATELLA] For all of those that are inland, the 10
25 years has since become about 12 to 15 years. For those

1 in Florida, the 10 years looks pretty good for those
2 that are near the ocean. And I'm doing this a little
3 bit from memory, you know. I don't keep everything in
4 my head here.

5 Q All right. Why - on that same sheet, why is unamortized
6 debt expense of about \$5200 being included as a capital
7 expenditure?

8 A [GUASTELLA] Because there's something called AFUDC,
9 allowance for funds used during construction, so because
10 we were spending money before these things were going
11 into rate base, we probably capitalized some allowance
12 for funds used during construction. It's part of the
13 Uniform System of Accounts.

14 Q Let me change gears just a little bit. Why doesn't the
15 company have any accumulated deferred income taxes on
16 its balance sheet?

17 A [GUASTELLA] For most of the years, we were using book
18 depreciation, not accelerated depreciation. In the last
19 couple of years, we began to use the accelerated
20 depreciation to keep our taxes - so we probably should
21 have some amount, but it would be a small amount because
22 the difference between the book and accelerated
23 depreciation is then a deduction for tax purposes, so
24 you multiply - as you probably know - the tax rate times
25 that. So we probably should have, for the past year or

1 two, some deferred tax credit on the balance sheet.

2 Q Does the company have a basis in its utility plant, for
3 income tax purposes?

4 A [GUASTELLA] Yes.

5 Q What is that?

6 A [GUASTELLA] It's the cost of the plant that we have. We
7 have book.

8 Q Okay. You were discussing, with Commissioner Whitfield,
9 about, essentially, a loan between your - Guastella and
10 the company, I believe. And ORS Witness Carlisle, at
11 page five of his testimony - can you take a look at
12 that, please?

13 A [GUASTELLA] If I may, Guastella Associates doesn't have
14 any loan with -

15 Q All right. Well, the amount owed. I'm looking at Mr.
16 Carlisle's testimony -

17 A [GUASTELLA] Yes.

18 Q - and its financing fees that the company owes to
19 Guastella Associates, correct?

20 A [GUASTELLA] That number is not correct. That number,
21 \$372,000, is the total fees. Of that, I think \$180,000,
22 or so, is legal fees, and \$150,000 is Guastella fees.
23 So Dr. Carlisle's figure is not correct.

24 Q And did I hear, earlier, you say that there's no
25 interest on that?

1 A [GUASTELLA] The legal fees have been paid. Guastella
2 Associates' fees, I think, are still due to Guastella,
3 but I don't add interest to any fees that I've not been
4 paid. I've charged the utility, and if they don't pay
5 it on a current basis - if the utility doesn't pay
6 Guastella on a current basis, I don't add any interest
7 to those.

8 Q Okay. You said the legal fees were paid.

9 A [GUASTELLA] Yes.

10 Q Was there any interest being charged on that?

11 A [GUASTELLA] No, because they were paid out of the
12 proceeds of the SunTrust borrowing.

13 Q And what's the time period over which these finance
14 charges are being incurred?

15 A [GUASTELLA] Fifteen years is the term of the \$2,750,000
16 term loan.

17 COMMISSIONER ELAM: Thank you. I have nothing
18 further.

19 CHAIRMAN HALL: Okay. We're going to take a
20 break, 15 minutes, and then we'll start back at
21 4:45.

22 [WHEREUPON, a recess was taken from 4:30
23 to 4:45 p.m.]

24 CHAIRMAN HALL: Thank you. Be seated.

25 Mr. White and Mr. Guastella, y'all ready?

1 MR. GRESSETTE: Oh, I'm sorry.

2 CHAIRMAN HALL: Yeah, we weren't quite
3 releasing you just yet.

4 Okay. Commissioner Howard.

5 EXAMINATION

6 BY COMMISSIONER HOWARD:

7 Q Mr. White.

8 A [WHITE] Yes.

9 Q Your Schedule, I guess it's WD-2 and SD-2, plant-in-
10 service —

11 A [WHITE] Yes.

12 Q — you start off both of them on a balance as of December
13 31, 2014. And I'll tell you where I'm going. I'm
14 concerned about or curious about what was plant-in-
15 service before 2014. How did you arrive at these
16 figures? Have you got any documentation to show me how
17 you arrived at these balances? And one motivating part
18 of the question is — correct me if I'm wrong — I was
19 under the impression that when they took it over from
20 International Paper, International Paper had depreciated
21 all the equipment in the plant and basically conveyed it
22 free of charge, and so I'm questioning \$8 million in
23 plant-in-service when plants were given free of charge.
24 That's where I'm coming from

25 MR. GRESSETTE: [Indicating].

1 A [WHITE] [Indicating.]

2 Well, in 2008, I examined the books and records of
3 International Paper. There were plant-in-service
4 figures on there. There weren't zeroes under those
5 categories of plant. There were original cost numbers
6 in the books and records of International Paper. So I
7 brought those values over to the Daufuskie Island books
8 and records when the ownership changed and when the
9 company ownership changed.

10 Q Even though you paid nothing for it.

11 A [WHITE] I don't know what Daufuskie Island paid for
12 them.

13 A [GUASTELLA] May I?

14 Q Yeah, please.

15 A [GUASTELLA] Daufuskie Island bought the stock of – not
16 Daufuskie Island. CK Materials bought the stock of Haig
17 Point Utility Company from International Paper. The
18 application to the Commission for approval of that
19 transfer included the list of the costs of plant as part
20 of the schedule within that application to the
21 Commission. And it's those dollars that we found on the
22 books and records, so it was not – there was no
23 contribution by CK Materials or, from what I know,
24 International Paper, either, because the cost of the
25 plant was from International Paper and it was Haig

1 Point, Inc., which is the developer of International
2 Paper, at some point in time, transferred all the assets
3 and the costs of those assets over to the utility and
4 set up on the books and records of the utility a paid-
5 in-capital level, so it was not contributed, it was a
6 funding by the developer of the cost of the plant so
7 that the liability on the liability side is reflected to
8 match the cost of the assets that were booked.

9 So what CK Materials paid was a payment for the
10 stock. And then there were other costs, as well. I
11 mean, they not only paid for the stock but they incurred
12 other costs. So there is no acquisition adjustment.

13 Q I understand what you're saying, but, I guess, still I'm
14 just sort of confused on that.

15 CHAIRMAN HALL: Your mic, Commissioner Howard.

16 COMMISSIONER HOWARD: Pardon?

17 CHAIRMAN HALL: Your mic.

18 COMMISSIONER HOWARD: Oh [indicating].

19 BY COMMISSIONER HOWARD:

20 Q Wastewater treatment plant is a physical thing. I mean,
21 it's physical plant and obviously a plant-in-service
22 type item.

23 A [GUASTELLA] Yes.

24 Q What was there transferred, as for example? In other
25 words, if it's \$8 million for both the water and the

1 sewer plant-in-service, how much of it did y'all add to
2 – what value did you add to that \$8 million from what
3 you received from International Paper or CK Materials?

4 **A** [GUASTELLA] CK Materials bought the stock. Once they
5 bought the stock, they bought Haig Point Utility
6 Company's ownership of the assets. So CK Materials only
7 bought the stock, and Haig Point Utility Company still
8 had the assets on its books, along with the liabilities
9 as a source of funding for those assets by the
10 developer. There wasn't a separate –

11 **Q** So they just transferred all their plant-in-service.

12 **A** [GUASTELLA] That's right.

13 **COMMISSIONER HOWARD:** Okay. Thank you, very
14 much.

15 **CHAIRMAN HALL:** Commissioners, any other
16 questions?

17 [No response]

18 Okay. I just have a few.

19 **EXAMINATION**

20 **BY CHAIRMAN HALL:**

21 **Q** Mr. Guastella, Mr. Morgan – ORS Witness Mr. Morgan – on
22 page eight of his direct testimony, he indicates that
23 the DHEC operating permits need to be updated to reflect
24 DIUC as the owner of its water and wastewater systems.
25 Has this been done?

1 A [GUASTELLA] We've — yes, we've applied — we've contacted
2 DHEC and told them to change the names.

3 Q Updated it?

4 A [GUASTELLA] And they are in the process of doing that.
5 It may already have been done, but we contacted them and
6 they said, "If it's not done, it's just taking us longer
7 to do it," but that's going to happen.

8 Q Okay. Now, let me ask you about the easement, now that
9 we have a complete Exhibit 2 and since you brought up
10 Mr. Delaney's sewage plant. The easement — I'm looking
11 on Exhibit 2, page 10, "Certain Easements." I read this
12 to mean only, generally, pipes and conduits. What land
13 is Mr. Delaney's property on?

14 A [GUASTELLA] Mr. Delaney bought what is called the
15 Eigelberger tract that consisted of a large number of
16 acres, of which I believe —

17 Q Two hundred acres, I think he said?

18 A [GUASTELLA] I believe that's correct. And I believe
19 five or six of those acres is where our Bloody Point
20 wastewater treatment plant is located.

21 Q Okay, but this easement seems to be only for Haig Point.

22 A [GUASTELLA] We have a — yeah, this is only for Haig
23 Point. There's another perpetual easement —

24 Q And I just don't have that document?

25 A [GUASTELLA] Exhibit 3? Exhibit 3, which — I don't have

1 it marked as a number, but after – DIUC_JFG_154 starts
2 Exhibit 3.

3 Q Okay. And that easement is in there?

4 A [GUASTELLA] It's the Indentured Grant of Easement and
5 Bill of Sale for All Personal Property. That was
6 transferred from the developer to Melrose Utility
7 Company and we then are the successor to Melrose Utility
8 – Daufuskie Island Utility Company is the successor to
9 Melrose Utility.

10 Q Okay. But his property is on Bloody Point. Bloody
11 Point was a later component of Melrose? Was it divided
12 or –

13 A [GUASTELLA] There were – this is between Bloody Point
14 Group, so if you read the easement, it's a bill of sale
15 for personal property.

16 Q Where's the –

17 A [GUASTELLA] It's the Bloody Point Group Limited
18 Partnership to Melrose Utility Company, so Melrose
19 Utility Company –

20 Q I'm sorry, what page is that easement on?

21 A [GUASTELLA] Right on the first page of Exhibit 3. It
22 identifies who this agreement is between.

23 Q Okay. But I don't understand the easement. I mean, I
24 would think it would be specifically delineated.

25 [Brief pause]

1 So but what he was testifying about was a plant.

2 Is that correct?

3 **A** [GUASTELLA] No, he's saying he bought the land.

4 **Q** Yeah, I understand that. But I'm saying, the equipment
5 that he's talking about is a plant, is it not?

6 **A** [GUASTELLA] Personal property –

7 **Q** This seems to indicate a sewage – still, just like the
8 other one I was talking about, it seems to be only pipes
9 and conduits and mains.

10 **A** [GUASTELLA] Turn to page two of Exhibit 3 under
11 "Infrastructure," and about five lines down, "Said
12 conveyance shall include two potable water wells and an
13 80,000-gallon-per-day wastewater treatment facility..."
14 That's the treatment facility that Mr. Delaney is
15 referring to.

16 **Q** Okay, but that's not listed under the easement, so I'm
17 not sure how that could be imputed to Mr. Delaney and
18 his property. Okay. All right, that's fine.

19 And then one last question about the condemnation
20 fees. You said you included that in the – tell me again
21 how you – the legal fees associated with the
22 condemnation, you included that in –

23 **A** [GUASTELLA] Land.

24 **Q** The cost of that land?

25 **A** [GUASTELLA] Yes.

1 Q Okay, because you considered that the original mix-up
2 was out of your control?

3 A [GUASTELLA] That's correct.

4 CHAIRMAN HALL: Okay. All right. Mr.
5 Gressette, any redirect?

6 MR. GRESSETTE: No. Thank you.

7 CHAIRMAN HALL: Okay. Thank you, Mr. White
8 and — oh, I'm sorry.

9 MR. PRINGLE: Well, I was going to wonder
10 whether the Commission would give me the indulgence
11 to do limited cross, based upon questions from the
12 Commissioners and the issues, based upon those
13 solely and limited to that?

14 CHAIRMAN HALL: Go ahead.

15 MR. PRINGLE: Okay.

16 RECROSS EXAMINATION

17 BY MR. PRINGLE:

18 Q Here we go again. Mr. Guastella, in a conversation that
19 you had with Commissioner Fleming, you mentioned the
20 incentive fee that allows you to receive some amount of
21 the total operating — total net utility operating
22 income, correct?

23 A [GUASTELLA] The incentive fee is based on a percentage
24 of the net operating income.

25 Q Right.

1 A [GUASTELLA] But the payment would come out of the net
2 income or equity of the stockholders.

3 Q Okay. But that incentive fee is equal to 20 percent of
4 the total net utility operating income of the utility.

5 A [GUASTELLA] Yeah.

6 MR. PRINGLE: Okay. All right. Madam Chair,
7 while I'm thinking about it, I'd like to – now that
8 everybody's got copies of it – I'd ask that the
9 management agreement be marked and entered as a
10 hearing exhibit.

11 CHAIRMAN HALL: All right. Hearing Exhibit
12 No. 9 will be the management agreement.

13 [WHEREUPON, Exhibit No. 9 was marked and
14 received in evidence.]

15 BY MR. PRINGLE:

16 Q This is very Vegas, this pose with the microphone. Let
17 me ask you very quickly about – you also had a mention,
18 perhaps in the same discussion with Commissioner
19 Fleming, that some of the loan proceeds from the loan
20 that we've been discussing went to pay \$1.6 million
21 attributed to CK? Is that correct??

22 A [GUASTELLA] It paid the principal balance on the loan
23 that CK Materials had with Coastal States Bank.

24 Q And, indeed, the payment of that loan didn't have any
25 benefit to ratepayers, at all, given that it was CK's

1 wrongly pledged assets that caused that debt to occur,
2 isn't that true?

3 A [GUASTELLA] No.

4 Q Okay. You've not given any testimony about how paying
5 \$1.6 million back, in connection with that debt,
6 benefited ratepayers.

7 A [GUASTELLA] Well, nobody asked me the question. If
8 you're asking that question now, I'll tell you.

9 Q I'm not.

10 A [GUASTELLA] Okay.

11 MR. PRINGLE: Thanks. That's all I have.

12 CHAIRMAN HALL: Okay.

13 MR. GRESSETTE: May I, briefly?

14 CHAIRMAN HALL: Mr. Gressette.

15 REDIRECT EXAMINATION

16 BY MR. GRESSETTE:

17 Q Just one question for you, Mr. Guastella. Could you
18 explain for the Commissioners the benefits to the
19 ratepayers of the \$1.6 million payment referenced by Mr.
20 Pringle?

21 A [GUASTELLA] Yes. The loan from SunTrust Bank converted
22 equity into debt; therefore, the rate of return was
23 reduced and the income taxes were reduced for rate-
24 setting purposes. So the customers benefited by having
25 a lower rate of return than it would otherwise have,

1 because the stockholders were willing to give up a 10.5
2 percent or 10 percent return on their equity in exchange
3 for 6.2 percent return on the interest on the debt. The
4 customers benefit because we then were able to use some
5 of that money to pay for plant and the rest of the money
6 to keep the utility from, in a sense, being part of a
7 default action that the Coastal States Bank had with CK
8 Materials as utility assets.

9 The interesting part of this discussion is none of
10 that goes into the rate-setting formula. Rates must be
11 set on the operating expenses of the utility and also
12 the cost of the facilities used and useful in providing
13 service to the customers. So the use of proceeds for
14 borrowed funds that were used does not impact any of
15 those numbers or any of those costs or the revenue
16 requirement that is calculated in accordance with rate-
17 setting practice and principles. So this is all
18 irrelevant to the numbers that you have before you, for
19 you to make a rate decision.

20 **CHAIRMAN HALL:** Okay. All right. Thank you,
21 Mr. Guastella and thank you, Mr. White.

22 **WITNESS GUASTELLA:** Thank you.

23 [WHEREUPON, the witnesses stood aside.]

24 **CHAIRMAN HALL:** Mr. Gressette, is that your –
25 oh, I'm sorry. Go ahead.

1 **MR. WALKER:** Sorry, Madam Chairman. I was
2 going to – I've been sitting down, but I've been
3 tasked with one final thing in our case.

4 **CHAIRMAN HALL:** Go ahead.

5 **MR. WALKER:** And that is, at this time, we're
6 moving for the introduction of the responses –

7 **CHAIRMAN HALL:** Okay. Can you go to the mic?
8 I'm sorry.

9 **MR. WALKER:** I'm sorry [indicating]. At this
10 time, the Applicant would move for the introduction
11 into evidence of the Responses to Interrogatories
12 and Request for Production of ORS as a hearing
13 exhibit, and also the Intervenor's Responses to the
14 Applicant's Second Set of Interrogatories and
15 Request for Production as a hearing exhibit. We
16 have copies to circulate. I'm not sure whether
17 they are of record with the Commission, or not.

18 **CHAIRMAN HALL:** Mr. Pringle?

19 **MR. PRINGLE:** I think this is the first time
20 I've ever heard of this happening.

21 **CHAIRMAN HALL:** Mr. Pringle, I'm sorry. Will
22 you go to a mic, too, please?

23 **MR. PRINGLE:** Oh, sorry. Yeah [indicating].
24 This is something I'm thinking about for the first
25 time. I mean, obviously, both the ORS and my

1 clients are going to have witnesses who testify, I
2 guess, about whom some of this discovery or to whom
3 this discovery relates. But I'm not sure of any
4 basis for considering it a hearing exhibit, unless
5 it is, you know, unless it's sponsored by
6 witnesses, unless it's the testimony of witnesses
7 or an exhibit, or is - I mean, that's not to say
8 that it couldn't be referred to in the cross-
9 examination of my witnesses or the ORS's witnesses.
10 I mean, they are documents and information. But
11 I'm not - and, again, for that, I'm not so sure,
12 you know, what the utility of them is, beyond being
13 used and the witnesses asked about them, but -

14 **CHAIRMAN HALL:** Okay. I think we have copies
15 of the answers - of the questions and the answers,
16 but they are not on DMS, so they are not public.
17 So by entering them into the evidence, they will
18 then be public. So I don't know - yeah, what is
19 the purpose, Mr. Walker? Because you will be able
20 to cross-examine them on them, and we don't
21 necessarily need to have copies.

22 **MR. WALKER:** The purpose is that they are
23 binding on the party, and there are a number of
24 things that are covered there that we won't have to
25 cover in our cross-examination because they are

1 covered in the responses, and we think it would
2 actually shorten our cross-examination because the
3 questions that we asked were very specific about
4 particular witnesses and what they did to prepare
5 for their testimony, and we would like to have that
6 in the record. And that was the reason we were
7 tendering it, in order to compress things a bit,
8 and because they were an admission. We understand
9 it's within the Chair's discretion, but that was
10 the reason.

11 MR. PRINGLE: I guess – I mean, I still would
12 – you know, still would have that continuing
13 objection based upon the fact that it's not clear
14 that it needs to be – it needs to be record
15 evidence, unless it comes out in the course of
16 actually examining the witnesses. I mean, they are
17 what they are, and it's not like there's something
18 that's particularly objectionable about them. So,
19 but my objection is more just about the unknown
20 than necessarily saying there is no basis in
21 Western jurisprudence for it. But that having been
22 said, they are what they are.

23 CHAIRMAN HALL: Okay. Ms. Hudson? I mean,
24 they're your interrogatories, too, so –

25 MS. HUDSON: They are our responses. We

1 worked with the Applicant to provide them earlier.
2 We provided them Friday. They were not provided to
3 the Commission. They were sent directly to the
4 Applicant. Otherwise, they would have been
5 delivered to the Applicant yesterday.

6 I agree with Mr. Pringle. You know,
7 generally, you would be asking the witness and the
8 answers would be elicited in that method.
9 Although, I see some benefit to some shortened
10 cross.

11 CHAIRMAN HALL: All right. Well, we'll allow
12 it, then. They will be Hearing Exhibit No. 10,
13 will be the Interrogatories and their Answers.
14 Give you something new to deal with, Mr. Pringle.

15 [WHEREUPON, Exhibit No. 10 was marked and
16 received in evidence.]

17 MR. WALKER: The Applicant has nothing further
18 in its case.

19 CHAIRMAN HALL: Okay. All right. So that is
20 the Applicant's case-in-chief.

21 Okay. Mr. Pringle?

22 MR. PRINGLE: Okay. The first panel for the
23 POAs – and we're going to do it a little bit out of
24 order than what may be on the hearing sheet – is to
25 have Mr. Vogel, Mr. Egly, and Mr. Simonelli, if

1 they could come along.

2 **CHAIRMAN HALL:** Okay. Come forward,
3 gentlemen.

4 [Witnesses affirmed]

5 THEREUPON came,

6 P A U L V O G E L ,

7 D O U G E G L Y ,

8 T O N Y S I M O N E L L I ,

9 called as witnesses on behalf of Intervenor Haig Point Club
10 & Community Association, Bloody Point Property Owners'
11 Association, and Melrose Property Owners Association, who,
12 having been first duly affirmed, were examined and testified
13 as follows:

14 **CHAIRMAN HALL:** All right. Mr. Pringle, will
15 each of your witnesses be testifying for a
16 particular property owners' association, or –

17 **MR. PRINGLE:** I think – not exactly, no, just
18 essentially on behalf of the group.

19 **CHAIRMAN HALL:** Okay.

20 **MR. PRINGLE:** And I think Mr. Walker is
21 standing up. I don't know –

22 **CHAIRMAN HALL:** Oh, I'm sorry, Mr. Walker.

23 **MR. WALKER:** No, I'm fine. We have a motion
24 as to these witnesses and the other witnesses being
25 offered by the associations.

1 CHAIRMAN HALL: Okay.

2 MR. WALKER: Our motion is that, based on
3 Hearing Exhibit No. 3, which is the settlement
4 agreement that the Commission has allowed into the
5 record, under Provision 2, it says the parties
6 agree – well, Provision 1 was they stipulated to
7 the prefiled testimony of each other. And then
8 Stipulation 2 of the settlement agreement is: "By
9 and between the parties, the parties agree that no
10 other evidence will be offered in the proceeding by
11 the parties other than the stipulated testimony and
12 exhibits and this settlement agreement, unless the
13 additional evidence is in support of the settlement
14 agreement or to respond to Commission questions."
15 So they have limited themselves to their prefiled
16 testimony. I'd also point out that in Article 5,
17 "The Parties agree to accept all adjustments and
18 recommendations in ORS's testimony and exhibits, as
19 modified by this settlement agreement and its
20 exhibits." So they have agreed – "they" being the
21 associations – have agreed to all of ORS's
22 adjustments; except for bad debt, which they have
23 agreed they will go back to what the company
24 proposed. And here, we are saying they can't have
25 it both ways. They can't say, "We're only going to

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1 offer stipulated testimony," and then come in and
2 put up witnesses. And there's no reason to take
3 their expert testimony, which is the next panel,
4 because they've agreed to ORS's adjustments. And
5 under Rule 103-846(A), irrelevant and immaterial
6 testimony should not be received, and it would be
7 confusing. Why are their experts going to testify
8 to adjustments if, in fact, they've agreed to all
9 of ORS's adjustments? It's late in the day.
10 They've agreed to it. It's either binding or it's
11 not binding, and they took the path of, "We've got
12 this agreement. We're just going to put in
13 stipulated – the prefiled testimony, and we're
14 going to agree to ORS's adjustments."

15 So we would move there be no testimony other
16 than prefiled testimony, and that even the prefiled
17 testimony of the experts be rejected because
18 there's no need for it. It's no longer relevant,
19 since they've agreed to all the adjustments of ORS,
20 except for the bad-debt adjustment.

21 MR. PRINGLE: The settlement is only between
22 the ORS and the three Intervenor. Obviously, Mr.
23 Walker's client can't have it both ways by not
24 being part of the settlement and then trying to
25 enforce it. And, further, there's nothing

1 inconsistent or having it both ways about offering
2 the testimony that has been prefiled and of all of
3 these witnesses. The settlement is not something
4 that the Commission is deciding an up-or-down on
5 right now, at all, and we've not asked that you do
6 that, because if we would have done that, we
7 would've asked to have been excluding what's going
8 on with the Applicant, and we're not taking that
9 approach, at all. So there's nothing inconsistent
10 and certainly nothing irrelevant about it,
11 especially because – and Ms. Hudson will tell you
12 this – the ORS's – even the testimony in the
13 settlement is largely what's involved in the ORS
14 testimony, and the amounts and whatever we did with
15 ORS is not binding in terms of what we are doing
16 with the Applicant.

17 We are still presenting a case as Intervenors,
18 as parties of record – as you can see by the cross-
19 examination that took place – that is something
20 wholly separate from what's going on with the –
21 what's happening and what we agreed to in the
22 settlement agreement. It doesn't bind – in the
23 same way it doesn't bind DIUC, it doesn't bind us
24 vis-a-vis DIUC in this case, and there is no
25 prejudice that results from it because you, as

1 commissioners, are going to be able to and do
2 understand the difference between that agreement
3 and this case, which, as you can tell – I think
4 it's pretty clear that this case has not been
5 settled today, you know, by the seven hours that
6 we've been here discussing it. So that's all I'll
7 say about it.

8 CHAIRMAN HALL: Ms. Hudson, let me hear from
9 you before I rule.

10 MS. HUDSON: I agree with everything Mr.
11 Pringle said.

12 CHAIRMAN HALL: Okay. Mr. Walker, your motion
13 is denied. I don't see how the Intervenor or ORS
14 could present their case-in-chief without
15 presenting their witnesses.

16 So, go ahead, Mr. Pringle.

17 MR. PRINGLE: Okay.

18 DIRECT EXAMINATION

19 BY MR. PRINGLE:

20 Q I'll just do this – Mr. Vogel, if you would, please
21 state your name and business address for the record.

22 A [VOGEL] My name is Paul Vogel. My address is 3 Fiddlers
23 Court, Daufuskie Island, South Carolina 29915.

24 Q Okay. Have you caused to be prefiled testimony in
25 question-and-answer format, consisting of 11 pages?

1 A [VOGEL] Yes.

2 Q If I asked you all the questions that appear in that
3 testimony, would your answers be the same as appear
4 therein?

5 A [VOGEL] Yes, they would.

6 Q Do you have any additions, deletions, or changes to make
7 to your testimony at this time?

8 A [VOGEL] No, I don't.

9 MR. PRINGLE: Okay. Do I do this now, or do I
10 wait until all three -

11 CHAIRMAN HALL: You can do it one at a time.

12 MR. PRINGLE: Okay. I'd like to ask that Mr.
13 Vogel's direct testimony be read into the record as
14 if given orally from the stand.

15 CHAIRMAN HALL: All right. Mr. Vogel's direct
16 testimony will be entered as if given orally.

17 [See pgs 315-324]

18 BY MR. PRINGLE:

19 Q Okay. Was there also an exhibit attached to your
20 testimony, Mr. Vogel?

21 A [VOGEL] Yes, there was.

22 Q Just tell the Commission what that is.

23 A [VOGEL] That is my professional resumé.

24 MR. PRINGLE: Okay. Madam Chair, I'd like to
25 ask that Mr. Vogel's testimony exhibit be marked

1 for identification and entered as the next hearing
2 exhibit. If you wanted to, you could have it -
3 okay, yeah, 11. Okay.

4 CHAIRMAN HALL: All right. Mr. Vogel's
5 exhibit will be Hearing Exhibit No. 11.

6 [WHEREUPON, Hearing Exhibit No. 11 was
7 marked and received in evidence.]

8 MR. PRINGLE: Okay. And we'll wait until
9 after all three to go in and do the summaries?

10 CHAIRMAN HALL: Wait.

11 MR. PRINGLE: Okay.

12 BY MR. PRINGLE:

13 Q Mr. Egly, could you please state your full name and
14 business address?

15 A [EGLY] My name is Douglas Egly. My address is 10 Haig
16 Point, Hilton Head, South Carolina 29928.

17 Q Okay. Have you caused to be prefiled four pages of
18 direct testimony in question-and-answer format?

19 A [EGLY] Correct.

20 Q Do you have any additions, deletions, or changes to make
21 to your testimony?

22 A [EGLY] I do not.

23 Q If I asked you all the questions that appear in that
24 testimony, would your answers be the same as appear
25 therein?

1 A [EGLY] Yes.

2 MR. PRINGLE: Madam Chair, at this time, I'd
3 like to ask that Mr. Egly's direct testimony be
4 read into the record as if given orally from the
5 stand.

6 CHAIRMAN HALL: All right. Mr. Egly's direct
7 testimony will be entered as if given orally.

8 [See pgs 328-331]

9 BY MR. PRINGLE:

10 Q Did you also attach one exhibit to your testimony?

11 A [EGLY] I did.

12 Q And it is, what?

13 A [EGLY] It's my resumé.

14 MR. PRINGLE: Madam Chair, I'd like to ask
15 that Mr. Egly's hearing exhibit be marked for
16 identification and entered as the next hearing
17 exhibit.

18 CHAIRMAN HALL: All right. Mr. Egly's resumé
19 will be Hearing Exhibit No. 12.

20 [WHEREUPON, Exhibit No. 12 was marked and
21 received in evidence.]

22 MR. PRINGLE: Okay. And I'm going to approach
23 that witness real quick, and give his testimony
24 back to him [indicating].

25 WITNESS EGLY: [Indicating.]

1 BY MR. PRINGLE:

2 Q Mr. Simonelli, if you would, please state your full name
3 and address for the Commission.

4 A [SIMONELLI] My name is Tony Simonelli. My address is 30
5 Fuskie Lane, Daufuskie Island, South Carolina.

6 Q Okay. Mr. Simonelli, have you caused to be prefiled
7 direct testimony with this Commission, consisting of
8 nine pages in question-and-answer format?

9 A [SIMONELLI] I have.

10 Q Do you have any additions, deletions, or changes to make
11 to your testimony at this time?

12 A [SIMONELLI] No, I do not.

13 Q If I asked you all the questions that appear in your
14 direct testimony, this written testimony, would your
15 answers be the same as appear therein?

16 A [SIMONELLI] Yes, they would.

17 MR. PRINGLE: Okay. Madam Chair, at this
18 time, I'd like to ask that Mr. Simonelli's direct
19 testimony be read into the record as if given
20 orally from the stand.

21 CHAIRMAN HALL: All right. Mr. Simonelli's
22 testimony will be entered as if given orally.

23 [See pgs 335-343]

24 BY MR. PRINGLE:

25 Q Mr. Vogel, can you give a brief summary of your

1 testimony?

2 A [VOGEL] Yes.

3 I have been a South Carolina resident since 1975
4 and a Daufuskie property owner since 1989. My principal
5 residence in Haig Point has been since 1991. I'm proud
6 to say that two of my three children attended the
7 University of South Carolina. My son, Paul Vogel, Jr.,
8 was a middle linebacker for the 1984 Gamecock football
9 team that went 10-and-1 on the season.

10 Just a little bit about – since I live at Haig
11 Point – about Haig Point itself: Haig Point consists of
12 719 lots; 262 of the lot owners have constructed homes
13 and receive water-and-sewer utility service from DIUC.
14 Two hundred thirty-nine [239] lot owners own undeveloped
15 lots, and the Haig Point Community HPCCA, which is the
16 Haig Point Community Association, owns 218 lots on Haig
17 Point, and I'll explain why that is important later.

18 As far as our general position, HPCCA understands
19 that DIUC must have the opportunity to collect
20 sufficient revenue to allow it to reliably deliver water
21 and sewer services on Daufuskie Island; however, DIUC is
22 currently generating over \$1 million in utility revenue
23 a year, and seems unable to responsibly utilize those
24 substantial resources. DIUC is proposing more than
25 double its current utility revenues in the current rate

1 Application. An increase in utility rates of that
2 magnitude, or even half that magnitude, would be a
3 devastating effect upon the fragile economic status of
4 the development of Daufuskie Island. This hits a number
5 of areas: Permanent residents would suffer an increase
6 with no improvements. Transitioning residents, who do
7 not live on, for instance, Haig Point or any of the
8 developments full-time or only part-time, pay \$367.48 a
9 quarter, even if they do not use a single drop of water,
10 and that's based on the large base rates. Lot owners
11 will pay an availability fee of \$248.22 per quarter, or
12 \$992.88 per year, for no use at all.

13 Haig Point owns 218 lots. The members' dues
14 currently include \$75,196 annually in availability fees
15 that we pay as our members' dues. Under the DIUC
16 proposal, the members would pay \$216,000 in availability
17 fees, on top the high water rates, due to the
18 availability fees on the lots.

19 If a potential home buyer considers a home in – if
20 a potential homeowner looks at water fees in the
21 Beaufort-Jasper Water Authority area or South Hilton
22 Head Island Water & Sewer District, the fees are
23 considerably less, which drive purchasers away from our
24 island.

25 We talked about conservation, and that was, I

1 believe, one of the questions. They do have progressive
2 rates for irrigation; however, the high fixed fees for
3 home use are very high, and the usage component is
4 rather small, so that discourages that. There's also a
5 basic difference between Daufuskie Island residents and
6 those in neighboring communities, in that – you've all
7 heard the stories about Hilton Head salting up, and the
8 saltwater intrusion. And as an aside, it's something I
9 know about. I was on a South Carolina Saltwater
10 Intrusion Committee for about three years. So the
11 communities of Hilton Head and some of the others have
12 spent considerable amounts of money to already take care
13 of saltwater intrusion, while, since DIUC pumps from the
14 Upper Floridan Aquifer, basically adds a little chlorine
15 and sends it out, whenever the land will salt up in the
16 future, that will – those fees will be on top of what
17 we're paying already.

18 I have in my evidence things about the failures. I
19 think we've heard enough about that.

20 Well, and as relation to that, I own three
21 properties on the island itself, and I know, if I don't
22 get a tax bill, I have to pay it. We, as home- or lot
23 owners, know that we have to pay our real estate taxes.
24 If, for some reason, such a bill does not show up, we
25 can go to bcgov.net – which somebody here said was an

1 excellent source, and it is – to see what the billing
2 should be. DIUC could have done the same for the fees
3 they collect. In addition to that, *The Island Packet*
4 lists all delinquent properties, and they should've been
5 able to see it there.

6 Again, for the availability fees, the Commission
7 should similarly dismiss the request to increase
8 availability fees on the undeveloped lots on Daufuskie
9 Island. The quarterly charges presently for Haig Point
10 are \$88; Melrose and Bloody Point, \$161. And there's a
11 proposed of \$248, so that goes additionally to what Haig
12 Point has to pay in addition to that in dues.

13 As is obvious, the proposed increases are
14 staggering, particularly for Haig Point. DIUC proposes
15 to more than triple the water availability fees for lot
16 owners in Haig Point and the other communities. Haig
17 Point residents pay, through the dues – with the
18 proposed rates, will have to pay \$216,448, up from the
19 present \$75,000, or an increase of \$141,252.

20 Q Does that conclude your summary?

21 A [VOGEL] Yes, that concludes my summary.

22 MR. PRINGLE: Thank you.

23 [PURSUANT TO PREVIOUS INSTRUCTION, THE
24 PREFILED DIRECT TESTIMONY OF PAUL VOGEL
25 FOLLOWS AT PGS 314-324]

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2014-346-W/S

IN RE:

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

DIRECT TESTIMONY OF
PAUL VOGEL

1 **Q. PLEASE STATE YOUR NAME, ADDRESS AND BUSINESS**

2 **AFFILIATION.**

3 A. My name is Paul Vogel. My address is 3 Fiddlers Court, Daufuskie Island, South
 4 Carolina 29915. A summary of my Professional Career is attached hereto as
 5 **Exhibit 1.** I retired in late 2010.

7 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING?**

8 A. I am testifying on behalf of Haig Point Club and Community Association, Inc.
 9 ("HPCCA"), an intervenor in this Docket.

10

11 **Q. MR. VOGEL, ARE YOU AUTHORIZED TO TESTIFY BEFORE THE**
 12 **COMMISSION IN THIS RATE PROCEEDING?**

13 A. Yes. The Board of Directors of HPCCA has authorized me to appear and present
 14 the views of our organization regarding the rate increase application (the

1 "Application") filed with the Public Service Commission (the "Commission") by
2 Daufuskie Island Utility Company, Inc. ("DIUC").
3

4 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY**

5 A. I am here to provide the position of the HPCCA in response to certain aspects of
6 DIUC's current application.
7

8 **Q. WHAT IS THE HISTORY OF YOUR CONNECTION WITH DAUFUSKIE**
9 **ISLAND?**

10 A. I have been a South Carolina resident since 1975 and a Daufuskie property owner
11 since 1989. My principal residence has been on Daufuskie Island and in Haig
12 Point since 1991. I was a HPCCA Board Member, and I am a member of the
13 Daufuskie Island Conservancy Board, which I concentrate mainly on water items.
14 Also, I am a Daufuskie Island Historical Foundation Board member. Finally, I
15 also own a second home within Haig Point at 25 Prestwick Green.
16

17 **Q. DO YOU HAVE ANY OTHER NOTABLE CONNECTIONS WITH**
18 **SOUTH CAROLINA?**

19 A. Yes. I am proud to say that two of my three children attended the University of
20 South Carolina system. My son, Paul Vogel, Jr., was the middle linebacker for
21 the 1984 Gamecock football team that went to a 10 and 1 season record.
22

1 **Q. PLEASE DESCRIBE HAIG POINT AND THE HAIG POINT CLUB AND**
2 **COMMUNITY ASSOCIATION.**

3 A. Haig Point consists of 719 lots. Two hundred and sixty-two (262) of the lot
4 owners have constructed homes and receive water and sewer utility service from
5 DIUC. Two hundred and thirty-nine (239) lot owners own undeveloped lots,
6 and HPCCA owns two hundred eighteen (218) lots within Haig Point. Those lots
7 do not receive utility service at this time. There are currently eight (8) lots under
8 constructionThe HPCCA is made up of property owners owning both developed
9 and undeveloped residential lots within Haig Point. The residential lots are
10 owned by permanent residents, those who are transitioning from working to
11 retiring, and lot owners who will build in the future.

12
13 **Q. WHAT IS THE HPCCA'S GENERAL POSITION WITH REGARD TO**
14 **THIS RATE REQUEST?**

15 A. The HPCCA understands that DIUC must have the opportunity to collect
16 sufficient revenue to allow it to reliably deliver water and sewer services on
17 Daufuskie Island. However, DIUC is currently generating over a million dollars
18 in utility revenue a year and seems unable to responsibly utilize those substantial
19 resources.

20 DIUC is proposing to more than double its current utility revenues with
21 the current rate application. An increase in utility rates of that magnitude, or even
22 one-half of that magnitude, would have a devastating effect upon the fragile

1 economic status of development on Daufuskie Island. The devastation comes in a
2 few forms:

- 3 • Permanent residents will suffer the increase with no improvements. The
4 increased revenue is for DUIC's income which amounts to approximately
5 8% while few of them can earn that amount on present incomes;
- 6 • Transitioning residents that do not live at HP full time will pay \$ 367.48 a
7 quarter even if they do not use a single drop of water;
- 8 • Lot owners will pay an availability fee of \$ 248.22 per quarter or \$992.88
9 per year for no use at all. We as Haig Point cannot justify such an amount
10 to potential lot owners. In some cases, these fees are more than the taxes
11 for the lots;
- 12 • As Haig Point owns 218 lots, the members' dues currently include
13 \$75,196 annually in availability fees—an exorbitant figure. Under the
14 DIUC proposal, members would pay \$216,448 in availability fees
15 annually;
- 16 • If a potential buyer considers a lot on HP or Hilton Head area, the
17 additional cost will drive such purchasers away;
- 18 • If a potential home buyer considers a home in the Beaufort-Jasper Water
19 and Sewer Authority or South Hilton Head water districts, the fees are
20 considerably less, which will drive such purchasers away.

21

1 **Q. DO THESE RATES ENCOURAGE CONSERVATION?**

2 A. Not really. As discussed in the Night Hearing, even though the irrigation has a
3 form of progressive rates, the water usage for water and sewer has no such
4 provision. In fact the base rate is so high that the use only adds a small
5 percentage to the cost, which will have a negative effect on reducing water usage.
6 Those homes that do not have an irrigation meter definitely fall into this category.
7 Even the irrigation rates are not aggressive enough to encourage water use
8 reduction. The second category goes from 18,000 to 60,000 gallons. The
9 normal usage per quarter for irrigation is 20,000 gallons per quarter. There should
10 be at least a break at double the lower limit of 18,000 gallons.

11

12 **Q. DESCRIBE IN MORE DETAIL HOW THE PROPOSED INCREASE**
13 **WILL AFFECT HAIG POINT?**

14 A. The majority of households in Haig Point contain two people, and some are part
15 time. This makes the increase more dramatic due to the increase of the base
16 charge when comparing the costs of neighboring communities. For example, the
17 average use in Haig Point is approximately 17,000 gal/ quarter for home use and
18 20,000 gal for irrigation. With these numbers, the total cost is in the range of
19 \$600 per quarter-- compared with the total cost in the BJWSA system of
20 approximately \$315, and the total costs in the South Island system of
21 approximately \$200.

22 There is also a basic difference between Haig Point and these neighboring
23 communities in that they have already addressed the salt water intrusion (at

1 considerable expense), while DUIC only pumps the water out of the ground and
2 adds chlorine. Someday when saltwater intrusion occurs additional monies will
3 have to be invested, making the rates even much higher.

4
5 **Q. WHAT EFFECT SHOULD THE UTILITY MANAGEMENT OF THE**
6 **SYSTEM HAVE UPON THE COMMISSION'S RULING IN THIS RATE**
7 **PROCEEDING?**

8 A. The Utility's failure to operate profitably with its current rates is, in large part,
9 due to its failure to properly manage the system and its utility business. The utility
10 pays more than \$157,000 annually for Guastella and Associates to manage the
11 system from its offices in Boston—and seeks in this Docket to increase that
12 management fee to over \$170,000. This absentee-management arrangement is
13 simply not working. Three examples of this are 1) the tax sale of the DIUC water
14 tower following DIUC's failure to pay property taxes, 2) the South Carolina
15 Department of Health and Environmental Control (DHEC) issuance of a notice of
16 violations related to the DIUC system; and 3) the South Carolina Department of
17 Revenue's (SCDOR) reassessment of property taxes for DIUC.

18
19 **Q. WHAT EVIDENCE DO YOU HAVE OF DIUC'S FAILURE?**

20 A. Mr. Guastella admitted same in his May, 2015 report to the Commission and
21 attached to his direct testimony in this Docket. Nowhere in that document does
22 DUIC take any ownership of its failures. In addition, that document states that the
23 Haig Point and Melrose waste treatment liner failed in March of 2012 and was not

1 repaired until over a year later. In the interim, these communities had a facility
2 with a significantly reduced capacity. The facility was able to handle the volume
3 at that time due to the use of a much smaller basin via a bypass. Had there been a
4 substantial increase in volume, (such as the opening of the Melrose Inn), that
5 workaround may not have been enough. We were told in the last rate hearing
6 that the increased rates would allow DUIC to correct the liner and other problems.
7 The claim that financing could not be obtained is an item that should have been
8 known when the 2012 rate hike went into effect.
9

10 **Q. WHAT DOES THE SALE OF THE WATER TOWER PROPERTY**
11 **DEMONSTRATE?**

12 A. The degree of incompetence and irresponsibility that led to this sale is truly
13 staggering. It is currently unknown whether the utility will be able to purchase
14 back its water tower and, if so, at what cost. During the entire time that DIUC was
15 failing to make these relatively small but crucially important payments to the
16 Beaufort County Treasurer, Guastella has apparently been paying its own
17 \$157,000 per year management fee like clockwork.
18

19 **Q. WHAT IS THE SIGNIFICANCE TO THIS PROCEEDING OF DIUC'S**
20 **FAILURE TO RETAIN OWNERSHIP OF ITS OWN WATER TOWER?**

21 A. The most obvious significance is that the operations of this utility system located
22 on South Carolina's southern-most barrier island are not being effectively
23 managed from offices located a thousand miles away in Boston. As Night

1 Hearing witness Steve Hill observed, DIUC “can’t attend to the day-to-day
2 business of answering their mail.”

3 The second significance is that DIUC’s failure to pay its County property
4 taxes, taxes that are a certain annual expense for every property-owning business,
5 shows that it is not effectively using its current assets. DIUC has demonstrated
6 that it is not a good steward of the more than a million dollars in annual revenue it
7 receives. Pouring more money into the DIUC bank account will not solve this
8 problem.

9 The third significance relates to the extremely small amount of this unpaid
10 bill (between \$338 and \$789). DIUC’s failure to retain this utility asset clearly
11 disproves the lynchpin of DIUC’s case for a rate increase: *DIUC’s current*
12 *problems are not caused by lack of money, and they will not be solved by this*
13 *Commission granting DIUC’s request for more money.* We as home or lot owners
14 know that we have to pay real estate taxes. If for some reason such a bill does
15 not show up we can go to BCGOV.net to see what the billing should be. DIUC
16 could have done the same for the fees they collect. In addition the Island Packet
17 lists all delinquent properties a few times before the tax sale, another item DIUC
18 could have done.

19
20 **Q. WHAT DOES THE NOTICE OF VIOLATIONS ISSUED BY DHEC**
21 **DEMONSTRATE?**

22 **A.** DHEC’s actions demonstrate yet again that DIUC cannot meet even the simplest
23 (albeit very important) aspects of its obligations as a regulated utility. DIUC

1 failed (among other things) to submit required discharge monitoring reports
2 (DMRs), and failed to meet its obligations to maintain records, reports, an
3 operator's logbook and an operations manual. These violations took place *after*
4 the previous rate case before this Commission, and *after* DIUC learned of the tax
5 sale regarding the water tower.

6
7 **Q. WHAT DOES THE DEPARTMENT OF REVENUE'S REASSESSMENT**
8 **DEMONSTRATE?**

9 A. Again, DIUC is not minding its affairs. This despite having the issue of the tax
10 sale serve a reminder of its existing obligation to manage its tax matters.

11
12 **Q. WHAT IS THE SIGNIFICANCE TO THIS PROCEEDING OF SCDOR'S**
13 **ASSESSMENT?**

14 A. DIUC seeks to recover over \$188,000 in revenue in connection with property
15 taxes.

16
17 **Q. PLEASE EXPLAIN THE POA'S POSITION WITH REGARD TO**
18 **AVAILABILITY FEES.**

19 A. The Commission should summarily dismiss DIUC's request to increase the
20 availability fees it charges to owners of undeveloped lots on Daufuskie Island.
21 The Utility's current quarterly availability charges, as well as its proposed
22 "Availability Rate," are as follows:
23

DIUC's Current and Proposed Water & Sewer Availability Rates:

	Haig Point	Melrose/Bloody Point	DIUC Proposed
Residential Water	31.05	76.38	107.49
Residential Sewer	55.19	85.08	140.73

As is obvious, the proposed increases are staggering, particularly for Haig Point. DIUC proposes to more than triple water availability fees for lot owners in Haig Point, and more than double sewer availability fees for Haig Point lot owners. As stated earlier, Haig Point residents would also have to pay for the Haig Point-owned lots in the amount of \$216,448, up from the present \$75,196—or an increase of \$141,252. Both of these increases are greater than the amount spent by DIUC for line maintenance.

Q. WOULD YOU PLEASE DESCRIBE THE CURRENT STATE OF DEVELOPMENT ON DAUFUSKIE ISLAND?

A. The island, once in a growth situation, is in a fragile state due to the economy, the default of the Daufuskie Island Company (Melrose and Bloody Point) and a lack of a public boating system. Each area of Daufuskie is only partially built out and requires growth to survive. Due to the aggressive marketing effort of Haig Point and the purchase of Melrose and Bloody Point by brave individuals, there is a chance that with an improved economy the island could start to rebound. A part of this rebound is dependent on costs. Property values are devalued

1 considerably, which can support growth. However, other items are hindering
2 growth, such as fuel costs to travel to and from Daufuskie Island, insurance costs
3 (which escalate each year) and, now, the potentially substantial increase in the
4 cost of water and sewer service.

5

6 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

7 **A. Yes it does. I appreciate the Commission's consideration of our evidence and**
8 the opportunity to present our position before you.

1 BY MR. PRINGLE:

2 Q Thank you. Mr. Egly, would you please give the summary
3 of your testimony?

4 A [EGLY] Good evening. It is evening now.

5 I am Doug Egly. I'm the CEO of Haig Point
6 Community Club & Association. I just started that
7 position in February of this year. I previously held a
8 similar position as manager of Black Diamond Ranch.
9 I've been in the development business, basically, for 23
10 years. Prior to coming here, I was at, as I said, Black
11 Diamond Ranch, in Lecanto, as well as Waterlefe Golf &
12 River Club and Tidewater Preserve, which were with WCI
13 Communities, which was Florida's largest homebuilding
14 company at the time.

15 I am here on behalf of the association. I'm also
16 here - my primary responsibility as CEO is to grow and
17 retain memberships of Haig Point Community Association.
18 It involves preparing and making purchase of lots and
19 building homes within Haig Point attractive to
20 prospective buyers. I would say my job is to get Mr.
21 Guastella many, many more customers. That is my job, to
22 sell homes and more memberships.

23 Some of the factors of why I'm here is that I am to
24 bring prospective buyers; they consider the cost of
25 living within communities from association fees, water

1 and sewer rates, and electrical rates, and the cost of
2 membership. All those items are a very large part in
3 the decision-making process of purchasing homes in our
4 community and on the island. I would say, as a
5 comparison, my most recent residence before Daufuskie
6 Island, our rates there were \$1.47 per 1000 gallons of
7 water and sewer, and our base rate there was \$9.31 per
8 month, which Daufuskie Island does it on a quarterly
9 basis so that basically would be \$28 per month – I'm
10 sorry, per quarter.

11 Q Does that conclude your summary?

12 A [EGLY] It does.

13 MR. PRINGLE: Okay.

14

15

16

17

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22

23 [PURSUANT TO PREVIOUS INSTRUCTION, THE
24 PREFILED DIRECT TESTIMONY OF DOUG EGLY
25 FOLLOWS AT PGS 327-330]

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2014-346-W/S

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

DIRECT TESTIMONY OF
DOUG EGLY

1 **Q. PLEASE STATE YOUR NAME, ADDRESS AND BUSINESS**

2 **AFFILIATION.**

3 A. My name is Doug Egly. My address is 10 Haig Point Cir, Hilton Head, S.C.
 4 29928. I have been the CEO of Haig Point Club and Community Association,
 5 Inc. ("HPCCA") since February 23, 2015. I was previously the Regional General
 6 Manager/COO at Black Diamond Ranch/Escalante Golf in Lecanto, Florida from
 7 2011 to 2015. Prior to that, I was Regional General Manager/COO at Waterlefe
 8 Golf & River Club and Tidewater Preserve in Bonita Springs, FL from July 1999
 9 to 2011. My resume is attached hereto as **Exhibit One**.

10

11 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING?**

12 A. I am testifying on behalf of HPCCA, an intervenor in this Docket.

13

1 **Q. MR. EGLY, ARE YOU AUTHORIZED TO TESTIFY BEFORE THE**
2 **COMMISSION IN THIS RATE PROCEEDING?**

3 A. Yes. The Board of Directors of HPCCA has authorized me to appear and present
4 the views of our organization regarding the rate increase application (the
5 "Application") filed with the Public Service Commission (the "Commission") by
6 Daufuskie Island Utility Company, Inc. ("DIUC").

7

8 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

9 A. I am here to provide the position of the HPCCA in response to certain aspects of
10 DIUC's current application.

11

12 **Q. WHAT ARE YOUR DAY-TO-DAY DUTIES AS CEO OF HPCCA THAT**
13 **RELATE TO THIS CASE?**

14 A. One of my primary responsibilities as CEO is to grow and retain the membership
15 of HPCCA. That job involves making the purchase of lots and the building of
16 homes within Haig Point attractive to prospective buyers.

17

18 **Q. WHAT ARE SOME OF THE FACTORS PROSPECTIVE BUYERS**
19 **CONSIDER WHEN MAKING A DECISION TO BUY ON DAUFUSKIE?**

20 A. Prospective buyers consider the cost to live within the community from
21 Association fees, water and sewer rates, electrical rates and cost of memberships.

22

1 Q. DO THE CURRENT RATES FOR UTILITY SERVICES PLAY A PART
2 IN THE DECISION TO BUY OR LIVE IN HAIG POINT?

3 A. Yes they do, and most prospects ask the question. The ones who don't ask at that
4 point typically ask after they get their first utility bill.
5

6 Q. BASED ON YOUR EXPERIENCE, WHAT EFFECT WOULD
7 INCREASED RATES IN WATER AND SEWER SERVICES AND
8 AVAILABILITY FEES HAVE ON YOUR ABILITY TO MARKET HAIG
9 POINT?

10 A. I believe that it will have a huge impact on our ability to sell new homes. We
11 already get compared to other communities on Hilton Head whose fees and
12 utilities are much lower.
13

14 Q. DO YOU OWN A HOME IN HAIG POINT?

15 A. I do.
16

17 Q. WHERE HAVE YOU LIVED PREVIOUSLY?

18 A. As set out above and in Exhibit One, I previously lived in Florida before moving
19 to Haig Point.
20

21 Q. HOW DO UTILITY RATES AT HAIG POINT COMPARE TO THOSE IN
22 FLORIDA?

23 A. For my my most recent recent residence before Daufuskie, I paid \$1.47 per 1,000
24 gallons for water and sewer, with a base rate of \$9.31/month for a ¾ inch meter.

1 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

2 A. Yes it does.

1 BY MR. PRINGLE:

2 Q Mr. Simonelli, could you please present your summary to
3 the Commission.

4 A [SIMONELLI] Sure.

5 I'm testifying on behalf of Melrose Property Owners
6 Association, as well as the Bloody Point Property
7 Owners' Association. I've been involved with Daufuskie
8 Island since 1986, first as a member, and as a property
9 owner since 1999 and full-time resident since 2003.

10 Melrose Plantation is consisting of 325 lots, 53 of
11 which are developed, and the remainder are undeveloped.
12 Bloody Point consists of 110 lots, 21 of which are
13 developed and 89 of which are undeveloped.

14 The rate request is for an increase between 211 and
15 238 percent. I'm just going to take one more minute to
16 talk about the current economic conditions on Daufuskie
17 Island. Property values on Daufuskie Island have
18 dropped by a greater amount than anywhere else in
19 Beaufort County, according to the County Administrator,
20 Gary Kubic. It continues to drop, even though the rest
21 of the county has started to pick up. Haig Point has
22 lost more than 250 members in the past few years, and
23 there are lots available there for \$1. In Melrose,
24 Melrose went into bankruptcy. Melrose and Bloody Point,
25 together, went into bankruptcy in January of 2009. The

1 Inn has been closed since March of 2009. If you tour
2 the island, you see the condos out on the ocean that are
3 falling apart.

4 The owner of Melrose, who purchased it out of
5 bankruptcy in 2011, owes over \$28 million to the lender
6 and has not paid back anything. Bloody Point was
7 purchased out of bankruptcy in 2011, as well, by an
8 individual who has connections for the last 30 years
9 with Daufuskie Island. This family has put additional
10 funds in, but has recently told us that he's unable to
11 put additional capital in and is looking for an
12 alternative.

13 The island is additionally split in two by a line
14 created years ago within the Coastal Barrier Resources
15 System. Half of the island is CBRA and the other half
16 is not. The half of the island that is not in CBRA,
17 which is Melrose and Bloody Point, is unable to get
18 federally funded flood insurance, and therefore, flood
19 insurance costs can be up to \$20,000.

20 My point is, is that the island is in very bad
21 shape, economically. These proposed increases, in
22 addition to taxes being paid right now, are going to
23 make it very clear that people will be forfeiting their
24 lots on a very regular basis. Real estate values will
25 continue to drop. I'm extremely concerned about the

1 future of Daufuskie Island. This is not going to help.
2 Thank you.

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[PURSUANT TO PREVIOUS INSTRUCTION, THE
PREFILED DIRECT TESTIMONY OF TONY
SIMONELLI FOLLOWS AT PGS 334-342]

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2014-346-W/S

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

DIRECT TESTIMONY OF
TONY SIMONELLI

1 **Q. PLEASE STATE YOUR NAME, ADDRESS AND BUSINESS**

2 **AFFILIATION.**

3 A. My name is Tony Simonelli. My address is 30 Fuskie Lane, Daufuskie Island
 4 South Carolina 29915. I have been a real estate broker on Daufuskie Island for
 5 the past eleven (11) years. I was previously Sr. Vice-President for Dendrite
 6 International, a technology firm associated with the pharmaceutical industry.
 7 Prior to that, I was Vice-President for Human Resources and Administration for a
 8 major international shipping company.

9

10 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING?**

11 A. I am testifying on behalf of Melrose Property Owner's Association, Inc.
 12 ("MPOA"), and Bloody Point Property Owner's Association ("BPPOA"), both
 13 intervenors in this Docket.

14

1 **Q. MR. SIMONELLI, ARE YOU AUTHORIZED TO TESTIFY BEFORE**
2 **THE COMMISSION IN THIS RATE PROCEEDING?**

3 A. Yes. The Boards of Directors of the BPPOA and the MPOA have authorized me
4 to appear and present the views of those organizations regarding the rate increase
5 application (the "Application") filed with the Public Service Commission (the
6 "Commission") by Daufuskie Island Utility Company, Inc. ("DIUC").
7

8 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

9 A. I am here to provide the position of BPPOA and MPOA in response to certain
10 aspects of DIUC's current application to increase its rates.
11

12 **Q. WHAT IS THE HISTORY OF YOUR CONNECTION WITH DAUFUSKIE**
13 **ISLAND?**

14 A. I have been involved with Daufuskie Island since 1986, a property owner since
15 1999, and a full time resident since 2003. I am currently President of the Bloody
16 Point Property Owners Association and have been for the past ten years. I also
17 served a two-year term on the Daufuskie Island Council.
18

19 **Q. PLEASE DESCRIBE MELROSE PLANTATION AND THE MPOA.**

20 A. Melrose Plantation is a largely residential real estate development on Daufuskie
21 Island. It was begun around 1986, and currently consists of 325 lots, 53 of which
22 are developed and 272 of which are undeveloped. The MPOA is an association of

1 the owners of the developed and undeveloped residential lots within Melrose
2 Plantation.

3
4 **Q. PLEASE DESCRIBE BLOODY POINT AND THE BPPOA.**

5 A. Bloody Point is a residential development on Daufuskie that was begun in 1989.
6 It currently consists of 110 lots, 21 of which are developed, and 89 of which are
7 undeveloped. The Bloody Point Property Owners Association is an association
8 whose members are the owners of developed and undeveloped properties within
9 Bloody Point.

10

11 **Q. HOW DO OAK RIDGE AND BEACH FIELDS FIT WITHIN THE**
12 **BLOODY POINT/MELROSE AREA?**

13 A. Both Oak Ridge and Beach Fields are served by the Melrose/Bloody Point portion
14 of the utility system. They are both largely undeveloped tracts. Oak Ridge
15 contains 60 lots – none of which are developed. Beach Field consists of 56 lots –
16 4 of which are developed and 52 undeveloped.

17

18 **Q. WHAT IS THE BLOODY POINT/MELROSE POA'S GENERAL**
19 **POSITION WITH REGARD TO THIS RATE REQUEST?**

20 A. The Utility is proposing to increase the water and sewer rates it will impose upon
21 our members by between 211% and 238%. An increase of this magnitude is both
22 outrageous, and completely unsupported by the evidence DIUC is presenting to
23 this Commission. The Utility has done an extremely poor job of managing the

1 system on the Daufuskie Island. This is a utility system that is located on South
2 Carolina's southern-most barrier island. The Commission well knows from our
3 night hearing that access to the island is by private ferry. There is limited public
4 ferry service to Daufuskie. DIUC's utilization of Guastella Associates to manage
5 its daily operations from Guastella's offices in Boston is expensive and it is not
6 working. The Commission should deny DIUC any rate increase until it can first
7 demonstrate to this Commission that it is capable of proper management.

8 For these reasons, the Commission should deny DIUC's request to
9 increase its rates.
10

11 **Q. ARE THE EXPENSES DIUC PAYS ITS ABSENTEE MANAGER**
12 **APPROPRIATE?**

13 A. I do not believe so. For the test year ended December 31, 2014, the expenses for
14 Outside Management Services were greater than the wages paid to those who
15 operated and maintained the system. We believe that a discrepancy of this
16 magnitude is excessive. On-site management that is more connected with
17 Daufuskie Island would not only improve services, it would also ensure more
18 complete billing and would likely cost substantially less. It is entirely possible
19 that an on-site manager would also eliminate DIUC's perceived need to hire
20 additional labor.
21

1 **Q. WHAT IS THE MELROSE/BLOODY POINT ASSOCIATIONS'**
 2 **POSITION IN RESPONSE TO THE UTILITY'S REQUEST TO UNIFY**
 3 **ITS RATE STRUCTURE?**

4 A. The Commission should deny this request. Customers within Melrose and
 5 Bloody Point currently receive a 22,500 gallon water allowance per quarter. Since
 6 our sewer bills are based upon water usage, this allowance applies to the sewer
 7 rates that Melrose and Bloody Point customers pay as well. Haig Point customers
 8 do not receive this usage allowance. Instead, their water and sewer usage charge
 9 begins with the first 1,000 gallons of water a customer consumes.

10

11 As a result of these rate differences, the average customer within Melrose/Bloody
 12 Point presently pays materially less for his or her residential water and sewer
 13 service than the average customer within Haig Point.

14

15 **Q. HOW WILL DIUC'S RATE REQUEST DIFFERENTLY AFFECT THE**
 16 **MELROSE AND HAIG POINT CUSTOMERS?**

17 A. It is easiest to see the difference by looking at a typical customer who uses exactly
 18 the 22,500 gallon quarterly allowance. The comparison is as follows:

19 **Dollar Increase of Residential Water & Sewer Rates Proposed by DIUC:**

20		Mel./Bloody Pt	Haig Pt	DIUC Proposed
21	Residential Water:	\$ 80.72	\$ 125.57	\$ 250.73
22	Residential Sewer:	\$ 80.72	\$ 140.74	\$ 272.92

23

Percentage Increase of Residential Water & Sewer Rates Proposed by DIUC:

	Mel./Bloody Pt	Haig Pt
Residential Water:	211%	100%
Residential Sewer:	238%	94%

While Haig Point's 100% increase for water (a *doubling*) and an 94% increase for sewer is certainly excessive, DIUC's customers living in the Melrose/Bloody Point developments will experience a 211% increase (a *tripling*) and a 238% increase for water and sewer, respectively.

Eliminating the Melrose usage allowance and applying DIUC's proposed rates will, therefore, unfairly impact those residential water and sewer customers living in the Melrose and Bloody Point communities.

**Q. DOES THE UTILITY'S OWN RATE INFORMATION SUPPORT
RETENTION OF THE CURRENT RATE DISCREPANCY BETWEEN
MELROSE/BLOODY POINT AND HAIG POINT?**

A. Yes it does. DIUC obtained the Melrose system out of bankruptcy. As I explain more fully below, it appears that the Utility paid little or nothing for the Melrose system. Consequently, while I am not a rate expert or accountant, it appears to me that the Utility's rate-base for the Melrose/Bloody Point portion of the system is almost zero, or, at the very least, substantially lower than the Haig Point portion of the system. Any water and sewer rates that are fairly based upon the Utility's rate-base must, therefore, be substantially lower for the Melrose/Bloody Point customers than they are for the Haig Point customers.

1 **Q. ARE THERE OTHER FACTS THAT COULD SUPPORT A DENIAL OF**
2 **DIUC'S REQUEST TO UNIFY ITS WATER AND SEWER RATE**
3 **STRUCTURE BETWEEN HAIG POINT AND MELROSE/BLOODY**
4 **POINT?**

5 A. Yes. It is important for the Commission to note that the water system serving
6 Haig Point is completely separate from the water system serving Melrose/Bloody
7 Point. While there is some overlap in sewer treatment between Haig Point and
8 Melrose/Bloody Point, the piping and lift stations are completely separate, and
9 certain portions of the treatment are completely separate as well.

10 For these reasons, the costs of providing water and sewer to these two
11 communities are largely separate and improvements to one system are not likely
12 to benefit the customers of the other.

13
14 **Q. WOULD YOU PLEASE DESCRIBE THE CURRENT ECONOMIC**
15 **CONDITIONS ON DAUFUSKIE ISLAND?**

16 A. Property values on Daufuskie Island dropped by a greater amount than anywhere
17 else in Beaufort County, according to the County Administrator, Gary Kubic.
18 They have continued to drop even though the rest of the County has begun a
19 recovery. Haig Point has lost more than 250 members over the last few years and
20 there are lots available for \$1. Many of the owners of lots there and elsewhere on
21 the island always bring up the carrying costs, which include taxes and fees
22 charged by DIUC for nothing other than future availability. Most lots in the

1 communities are unimproved and therefore the owners are burdened by fees for
2 which they are receiving no service.

3 The Daufuskie Island Resort went into bankruptcy in January, 2009. The Inn has
4 been closed since March of that year. If you tour the Island, you can see the
5 cottages on the ocean that are falling apart, no care having been shown to them
6 since 2009.

7 The owner of Melrose, who purchased out of bankruptcy in 2011 owes over \$28
8 million to his lender, and has not paid back anything owed. There are also
9 constant concerns from vendors about their invoices.

10 Bloody Point was purchased out of bankruptcy in 2011 by an individual who has
11 had connections with the island for over 30 years, That family has put in
12 substantial funds to bring back Bloody Point from what most people had called a
13 sad state. But there is concern as to how long anyone can keep putting money
14 into the island.

15 The island is split in two by the line created many years ago within the Coastal
16 Barrier Resource System, known as CBRA, which does not allow for federal
17 flood insurance to be obtained by owners on behalf of the island. The insurance
18 costs on that half of the island can be as much as \$20,000, while on the other side
19 it remains minimal.

20 My point is that this island is in bad shape economically and DIUC is asking to
21 make it worse.

22 In addition to being the President of the Bloody Point POA, I am a real estate
23 broker and I can tell you that the proposed increases will put the availability fees

1 above the taxes for many lots, and will further prevent owners from retaining their
2 properties on this economically distressed island.

3
4 **Q. ARE THERE ANY EXTRAORDINARY MAINTENANCE COSTS THAT**
5 **DAUFUSKIE PROPERTY OWNERS MUST PAY THAT FURTHER**
6 **INCREASE THE FINANCIAL HARDSHIP THEY ARE EXPERIENCING?**

7 Yes. As a barrier island, Daufuskie has experienced some extraordinary problems
8 that property owners have had and will continue to need to rectify. One example
9 is that property owners had to build two groins into the water to solve a major
10 erosion problem, and we continue to collect for their maintenance to address
11 ongoing potential erosion. The State of South Carolina provided no financial
12 assistance for this project. We also have a crumbling sea wall at Melrose that
13 threatens homes along the beach there. Repairing this wall will cause another
14 major expenditure.

15 We are an island that gets no help from the county or state; we have no
16 regular ferry system other than the one that Haig Point Club and Community
17 Association provides exclusively to its members. Some property owners within
18 Melrose and Bloody Point have opted to join Haig Point, at great cost, solely in
19 order to have a reliable and necessary link to the mainland.

20
21 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

22 **A.** Yes it does. I appreciate the Commission's consideration of our evidence and
23 the opportunity to present our position before you.

1 MR. PRINGLE: Well, we tender these witnesses
2 for everybody that wants to ask questions.

3 CHAIRMAN HALL: All right. Mr. Gressette?

4 MR. GRESSETTE: No questions from the
5 Applicant.

6 CHAIRMAN HALL: Okay. All right. Well,
7 that's it.

8 Oh, I'm sorry, Ms. Fox. I keep forgetting
9 about you.

10 MS. FOX: No questions.

11 CHAIRMAN HALL: No? All right.

12 Mr. Pringle, then - oh, I'm sorry.
13 Commissioners. Commissioner Fleming.

14 EXAMINATION

15 BY COMMISSIONER FLEMING:

16 Q Thank you for being here. I wanted to ask - we've heard
17 Mr. Guastella say that, if he doesn't get the revenue
18 that he feels is appropriate, it could cause the company
19 to go into bankruptcy, or could. What is your viewpoint
20 about that, and what that would do to the island?

21 A [SIMONELLI] First of all, I don't believe that's the
22 case, one; two, I wish I had the attorneys that created
23 Mr. Guastella's management contract when I was looking
24 to do management contracts.

25 Q Don't we all.

1 A [SIMONELLI] I believe it's overly rich. I think that
2 some of the items that were mentioned in the testimony
3 were surprising; in some cases, inaccurate. And I don't
4 believe that's going to be the case. They perhaps have
5 done significant work at Haig Point recently. There has
6 been nothing done at Bloody Point or at Melrose over the
7 past few years. I don't think that the costs are what
8 they are.

9 A [VOGEL] The concern with DIUC is the way it's operated.
10 And as it's been pointed out – I don't want to rehash
11 that thing with the water tower and the liner. It took
12 forever to get that installed. I think it was over a
13 year until they finally got it installed. There are
14 many things that could've been done. And there's just
15 no provision for future saltwater intrusion. Hopefully,
16 the testimony of the following, on the economic issues,
17 will show that they could operate in what was presented,
18 and they should be able to do it within those
19 parameters. If they would go defunct, hopefully there
20 would be others to take it over.

21 Q And Mr. Egly, you have your job cut out for you.

22 A [EGLY] I sure do. But I also knew this, going into this
23 project, that I had my work cut out for us as a
24 community and as an island, because I have learned that
25 everything we do on Daufuskie, we do as a group. It's

1 not just Haig Point; it's Melrose, it's Bloody Point.
2 So we're all in this together, so anything that we can
3 do, we do together to help each other. And should, you
4 know, bankruptcy come to Daufuskie Island Utility
5 Company, obviously, we will overcome that. You know,
6 we'll help however we can. We'll find a buyer. The
7 sky's the limit on what we do when it happens.

8 Q And you mentioned delinquent property – tax property
9 payments are listed in *The Packet*. Do you know if these
10 particular payments were listed in *The Island Packet*?

11 A [SIMONELLI] All are listed. Every October – every first
12 Monday of October, there's a tax sale, and for weeks
13 before that, in *The Packet* and online, the taxes – the
14 tax-delinquent properties are listed.

15 Q Were these particular properties –

16 A [SIMONELLI] I do not know that.

17 Q – listed, that you know of?

18 A [SIMONELLI] I do not know that.

19 Q Okay.

20 A [VOGEL] Since all this came out afterwards, there was no
21 way to check that, unless you look up old newspapers.

22 Q Well, it was just mentioned, and I just wondered if
23 someone knew.

24 A [VOGEL] Well, I mentioned it because some of us do look
25 through that list to see, you know, who is delinquent,

1 and if it's some of ours, if something can be done about
2 it, to make sure they get off of that.

3 Q And I haven't really had time to go through the
4 settlement, since it came in so late, but I believe
5 you're proposing different rates for Melrose and
6 Daufuskie? Is that correct? Are you in agreement for
7 the same rates?

8 A [SIMONELLI] We are now in agreement.

9 Q You're now in agreement.

10 A [SIMONELLI] Currently, Melrose and Bloody Point have a
11 22,500-gallon allowance each quarter, but we are now in
12 agreement that we will have similar rates all the way
13 through.

14 Q Throughout.

15 A [EGLY] Throughout.

16 A [SIMONELLI] Yes, ma'am.

17 CHAIRMAN HALL: Okay. Thank you for that
18 understanding.

19 Thank you.

20 CHAIRMAN HALL: All right, Commissioners. Any
21 other questions?

22 [No response]

23 Mr. Pringle?

24 MR. PRINGLE: No questions.

25 CHAIRMAN HALL: Okay. All right. You can

1 call your next panel.

2 Thank you, gentlemen.

3 [WHEREUPON, the witnesses stood aside.]

4 [Witnesses affirmed]

5 THEREUPON came,

6 H A R R Y J U E ,

7 L Y N N M . L A N I E R ,

8 C H A R L E S L O Y ,

9 called as witnesses on behalf of Intervenor Haig Point Club
10 & Community Association, Bloody Point Property Owners'
11 Association, and Melrose Property Owners Association, who,
12 having been first duly affirmed, were examined and testified
13 as follows:

14 DIRECT EXAMINATION

15 BY MR. PRINGLE:

16 Q Mr. Jue, if you could, please state your full name and
17 business address for the Commission.

18 A [JUE] Harry Jue. 114 Melrose Drive, Savannah, Georgia.

19 Q Okay. Mr. Jue, have you caused to be prefiled in
20 connection with this case direct testimony consisting of
21 five pages in question-and-answer format?

22 A [JUE] Yes, sir.

23 Q Okay. Do you have any additions, deletions, or changes
24 to make to that testimony?

25 A [JUE] No, I do not.

1 Q Okay. If I asked you all the questions that appear in
2 that testimony, would your answers be the same as appear
3 therein?

4 A [JUE] Yes.

5 MR. PRINGLE: Okay. Madam Chair, at this
6 time, I'd like to ask Mr. Jue's direct testimony be
7 read into the record as if given orally from the
8 stand.

9 CHAIRMAN HALL: All right. Mr. Jue's
10 testimony will be read into the record as if given
11 orally.

12 [See pgs 360-364]

13 BY MR. PRINGLE:

14 Q Okay. And does your direct testimony also have an
15 exhibit, Mr. Jue?

16 A [JUE] Yes, a resumé.

17 MR. PRINGLE: Okay. Madam Chair, I'd like to
18 ask that Mr. Jue's hearing exhibit – or, testimony
19 exhibit be marked for identification and made the
20 next hearing exhibit.

21 CHAIRMAN HALL: All right. Mr. Jue's exhibit
22 will be Hearing Exhibit No. 13.

23 [WHEREUPON, Exhibit No. 13 was marked and
24 received in evidence.]

25 <

1 **BY MR. PRINGLE:**

2 **Q** Mr. Lanier, can you state your full name and business
3 address for the Commission.

4 **A** [LANIER] Yes, my name is Lynn Lanier. My business
5 address is 1850 Parkway Place, Marietta, Georgia.

6 **Q** Did you cause to be prefiled direct testimony in this
7 case consisting of 33 pages in question-and-answer
8 format?

9 **A** [LANIER] I did.

10 **Q** Okay. Do you have any additions, deletions, or changes
11 to make to your testimony?

12 **A** [LANIER] Yes, I do.

13 **Q** Okay. Could you just walk the Commission through those
14 by mentioning page number and line number?

15 **A** [LANIER] Sure.

16 **Q** Okay.

17 **A** [LANIER] Subsequent to submitting my testimony, I
18 realized that I had failed to include the gross-up for
19 bad-debt expense and the revenue tax on the nonequity
20 portions of the revenue requirements in my Exhibit 3. I
21 have corrected that and altered the bad-debt rate from
22 1.22 percent to 1.36 percent, which is what the company
23 had used in its filing. I also increased the revenue
24 tax from .56 percent, which I had calculated from the
25 company's filing, to .86 percent, which is what ORS had

1 used in their testimony. The company had used .631
2 percent.

I applied the bad-debt rate and the revenue tax gross-up to nonequity return revenue requirements. This resulted in an increase in the overall revenue increase in required revenue from 37.9 percent to 39.9 percent, a difference of two percentage points. And I have provided a revised Exhibit 3.

9 The changes to my testimony are on page nine, line
10 20. The number will change —

11 **Q** Wait till everybody gets there. Just let everybody —

12 [Brief pause]

13 All right, go ahead.

14 A Page nine, line 20, the number will change from 37.9
15 percent to 39.9 percent. On page 10, lines one and two,
16 the number will change from 50.2 percent to 52.9
17 percent, and from 23.2 percent to 26 percent. And the
18 number 408,000 will change to 429,442.

19 On page 25, line 17, the total revenue –

20 Q Wait till everybody gets there.

21 [Brief pause]

22 A Page 25, line 17, the total revenue requirement will
23 change from \$1,484,806 to \$1,505,905. And the amount of
24 the increase will change from \$408,343 to \$429,442.
25 Then on line 18, the overall increase changes from 37.9

1 percent to 39.9 percent. Line 20, water, 50.2 percent
2 to 52.9 percent; and on the sewer, 23.2 percent to 26
3 percent.

4 **Q** Okay. Do you have any additional additions, deletions,
5 or changes to make to your testimony?

6 **A** [LANIER] No, I don't.

7 **Q** If I asked you all the questions in your testimony, as
8 amended, would your answers be the same?

9 **A** [LANIER] They would.

10 **MR. PRINGLE:** Okay. Madam Chair, I'd like to
11 ask that Mr. Lanier's direct testimony be read into
12 the record as if given orally from the stand.

13 **CHAIRMAN HALL:** All right. Mr. Lanier's
14 direct testimony will be entered as if given
15 orally.

16 *[See pgs 418-449]*

17 **BY MR. PRINGLE:**

18 **Q** And, Mr. Lanier, did you also include five exhibits with
19 your testimony?

20 **A** [LANIER] I did.

21 **Q** Okay. And one of those particular exhibits is Exhibit
22 3, which has been switched out, and the court reporter
23 has a copy of the Amended Exhibit 3. And just to
24 clarify – you already said this – your Amended Exhibit 3
25 reflects the changes that you just published to the

1 Commission?

2 A [LANIER] That's correct.

3 MR. PRINGLE: Okay. Mr. Chairman, I'd - or,
4 Madam Chair, excuse me, I would ask that Mr.
5 Lanier's five exhibits, and particularly the
6 substituted Exhibit 3, be marked for identification
7 and made the next hearing exhibits.

8 CHAIRMAN HALL: All right. Mr. Lanier's five
9 exhibits will be a composite Hearing Exhibit No.
10 14, with the substituted Exhibit 3.

11 [WHEREUPON, Exhibit No. 14 was marked and
12 received in evidence.]

13 BY MR. PRINGLE:

14 Q Mr. Loy, would you please state your name and business
15 address for the Commission.

16 A [LOY] My name is Charles Loy. My address is 919
17 Congress Avenue, in Austin, Texas.

18 Q Okay. Mr. Loy, have you caused to be prefiled direct
19 testimony in this case consisting of 33 pages in
20 question-and-answer format?

21 A [LOY] Yes.

22 Q Do you have any additions, deletions, or changes to make
23 to your testimony at this time?

24 A [LOY] Not to my direct, no.

25 Q If I asked you all the questions that appear in this

1 direct testimony, would your answers be the same?

2 A [LOY] Yes.

3 Q Okay. Did you also prefile surrebuttal testimony in

4 this case, consisting of 12 pages in question-and-answer

5 format?

6 A [LOY] Yes.

7 Q Do you have any additions, deletions, or changes to make

8 to that testimony?

9 A [LOY] Yes, I have two quick changes. On page four, line

10 17, the "171" should be "266."

11 Q Okay. So, on line 17 of page four, the number "171,000"

12 should be replaced with –

13 A [LOY] "266,000."

14 Q "\$266,000."

15 A [LOY] Yes.

16 Q Okay.

17 A [LOY] And on the same page, line 21, the "171,000"

18 should be replaced with "266,000."

19 Q Okay. That's on line 21, "\$266,000" instead of

20 "\$171,000." Do you have any additional changes to make

21 to your surrebuttal testimony?

22 A [LOY] No, that's it.

23 Q Okay. If I asked you all the questions that appeared in

24 that surrebuttal testimony, would your answers be the

25 same as therein?

1 A [LOY] Yes.

2 MR. PRINGLE: Madam Chair, I would like to ask
3 that Mr. Loy's direct testimony and surrebuttal
4 testimony be read into the record as if given
5 orally from the stand.

6 CHAIRMAN HALL: All right. Mr. Loy's direct
7 and surrebuttal will be entered into the record as
8 if given orally.

9 [See pgs 368-400 - Direct]

10 [See pgs 402-413 - Surrebuttal]

11 BY MR. PRINGLE:

12 Q Okay. And, Mr. Loy, does your surrebuttal testimony
13 also include an exhibit?

14 A [LOY] Yes.

15 MR. PRINGLE: Okay. I'd like to ask that the
16 exhibit to Mr. Loy's surrebuttal testimony be
17 marked for identification and made the next hearing
18 exhibit.

19 CHAIRMAN HALL: His surrebuttal?

20 MR. PRINGLE: It would be to his surrebuttal.

21 CHAIRMAN HALL: We don't have an exhibit to
22 his surrebuttal. We do for his direct, but not for
23 his surrebuttal.

24 MR. PRINGLE: If we could go look at the DMS
25 again, I think that...

1 [Brief pause]

2 CHAIRMAN HALL: All right. That's fine.

3 We'll dig it up.

4 MR. PRINGLE: Okay.

5 CHAIRMAN HALL: But it will be Hearing Exhibit
6 No. 15.

7 [WHEREUPON, Hearing Exhibit No. 15 was
8 marked and received in evidence.]

9 MR. PRINGLE: Okay. Thank you, Madam Chair.

10 COURT REPORTER: Will you need to refer to
11 that?

12 MR. PRINGLE: I'm not so sure that it will be
13 referred to extensively. There may be some
14 mention.

15 CHAIRMAN HALL: Okay. If it is, we'll find
16 it. They'll dig it up for us.

17 BY MR. PRINGLE:

18 Q Mr. Jue —

19 CHAIRMAN HALL: Oh, I'm sorry. Mr. Pringle,
20 what about his exhibit to his direct?

21 MR. PRINGLE: Oh, thank you, Madam Chair.

22 BY MR. PRINGLE:

23 Q Did you also have an exhibit to your direct testimony?

24 A [LOY] Yes, I did.

25 MR. PRINGLE: Okay. I'd like to ask that that

1 exhibit be marked for identification and entered in
2 as perhaps the previous exhibit to the surrebuttal,
3 although I did the surrebuttal first, so...

4 CHAIRMAN HALL: That's okay. Exhibit No. 16.
5 [WHEREUPON, Hearing Exhibit No. 16 was
6 marked and received in evidence.]

7 BY MR. PRINGLE:

8 Q All right. Mr. Jue, could you please give a summary of
9 your testimony?

10 A [JUE] Yes.

11 I was asked to give an opinion as to overall
12 condition of the system, its remaining useful life, and
13 its depreciated value. I did not review any operating
14 records, regulatory compliance records, or review actual
15 operation status of equipment. It was a walk-through
16 inspection conducted in one day.

17 All of the above ground components of the system
18 were inspected; that is, the water well's, the treatment
19 plant, and the storage tanks, et cetera, disinfection
20 equipment. None of the underground facilities were
21 looked at, and we just assumed, based on the condition
22 of what I saw aboveground, and I assigned a rating that
23 was comparable to that rating.

24 The system overall, I felt, was a blend of the old
25 and the new. It was evident that over time the

1 equipment has changed out, due to failures, expansion to
2 new service areas, or to achieve regulatory compliance.
3 This is pretty much the same game plan of any water-and-
4 sewer utility. The systems observed were rated on a
5 scale of 1 to 5. I use that because design and
6 engineering criteria is 50 years' life for equipment and
7 also manufacturers' recommendations all use, pretty
8 much, 50 years. So it's fairly easy, since I was asked
9 to take a quick look at what was going on at the water
10 and sewer systems on the island, that 1-to-5 scale is
11 used. Basically, 5, which was the highest, based on it,
12 it was new or fairly new equipment. And 1 was it was
13 not well maintained, deteriorated, et cetera.

14 I looked at 10 major systems on the island: the
15 wells, again; the elevated tanks; and the treatment
16 plant and its components. An overall rating I gave all
17 those was 3.5 out of 5.

18 As far as the — I also looked at the inventory,
19 that was given to me prior to the inspection, of the
20 assets of the system, and the table — we broke it down
21 in five-year increments as far as age, the original
22 cost, and DIUC's reported accumulated depreciation. It
23 showed that all the systems that were pretty much over
24 20 years ago reflected accumulated depreciation of 14.7
25 percent; all the others range from 12.8 to 1.3.

1 Overall, it was reported 10 percent depreciable assets.

2 My conclusion was, if I – I assigned a 3.5 rating
3 to all that I saw, I was pretty much looking at it out
4 of a 50-year life, as 35 remaining years remaining.
5 Therefore, simple math shows that it was 30 percent
6 depreciated. So I looked at that 30 percent number as a
7 fair number that I gave that was depreciated on the
8 island. Being involved in water and sewer facilities
9 all my life, especially on the coast, I know what
10 coastal weather and hot soils do to equipment. It will
11 depreciate, whether it's running or whether it's
12 remaining dormant. So that's it.

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22
23 [PURSUANT TO PREVIOUS INSTRUCTION, THE
24 PREFILED DIRECT TESTIMONY OF HARRY JUE
25 FOLLOWS AT PGS 359-363]

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2014-346-W/S

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

DIRECT TESTIMONY OF
HARRY JUE

1 **Q. PLEASE STATE YOUR NAME, ADDRESS AND BUSINESS**

2 **AFFILIATION.**

3 A. My name is Harry Jue. My address is 114 Melrose Drive, Savannah, Georgia. I
 4 am presently employed by Hussey Gay Bell Engineering Firm as a consultant
 5 concerning water and sewer issues.

6

7 **Q. PLEASE DESCRIBE YOUR BACKGROUND AND EXPERIENCE.**

8 A. I am retired from the City of Savannah where I served as the Water and Sewer
 9 Bureau Chief for 31 years. A copy of my resume is attached hereto as Exhibit
 10 One.

11

12 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING?**

13 A. I am testifying on behalf of Haig Point Club and Community Association, Inc.
 14 ("HPCCA"), Melrose Property Owner's Association, Inc. ("MPOA"), and Bloody
 15 Point Property Owner's Association ("BPPOA") (the "POA Intervenors").

1

2 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

3 A. I conducted an onsite inspection of the water and sewer facilities owned and
4 operated by the Daufuskie Island Utility Company, Inc. (DIUC) on September 15,
5 2015. The purpose of the onsite inspections of the major utility systems was to
6 render an opinion as to the condition of the system, its remaining useful life, and
7 its depreciated value. I did not review operating maintenance records, regulatory
8 compliance records, or review actual operational status of the equipment.

9

10 **Q. WHAT DID YOU INSPECT?**

11 A. I inspected all major above ground components of the system, which included
12 water supply production, storage and disinfection facilities, and the wastewater
13 treatment and disposal systems. I did not inspect any underground system (such as
14 water distribution, metering, fire protection, sewage force mains, gravity lines and
15 sewage pumping stations).

16

17 **Q. WHAT DID YOU OBSERVE?**

18 A. The utility systems were a blend of the old and new. It was evident that over time,
19 equipment has been changed out or expanded due to failure, expansion to new
20 service areas or to achieve regulatory compliance. The systems observed were
21 rated on a scale of “one” (being the lowest) to “five” (being the highest). A
22 rating of “five” would indicate that the equipment was in a new or like new

condition, while a rating of “one” would indicate that the equipment was old and well beyond it's useful life and operational status doubtful.

The following table indicates the rating evaluation on this “one” to “five” scale of the major systems observed during the September 15, 2015 inspection:

#	System/Location	Rating (1 to 5 scale)
1	Haig Point Well #1	3.0
2	Haig Point Well #2	2.5
3	Haig Point Waste Water Treatment Plant	3.5
4	Haig Point Well #3	3.0
5	Elevated Water Tank, 125MG	3.0
6	Melrose Well #1	3.0
7	Melrose Well #2	3.0
8	Bloody Point Waste Water Treatment Plant	3.0
9	Bloody Point Well #1	3.0
10	Bloody Point Well #2	2.5

While observation of the entire system was not included in the inspection, the water wells, water tank storage and wastewater treatment plants do represent a major part of the value of the overall system. Based on the above scores for the observed systems, and assuming the unobserved components of the system are in similar condition, it would be reasonable to assign a rating of no more than “3.5” to the overall system.

Q. DID YOU REVIEW THE ASSET VALUES, INCLUDING DEPRECIATION, AS REPORTED BY DIUC?

A. Yes. I was provided with an inventory of the December 31, 2014 assets of the utility system. This inventory showed that the system as of that date had depreciable assets with a total original cost of \$7,964,379 and a book value of

\$7,176,741. The following table shows this reported original cost broken down by year of installation (in five-year ranges), associated accumulated depreciation that was recorded by DIUC, and the DIUC book value:

Asset Summary as of 12/31/2014 as reported by DIUC					
Year Installed	Age (years)	Original Cost	DIUC's reported Accumulated Depreciation (at 12/31/2014)	DIUC's Book Value	Percent Depreciated
1986 thru 1994	over 20	\$ 3,762,771	\$ 553,952	\$ 3,208,819	14.7%
1995 thru 1999	16-20	288,906	37,051	251,855	12.8%
2000 thru 2004	11-15	1,252,977	124,927	1,128,050	10.0%
2005 thru 2009	6-10	1,665,676	60,153	1,605,523	3.6%
2010 thru 2014	1-5	873,638	11,556	862,082	1.3%
Depreciable assets total		7,843,967	787,638	7,056,329	10.0%
Non-depreciable assets		120,412	-	120,412	0.0%
Total assets		\$ 7,964,379	\$ 787,638	\$ 7,176,741	9.9%

This table indicates that as of December 31, 2014 DIUC had depreciated only 10.0% of the total depreciable assets of the system, and in fact even systems installed over 20 years ago reflected accumulated depreciation by DIUC of only 14.7%.

Q. DID YOU DRAW ANY CONCLUSIONS REGARDING APPROPRIATE ACCUMULATED DEPRECIATION FOR DIUC?

A. An utility system with an overall score of "3.5" would be expect to have on average approximately 35 remaining years of life (out of an expected 50 year life) and would be expected to reflect accumulated depreciation of approximately 30%. If total accumulated depreciation of 30% were recognized, the total book value of the system would be \$5,611,189 instead of the \$7,176,741 reported by DIUC.

1 Q. DOES THAT CONCLUDE YOUR TESTIMONY?

2 A. Yes.

1 BY MR. PRINGLE:

2 Q Okay. Mr. Loy, if you could summarize your direct and
3 surrebuttal testimony.

4 A [LOY] Well, I am recommending that the company's
5 proposed complete system analysis methodology be
6 corrected to reflect the proper regulatory accounting;
7 that is, accumulated depreciation should be increased to
8 reflect full depreciation, and rates to reflect the full
9 depreciation rates and to reflect the actual value of
10 the plant, rather than extending the book value beyond
11 the plant's useful life.

12 Theoretically, you know, given the low growth
13 rates, it's very possible that at some point in time in
14 the future, far future, net plant could be greater than
15 gross plant. That is, accumulated depreciation could be
16 closer to zero or even positive.

17 I also am recommending that contributions in aid of
18 construction be increased to reflect the fact that a
19 large portion of the utility plant written off by
20 International Paper was actually donated or contributed.

21 Earlier today, there was considerable discussion
22 about the mysterious property tax, how it all of a
23 sudden happened. And what I've said in my testimony is
24 that, basically, the property - the DOR never knew about
25 the utility plant. It was never there. It was in IP's

1 books and it was expensed along with all the lot sales.
2 Only in 2004 did it all appear, after an examination of
3 past records or whatever, from what I can tell.

4 Also, I recommend that the company properly record
5 acquisition adjustments related to its purchase of Haig
6 Point Utility and Melrose Utility Company. Earlier, Mr.
7 Guastella made the comment that an acquisition
8 adjustment wasn't recorded because it was a stock
9 acquisition. Well, that's not correct. NARUC – even if
10 it is a stock acquisition, NARUC requires you to record
11 an acquisition adjustment. And, in fact, the
12 Commission, on their annual report, has a section just
13 for reporting acquisition adjustments.

14 Basically, these adjustments are about – reduced
15 plant about \$3.7 million. And although that does reduce
16 return, it does also reduce depreciation expense and it
17 should reduce property expense, as well.

18 So I would say that, also, that the company has
19 really not given me any explanation as to why my
20 recommendations for the complete system analysis and
21 acquisition adjustments are not correct.

22 Q One follow-up, based upon your testimony. You mentioned
23 that there were a number of years where there weren't
24 plant values. What did the annual reports filed with
25 this Commission, back in 1999 through 2004, say on that

1 point?

2 A [LOY] Yeah, there was no plant values in the annual
3 reports, reported. Only in 2004 did they appear.
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23 [PURSUANT TO PREVIOUS INSTRUCTION, THE
24 PREFILED DIRECT TESTIMONY OF CHARLES LOY
25 FOLLOWS AT PGS 367-399]

MERITS HEARING - VOLUME 2 OF 2
10/28/15

PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2014-346-W/S

IN RE:	)	
	)	
Application of Daufuskie Island Utility	)	DIRECT TESTIMONY OF
Company, Inc. for Approval for Water	)	CHARLES LOY
and Sewer Rates, Terms and Conditions	)	

1 **Q: PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A: My name is Charles Loy. My business address is 919 Congress, Suite 800 Austin,
3 Texas 78701. I am a Principal with GDS Associates, Inc. ("GDS"). GDS Associates,
4 Inc. ("GDS") is a utility consulting and engineering firm with its principal offices in
5 Marietta, GA. My business address is 919 Congress, Suite 800 Austin Texas 78701.

6 **Q: PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND.**

7 A: I received the degree of Bachelor of Business Administration in Accounting from the
8 University of Texas at Austin. I am a Certified Public Accountant in Texas.

9 **Q: PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE.**

10 A: Before joining GDS in June of 2001, I was General Manager of Rates and Regulatory
11 Affairs of AquaSource Inc., a wholly-owned water and wastewater subsidiary of DQE,
12 a publicly traded electric utility located in Pittsburgh, Pennsylvania. My
13 responsibilities at AquaSource included the organization, preparation and management

1 of various rate filings and testimony in connection with rate requests and other
2 regulatory matters in the twelve states in which AquaSource owned and operated
3 utility properties.

4 Before joining AquaSource, I was a Manager of Regulatory Affairs for Citizens
5 Utilities Company - Public Services Sector. I was responsible for various regulatory
6 matters, including rate cases, for water/wastewater, gas, and electric services in eight
7 states. Before joining Citizens, I was a Rate Manager with Southern Union Gas where
8 I prepared rate filings, cost-of-service studies, and testimony for the various
9 jurisdictions in Texas and Oklahoma. My utility regulation experience began with
10 Diversified Utility Consultants as a Senior Analyst. I assisted in the review and
11 analysis of various gas, electric, and water company rate filings.

12 **Q: HAVE YOU PREVIOUSLY PRESENTED TESTIMONY BEFORE**
13 **REGULATORY COMMISSIONS AND/OR OTHER AGENCIES?**

14 A: Yes, A list of regulatory proceedings in which I have been involved and presented
15 expert testimony is attached to my direct testimony as **Appendix A**.

16 **Q: WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS MATTER?**

17 A: I have been asked to review the rate increase application of Daufuskie Island Utility
18 Company ("DIUC") as submitted, particularly accounting and rate base issues and
19 some related expenses, including depreciation expense, amortization expense, and
20 property tax expense. In this regard, I have proposed several changes to DIUC's
21 requested revenue requirements for water and for wastewater service.

22

1 Q: HAVE YOU PREVIOUSLY TESTIFIED ON SUCH MATTERS BEFORE
2 REGULATORY COMMISSIONS?

3 A: Yes, I have.

4 Q: HAVE YOU REVIEWED DIUC'S FILING IN THIS MATTER?

5 A: Yes, I have.

6 Q: WHAT IS YOUR OVERALL VIEW OF THE COMPANY'S FILING?

7 A: In my opinion, the Company has not followed proper GAAP and regulatory
8 accounting practices, as prescribed in the National Association of Regulatory
9 Commissioners (NARUC) Uniform System of Accounts (USoA), which the South
10 Carolina Public Service Commission ("Commission" or "PSC"), requires all water and
11 wastewater utilities under its jurisdiction to follow.

12 Q: WHAT ACCOUNTING IRREGULARITIES DO YOU BELIEVE YOU HAVE
13 FOUND?

14 A: Going back to the establishment of Haig Point Utility Company ("HPUC") by
15 International Paper Company, the utility plant and the transfer transactions were not
16 properly booked. Also, subsequent adjustments made when HPUC sought rate relief in
17 2005 and again when HPUC was acquired by CK Materials in 2008 resulted in
18 incorrect plant asset and equity amounts on financial statements and on later rate base
19 amounts. Consequently, I am recommending adjustments in plant asset accounts and
20 rate base, which have the effect of reducing the rate base and expenses.

21

1 **Q: CAN YOU OUTLINE IN SUMMARY FASHION THE ADJUSTMENTS YOU**
2 **ARE PROPOSING?**

3 A: Yes. First, I propose that accumulated depreciation be increased to reflect the full
4 depreciation rates and to more accurately reflect the actual depreciated value of the
5 system. Second, I propose an adjustment to increase the Contribution-in-aid-of
6 Construction ("CIAC") to reflect the fact that a large portion of utility plant was
7 actually "contributed plant" and should have been booked as such. Third, I propose
8 that a negative acquisition adjustment be recorded to reflect the difference in what
9 was paid for the utility plant and the net book value of the plant.

10 And last, because depreciation expense, amortization expense, and property taxes are
11 affected by changes in plant values, I am proposing adjustments to depreciation
12 expense, amortization expense, and property tax expense.

13 **Q: What will be the effect of these proposed changes?**

14 A: The Rate Base will be reduced significantly, as will the Company's equity level and
15 expenses. These adjustments will have the effect of reducing the Company's revenue
16 requirements.

17 **Q: WHAT ADJUSTMENTS ARE YOU RECOMMENDING BE MADE TO THE**
18 **COMPANY'S PROPOSED RATE BASE FOR THE WATER SYSTEM AND**
19 **FOR THE WASTEWATER SYSTEM?**

20 A: In Table 1, below, I have summarized my proposed adjustments to the utility's
21 proposed water system rate base and wastewater system rate base.

TABLE 1
Adjustments to Rate Base

	Water System	Sewer System	Total System
1 Increase Accum Depr for UF	\$ (729,045)	\$ (1,182,430)	\$ (1,911,475)
2 Increase CIAC for HPUC	\$ (1,368,149)	\$ (2,552,421)	\$ (3,920,570)
3 Increase CIAC Amortization	772,017	1,314,498	2,086,515
4 Net CIAC	\$ (596,132)	\$ (1,237,923)	\$ (1,834,055)
5 Total Rate Base Adjustments	\$ (1,325,177)	\$ (2,420,353)	\$ (3,745,530)

2 **Q: PLEASE EXPLAIN THE REASON FOR THE ADJUSTMENTS ON LINE 1 IN**
3 **TABLE 1.**

4 A: This adjustment increases accumulated depreciation in order to comply with GAAP
5 and the appropriate regulatory accounting used for setting rates. Additionally, the
6 adjustment reflects the proper age and condition of the utility property. I have taken
7 the continuing property records (CPR) provided by the Company and recalculated
8 accumulated depreciation using the latest depreciation rates established by the
9 Company. The proposed accumulated depreciation reflects depreciation expense from
10 the "in service" date through the end of the test year, 12/31/2014.

11 **Q: YOU STATED THAT YOU RECALCULATED THE ACCUMULATED**
12 **DEPRECIATION USING THE RATES ESTABLISHED BY THE COMPANY.**
13 **WHY WOULD YOU NEED TO RECALCULATE THE ACCUMULATED**
14 **DEPRECIATION?**

15 A: While the Company is using the appropriate service life rates, the rates have been
16 reduced to reflect a "utilization" factor (UF). I believe the UF is meant to reflect the
17 fact that the system either has not been completely built out or is not fully utilized in
18 providing service. Thus, rather than crediting the accumulated depreciation for an

1 amount that is based on the assigned service life rate for each particular plant item,
2 DIUC is using UF-adjusted rates that reduce the depreciation expense amounts
3 charged to accumulated depreciation by as much as 53% for water and 65% for sewer.

4 **Q: IS IT APPROPRIATE FOR GAAP AND REGULATORY ACCOUNTING**
5 **PURPOSES TO USE UF ADJUSTED DEPRECIATION RATES?**

6 A: If done correctly, yes. However, DIUC's methodology is not in accordance with
7 GAAP or regulatory accounting guidelines. Apparently, since DIUC has owned this
8 utility it has under-depreciated plant by the amount of the excluded or "non-utilized"
9 portion of the plant included in rate base. This has two undesirable impacts from a
10 regulatory accounting prospective. First, the accumulated depreciation reflected in the
11 books, records, and Annual Reports to the PSC, does not properly reflect the age and
12 condition of the plant. Secondly, since the "non-utilized" portion of plant is not
13 properly removed from plant, rate base is overstated, which results in an excessive and
14 unjustified Return on Rate Base. And as I will discuss later, it also results in much
15 higher property tax expense. Depreciation is meant to return the investment in plant
16 built to serve customers to the owners over its estimated useful life. Thus, the plant
17 should be depreciated using the useful lives established by the Company and approved
18 by the PSC without the application of utilization factors.

19

1 **Q: ASSUMING THE USE OF UF-ADJUSTED DEPRECIATION RATES IS A**
2 **REASONABLE METHODOLOGY FOR RATEMAKING, WHAT WOULD BE**
3 **THE APPROPRIATE REGULATORY ACCOUNTING TREATMENT?**

4 A: GAAP and the appropriate regulatory accounting guidelines require that plant be fully
5 depreciated using the useful lives established and the portion of “non-utilized”
6 depreciation expense be placed in a deferred account for later recovery. Further, I am
7 not aware of any case where this Commission has approved UF adjusted depreciation
8 rates in the past.

9 **Q: DID YOU CALCULATE OR ESTIMATE THE DEFERRED AMOUNT THE**
10 **COMPANY IS ENTITLED TO RECOVER?**

11 A: Yes. I calculated the deferred amount to be \$316,142. In determining this amount I
12 first determined how much UF adjusted depreciation expense DIUC added since
13 acquiring HPUC and Melrose Utility Company (“MUC”). I calculated the difference
14 between the accumulated depreciation of plant when DIUC was first established
15 (12/31/2007) and the DIUC accumulated depreciation at Test Year end, per books and
16 per the PSC Annual Reports. I then added back the various accumulated depreciation
17 adjustments detailed in past Annual Reports, such as Salvage, Retirements, and Cost
18 of Removal as depicted in Table 2, below.

19

TABLE 2
Calculation of DIUC UF Adjusted Depreciation Expense Added Since Formation

	<u>Water System</u>	<u>Sewer System</u>	<u>Total System</u>
1 DUIC Accum Depre 12/31/2014	\$ (382,950)	\$ (404,688)	\$ (787,638)
2 DUIC Accum Depre 12/31/2007	(233,744)	(273,811)	(507,555)
3 Change in Accum Depre DUIC	\$ (149,206)	\$ (130,877)	\$ (280,083)
4 Accum Depre Adj. per Annual Reports	(127,974)	(109,607)	(237,581)
5 DUIC UF Adj. Depre Exp. Added	\$ (277,180)	\$ (240,484)	\$ (517,664)

I then determined the GAAP/Regulatory accumulated depreciation as reflected in the calculated Accumulated Depreciation amount explained above. I began with the unadjusted GAAP/Regulatory accumulated Depreciation expense and removed the GAAP/Regulatory Accumulated Depreciation at the acquisition dates of both HPUC and MUC, as shown in Table 3 below.

TABLE 3
Calculation of Non-UF Adjusted Depreciation Expense Added Since Formation

	<u>Water System</u>	<u>Sewer System</u>	<u>Total System</u>
1 GAAP/Reg Accum Depr Exp	\$ (1,239,970)	\$ (1,699,111)	\$ (2,939,080)
2 HPUC GAAP/Reg Depr Exp @ Acquisition	\$ (684,408)	\$ (1,005,357)	\$ (1,689,765)
3 MUC GAAP/Reg Depr Exp @ Acquisition	(137,187)	(278,321)	(415,509)
4 DUIF GAAP/Reg Depr Exp. Added	\$ (418,375)	\$ (415,433)	\$ (833,806)

The difference in the two amounts calculated in Tables 2 and 3, above, represents the amount DIUC is entitled to recover, as shown in Table 4 below, for the water, sewer, and combined systems, respectively.

TABLE 4
Calculation of DIUC Depreciation Recovery Amount

	<u>Water System</u>	<u>Sewer System</u>	<u>Total System</u>
1 DIUF GAAP/Reg Depr Exp Added	\$ (418,374)	\$ (415,432)	\$ (833,806)
2 DIUC UF Adj Depr Exp Added	(277,180)	(240,484)	(517,664)
3 DIUC GAAP Deferral Recovery	\$ (141,194)	\$ (174,948)	\$ (316,142)

Q: WHEN SHOULD DIUC BE ALLOWED TO RECOVER THE DEFFERAL?

A: If the Commission determines that the UF adjusted depreciation is appropriate, the above deferral should be established as a regulatory asset on the Company's books. Going forward, DIUC should add the difference between the UF adjusted depreciation expense and the GAAP/Regulatory depreciation expense amount to Accumulated Depreciation and to the deferred account. Future recovery of the ongoing deferral should be done using a methodology based on a fully built and utilized system. Since, according to the Company's justification, the non-UF adjusted depreciation expense is related to the non-utilization of the system by water and sewer customers, the deferred depreciation expense is related to the difference in the number of current customers and the number of customers when the system is fully utilized. Thus, when a customer is added, a pro rata portion of the deferral could begin to be amortized to expense either over the overall remaining useful life of the assets or a reasonable estimate of when the system will be fully utilized. For instance, if the period of time were 20 years, the deferred depreciation expense per customer would be amortized and charged to expense over 20 years. Establishment of a deferral amount or regulatory asset and its recovery requires PSC approval. I believe the Company should be

1 allowed to present a reasonable methodology to recover the deferral should the
2 Commission approve the on-going use of the UF adjusted depreciation rates.

3 **Q: TO YOUR KNOWLEDGE HAS THE PSC APPROVED THIS**
4 **METHODOLOGY IN PREVIOUS RATE ORDERS?**

5 A: No. I have reviewed past orders and did not find specific approval for the DIUC UF
6 methodology. It appears that all the rate cases have been settled by DIUC and
7 subsequent Orders have reflected the settlement agreement. I did not find approval for
8 this methodology.

9 **Q: WOULD YOU RECOMMEND TO THIS COMMISSION THAT IT ACCEPT**
10 **THE COMPANY'S UF METHODOLOGY?**

11 A: No, not at this time. The Company has not presented any information that adequately
12 explains why this methodology should be used for rate making or regulatory
13 accounting purposes. I have never seen this methodology used in the 25 years I have
14 been involved in ratemaking and regulatory accounting. Adjustments to reflect excess
15 capacity or plant not "used and useful" (due to over building, imprudence, etc.), are
16 the only rate making adjustments I am aware of that are somewhat comparable to the
17 Company's UF methodology. Typically, the "non-used and useful" plant is removed
18 from rate base and the depreciation expense related to that plant is excluded for
19 ratemaking purposes. If the plant is placed in Plant Held for Future Use (PHFU),
20 depreciation may be suspended, but only for a short time period. This is not the case
21 with the Company's UF methodology. While part of the depreciation expense is
22 excluded from the revenue requirement, the original cost of the "non-utilized" portion

1 of plant remains in rate base. Further, the Company's UF methodology should apply
2 the rate making principle of "matching" and remove the associated plant and
3 corresponding CIAC from rate base or explain why it is not reasonable to do so.
4 DIUC's methodology suggests that since the "non-utilized" plant in rate base will not
5 be "utilized" until future customers connect, the plant is not aging or depreciating.
6 Practically speaking, you cannot shut down a portion of the plant. In essence it is all
7 being used, even though not to capacity. It is unreasonable to assert that the lack of
8 active customers somehow suspends time and the action of environmental elements.
9 The Company has not presented any evidence that this is the case. As I stated above,
10 depreciation is meant to return the investment to the owners over its *estimated* useful
11 life. Depreciation is not a measure of actual consumption or use of plant. Proper
12 regulatory accounting aside, common sense indicates that the condition of DIUC's
13 plant is not properly reflected in its recorded accumulated depreciation. This is also
14 supported by the testimony of Mr. Harry Jue. Mr. Jue determined that DIUC's plant is
15 older and its condition reflects considerably more wear and tear than is reflected on
16 DIUC's books. As reflected in his testimony, Mr. Jue recommends accumulation
17 depreciation percentage of 30% and a depreciated value of the plant, based on the
18 Company's schedule of plant assets as provided in response to the Office of
19 Regulatory Staff's ("ORS's") data and information request, 1.56.

20 **Q: WOULD THE COMPANY'S APPLICATION OF THE UF METHODOLOGY BE**
21 **CORRECT IF IT MADE ALL THE CHANGES YOU DESCRIBE ABOVE?**

22 **A:** No.. DIUC currently collects Availability Fees from all property owners to whom
23 water and sewer service have been made available, although the service is not being

1 utilized. DIUC's collection of Availability Fees is inconsistent with its UF
2 methodology.

3 **Q: PLEASE DEFINE AVAILABILITY FEES AND WHY THE COMPANY'S**
4 **COLLECTION OF AVAILABILITY FEES PREVENTS IT FROM**
5 **APPLYING THE UF METHODOLOGY.**

6 **A:** Availability fees are typically charged to owners of vacant lots who may connect to
7 the water and wastewater system in the future. DIUC's establishment and collection
8 of availability fees recovers depreciation expense (among other things). AWWA
9 Manual M1 (5th Edition), "Principles of Water Rates, Fees, and Charges" states on
10 page 212 regarding Availability fees:

11 "For investor-owned utilities, a fixed rate would include *depreciation*
12 *expense*, taxes, and return (as applied to the value of the plant in
13 question), as well as O&M expenses" (emphasis added).

14 Thus, depreciation expense on the "non-utilized" plant is already being recovered by
15 DIUC from the revenue generated by the Availability Fees. There is no need for
16 depreciation expense to be adjusted by a utilization factor. This is supported by the fact
17 that DIUC's Availability Fees are almost as high as the charges for current active
18 customers, (excluding consumption charges).

19

1 **Q: WHAT SHOULD HAPPEN TO THE \$316,142 DEFERRAL IF THE UF**
2 **METHODOLOGY IS SUSPENDED?**

3 A: The \$316,142 deferral still represents investment that DIUC has not been able to
4 recover in rates. The Company should be allowed to recover the deferral in rates over
5 the period of time it was created, seven years, or approximately \$45 thousand per year.

6 **Q:** Are you recommending that the UF Methodology be suspended.

7 A: Yes I am.

8 **Q: SHOULD THIS DEFERRED DEPRECIATION EXPENSE AMOUNT BE**
9 **PLACED IN RATE BASE?**

10 A: No it should not. It represents the recovery of or return *of* the Company's investment,
11 only, and it does not represent cash working capital as other deferred account balances
12 may.

13 **Q: PLEASE EXPLAIN THE CIAC ADJUSTMENT DEPICTED ON LINES 2**
14 **THROUGH 4 PRESENTED IN TABLE 1, ABOVE.**

15 A: In my opinion, the majority of plant purchased by DIUC from HPUC should be
16 reflected as Contributions in Aid of Construction (CIAC), not as invested plant. My
17 conclusion is based on my review of several documents presented in this Docket, the
18 last DIUC rate case Docket, and past Commission Annual Reports obtained from the
19 Commission. The adjustment on Lines 2 and 3 represents the resulting increases in
20 CIAC and related amortization, respectively.

21

1 **Q: DIUC HAS BEEN IN OPERATION FOR THE LAST SEVEN YEARS SINCE**
2 **ACQUIRING HPUC. NOW, AFTER SEVEN YEARS, YOU BELIEVE THAT**
3 **THE COMPANY MISCLASSIFIED CIAC PLANT?**

4 **A:** Yes. I believe the original owner of HPUC, International Paper (IP) and later Haig
5 Point Inc. (HPI), a developer, treated the utility plant in HPUC as inventory and
6 expensed these costs as development costs. As a result, and as I explain below, HPUC
7 did not maintain plant balances or report plant balances on its Commission annual
8 reports for many years. Instead, HPUC's plant remained on the developer's books
9 until Haig Point Inc. (HPI) sold all the lots and was ready to exit the Daufuskie Island
10 real estate market. When HPUC considered seeking rate relief in 2005 (some 20 years
11 after its initial rate case before the Commission), it discovered it had no supporting
12 plant records or rate base. . Working with Mr. Guastell, HPUC developed an original
13 cost trending study to establish original cost values for the undocumented (or
14 expensed) plant. Once the study was completed, the values were reported in the PSC
15 Annual Reports and HPI contributed or "assigned" all the utility plant, easements and
16 rights of way to HPUC. A rate increase was granted (in 2005) and HPI sold HPUC to
17 CK Materials in 2008, later renaming the Company to Daufuskie Island Utility
18 Company ("DIUC"). Since most of the plant in the rate case was donated to HPUC, it
19 should have been classified as CIAC. According to GAAP and regulatory accounting
20 principles, once plant is first committed to service as CIAC, it should remain CIAC,
21 regardless of who the owner is or what was paid for it.

22

1 **Q: HOW DID YOU ARRIVE AT THIS CONCLUSION?**

2 A: It began with my investigation into the astounding increase in property taxes, as
3 described on page 3 in the Direct Testimony of Mr. Guastella. I was puzzled with how
4 property taxes could increase from \$10,000 to a whopping \$270,000 in less than a
5 year. DIUC is also seeking recovery of over \$500,000 thousand in past property taxes,
6 which it is carrying in a deferred account. So, the question arises as to why HPUC's
7 property taxes have historically been so low. I obtained all of the DIUC, HPUC and
8 MUC Annual Reports to the PSC in order to investigate plant values and reconcile the
9 huge property tax increase. Annual Reports were received for HPUC from 2000
10 forward.

11

12 **Q: WHAT DID THE HPUC PSC WATER ANNUAL REPORTS FILED PRIOR**
13 **TO 2004 REVEAL?**

14 A: The 2000, 2001, 2002 and 2003 HPUC Water Annual Reports showed no plant
15 balances at all. The reports showed only revenues and expenses with a small amount
16 of "non-utility" property or plant. This confirms that all plant had been contributed.
17 There was no source of financing such as debt, paid in capital, or contributions, and
18 there were no cash balances reported. The only liabilities shown were small amounts
19 for accounts payable and deferred income taxes.

20

1 Q: WHAT DID THE HPUC PSC SEWER ANNUAL REPORTS FILED BEFORE
2 2004 REVEAL?

3 A: From my understanding, there were no separate HPUC sewer Annual Reports filed.
4 Only Haig Point- Melrose Annual Reports were filed. The Haig Point-Melrose filing
5 was for a jointly owned wastewater treatment plant between two developers who
6 owned developments adjacent to each other. The developers' two sewer utilities
7 shared in the operation and maintenance of the treatment plant. The 1985 agreement to
8 build and operate the wastewater treatment plant was between International Paper
9 (HPI's predecessor) and the Melrose Group, not the developer utilities. Both the 2001
10 and 2002 reports showed a gross value for the treatment plant of about \$2.42 million,
11 which corresponds to the agreement. I believe that since the utility was owned by two
12 parties, the costs were tracked separately for the agreement and Annual Reports.
13 However, the treatment plant was classified as General Plant rather than being
14 segregated into its different plant accounts in the utility plant detail section of the
15 Annual Report. The General Plant amount was segregated into two values: one value
16 for "Land and Land Rights" which tied to the two developer's treatment plant
17 agreement, and the other value as "Structures and Improvements" or the same sort of
18 term that a developer would use on its property tax reports. Both Annual Reports show
19 about \$703 thousand in accumulated depreciation as 12/31/2001 and 12/31/2002. In
20 other words, there was no change between 2001 and 2002. The treatment plant was
21 57% depreciated at the end of each of these periods and the **net plant** was zero. Again,
22 there were no sources of financing such as debt or paid in capital, only accounts
23 payable to associated companies.

1 **Q: HOW CAN PLANT THAT IS 57% DEPRECIATED HAVE A NET VALUE OF**
2 **ZERO?**

3 A: There was an offsetting amount of \$539,000 recorded in "Other Utility Plant
4 Adjustments" with the notation "Reserve Prop. Held" next to it. I assume the note was
5 an abbreviation for the term "Reserve Properties Held".

6 **Q: IS "RESERVE PROPERTIES HELD" A UTILITY TERM?**

7 A: No, it is not. It is a term used by developers. There was a time when developers
8 accounted for water and sewer utility plant as "inventory" which was typically booked
9 to the Reserve Property Held (RPH) account. As home builders and retail land sales
10 developers sold their houses or lots, they would remove a portion of the costs from the
11 RPH account and expense it to offset the sales revenue to determine gross margins.

12 **Q: IF RPH ACCOUNTS REPRESENT INVENTORY, WHY WOULD IT BE**
13 **REFLECTED AS A CREDIT IN THE COMPANY'S ANNUAL REPORT?**

14 A: I believe the Annual Report credit entry was meant to reflect that the remaining net
15 balance is on the developers' books, classified as RPH. This would prevent the
16 property from being taxed twice for property tax purposes (i.e., once on the developer
17 and once on the utility).

18 **Q: WHY WOULDN'T HPI JUST CLASSIFY IT AS CIAC?**

19 A: Since all the Annual Report amounts are also on the books of the developer, it would
20 be difficult to explain to the DOR that the developer made a "contribution" to itself. It
21 makes more sense to show a RPH credit on the Annual Report with a debit reported on
22 the developer's books, helping the DOR better understand should the developer be

questioned on the utility property balances. I should note that the 2000-2003 Annual Reports did not show any property tax expense either.

Q: WHAT DID THE HPUC PSC WATER AND SEWER ANNUAL REPORTS FILED AFTER 2004 REVEAL?

A: Beginning in 2004, \$4.1 million in net plant appears in the PSC Annual Reports for HPUC. Although well over half of the plant had been in service for at least 15 years or more, it was only depreciated by about 5.5%, as shown in Table 6, below.

TABLE 6
HPUC 2004 PSC Annual Reports

	<u>Water System</u>	<u>Sewer System</u>	<u>Total System</u>
1 Gross Plant	\$ 1,731,215	\$ 2,628,049	\$ 4,359,264
2 Accumulated Depr	(106,504)	(133,578)	(240,082)
3 Net Plant	\$ 1,624,711	\$ 2,494,471	\$ 4,119,182
4 Plant Depr %	6.15%	5.08%	5.51%

“Common Stock” and “Other Paid in Capital” also appear in the equity section of the reports. There was no debt reported and no property taxes reported. Clearly, the equity shown relates to the contributed plant. That is, there were no funds to support the equity investment other than the contributed plant. Again, there were no cash balances recorded in the balance sheet. Cash is not reported in the balance sheet until after HPUC is purchased.

Q: DO YOU HAVE AN EXPLANATION FOR WHAT HAPPENED IN 2004 THAT CAUSED THE UTILITY PLANT TO APPEAR?

A: As I explained earlier, HPUC hired Mr. Guastella to ready HPUC for sale. Unfortunately, the Company did not have any rate base because it had all been

1 expensed as “cost of goods sold” as lot were sold. Mr. Guastella probably inventoried
 2 the plant and identified certain records that helped date the plant. He probably then
 3 performed an original cost trending study (discussed later) to establish original cost
 4 plant values. In Mr. Guastella’s *Report on Capital Improvements*, dated May, 2015, he
 5 states that “transition from IP required development of adequate records”. I presume
 6 he meant property records. Later, after plant has been identified and the 2004 Annual
 7 Report filed, the following occurs, according to Mr. Guastella’s May 2015 report:

8 “In 2005, Haig Point, Inc. ("Haig Point"), formerly International Paper
 9 Realty Corporation of South Carolina, assigned all easement rights to
 10 construct, operate, maintain and replace the water and wastewater
 11 utility systems throughout the Haig Point development area.”
 12

13 The “assignment” or developer contribution included all the “newly developed” or
 14 trended utility plant as well. As I indicated earlier, all the utility plant had been owned
 15 by the developer, but charged to expense as the lots were sold.

16 **Q: HOW DID YOU IDENTIFY THE TRENDING CIAC PLANT?**

17 A: The trending utility plant balances are provided in the 2004 and subsequent PSC
 18 Annual Reports are detailed on page 2 of Disclosure Schedule 3.13(a) in the HPUC
 19 Purchase Agreement. The dates listed after the plant descriptions reflect “Operating
 20 Permit Issuance” dates, not “in service” dates. Operating permit dates can be used to
 21 date plant when developing an original cost trending study. These studies are typically
 22 performed when there are no supporting cost records of plant. The NARUC USoA
 23 requires an “estimate” of plant values when there is no supporting documentation
 24 available. Original cost trending studies have been an accepted methodology to

1 establish these values. However, a trending study is not needed when the plant has
2 been contributed by a developer.

3 **Q: FROM YOUR EXPERIENCE, WHAT HAPPENS WHEN A UTILITY USES**
4 **AN ORIGINAL COST TRENDING STUDY TO SUPPORT ITS PLANT IN**
5 **RATE BASE?**

6 A: Typically the study is presented in a rate proceeding where the parties involved can
7 review and analyze the study. If not formally presented in a rate proceeding, the study
8 is made available if intervenors ask for plant documentation.

9 **Q: DID YOU ASK FOR PLANT DOCUMENTATION?**

10 A: Through Counsel, I did ask if the plant was supported by a trending study. The
11 Company objected to the request and no information was provided.

12 **Q: IF IN FACT THERE IS AN ORIGINAL COST TRENDING STUDY, IS IT**
13 **IMPORTANT THAT IT BE REVIEWED AND ANALYZED FOR**
14 **REASONABLENESS?**

15 A: Yes, but not in this case because the plant was contributed by a developer. Therefore,
16 the trending study has no impact on rates. The plant and corresponding accumulated
17 depreciation offset the CIAC and corresponding amortization. It is important that the
18 CIAC liability is amortized along with the plant that created the liability, thus both
19 properly offset each other and the ratepayers receive full credit for the donated plant.
20 At the same time, the Company is depreciating the plant along with the liability. This
21 prevents the CIAC liability from remaining on the books beyond the life of the plant it
22 reflects.

Q: WHAT IS YOUR RECOMMENDATION TO THE COMMISSION REGARDING THE ORIGINAL COST OF PLANT?

A: I recommend that the Commission treat the plant in question as CIAC. The fact that developers contribute a significant amount of plant to utilities should not be considered strange or unusual. On the contrary, it is strange that a small rural utility like DIUC does not have more CIAC. Many small rural water and sewer IOUs have a significant amount of contributed capital. In my experience, the smaller the utility the higher the percentage of CIAC. Without CIAC, utility rates would be very high, which discourages lot or home sales. Having utility services available at a reasonable cost tremendously enhanced the value of the developer's lots or homes.

Q: ARE THERE RATE IMPACTS OTHER THAN RATE BASE THAT RESULT FROM THE CIAC MISCLASSIFICATION

A: Yes. The CIAC amortization that offsets depreciation needs to be adjusted. Table 7 below includes the full amount of "Non-UF" adjusted depreciation to reflect the adjustments I discussed earlier as well as the CIAC amortization adjusted to reflect the additional HPUC CIAC.

TABLE 7
Adjustment to Depreciation Expense and CIAC Amortization

	<u>Water System</u>	<u>Sewer System</u>	<u>Total System</u>
1 Non-UF Adjusted Depr	\$ 86,860	\$ 103,981	\$ 190,841
2 HPUC CIAC Amortization	(36,394)	(61,451)	(97,845)
3 Net Depreciation Exp	\$ 50,466	\$ 42,530	\$ 92,996
4 DIUC Depreciation Exp	\$ 41,938	\$ 53,328	\$ 95,266
5 Adjustment	\$ 8,528	\$ (10,798)	\$ (2,270)

1 **Q: WHAT EFFECT DID THE CIAC MISCLASSIFICATION HAVE ON PLANT**
2 **VALUES AND THE RESULTING PROPERTY TAXES BASED UPON THOSE**
3 **PLANT VALUES?**

4 A: The failure to apply CIAC properly, combined with the artificially low accumulated
5 depreciation addressed earlier, resulted in a very high valuation of plant for property
6 tax assessments.

7 **Q. DID YOUR REVIEW REVEAL OTHER FACTORS THAT MAY HAVE**
8 **RESULTED IN A VERY HIGH VALUATION OF PLANT FOR PROPERTY**
9 **TAX PURPOSES?**

10 A. Yes. If DIUC (and its predecessors) had recorded its acquisitions according to the
11 NARUC USoA, a lower plant balance for property tax reporting (but not for rate case
12 purposes) would be reflected in the books because there would be a large offsetting
13 negative acquisition adjustment. The difference between the purchase price and net
14 plant, less net CIAC, should be recorded in NARUC plant account 116 "Utility Plant
15 Acquisition Adjustments".

16 **Q: PLEASE EXPLAIN WHY IT IS IMPORTANT FOR THE COMPANY TO**
17 **REPORT AN ACQUISITION ADJUSTMENT ON ITS BOOKS AND IN**
18 **THE COMMISSION ANNUAL REPORTS.**

19 A: In addition to the tax consequences I describe below, I believe an acquisition
20 adjustment will allow the Company to reflect the proper amount of equity on its
21 books. Although the Company refused to provide us the accounting entries that
22 established its acquisitions, it appears the equity section of the Company's balance

1 sheet may be overstated. Currently the Company is reporting around \$5.5 million of
2 investments in Capital Stock and Paid-In Capital. However, from what I can tell, only
3 \$2 million to \$3 million has actually been invested. It appears that what should have
4 been negative acquisition adjustments were instead booked in the equity section of the
5 balance sheet.

6

7 **Q: DID YOU UNDERTAKE TO CALCULATE APPROPRIATE ACQUISITION**
8 **ADJUSTMENTS FOR DIUC?**

9 A. Yes. I sought to determine purchase price paid for Melrose and HPUC, and then
10 compare those amounts to the corresponding net plant.

11 **Q: WHAT PRICE DID DIUC PAY TO ACQUIRE HPUC AND MUC?**

12 A: The Company paid \$500,000 for MUC, as indicated in the bankruptcy documents
13 provided. I do not know exactly how much was paid for HPUC because the purchase
14 price was redacted from the HPUC purchase contract that was provided.

15 **Q: HOW DID YOU DETERMINE THE PRICE PAID FOR HPUC?**

16 A: I developed a proxy amount based on the contract that DIUC has with Mr. Guastella
17 for the management of DIUC. I estimated the purchase price for HPUC by using the
18 incentive base amount agreed to in the GA Associates management contract with
19 DIUC. The contract states that upon the owner's sale or divestiture of DIUC, GA
20 Associates is entitled to a percentage share of the "adjusted purchase price" above
21 \$2,065,387. The contract defines the "adjusted purchase price" as follows:

1 “The Adjusted Purchase Price reflects the current purchase price and related
2 costs incurred by the Parent to acquire the utility.”

3 The benchmark represents the total amount DIUC paid for HPUC and MUC. My
4 estimated purchase price for HPUC is \$1,565,387 or \$2,065,387 less the \$500,000
5 paid for MUC.

6 **Q: HAVE YOU CALCULATED ACQUISITION ADJUSTMENTS FOR HPUC**
7 **AND MUC?**

8 A: Yes. I assumed a closing date for HPUC of 8/2008 and a closing date for MUC of
9 4/2010. I adjusted the HPUC 2009 Annual Report and the Plant Values used for
10 Melrose in the last rate case to arrive at net plant and net CIAC. The calculation for
11 HPUC is presented in Table 8. The calculation for MUC is presented in Table 9.

TABLE 8
Calculation of HPUC Acquisition Adjustment

1 Purchase Price		\$ 1,565,387
2 Plant	\$ 5,891,173	
3 Accum Depr	<u>(446,428)</u>	
4 Net Plant		\$ 5,444,745
5 Less: CIAC	\$ (470,795)	
6 Accum Amort	<u>35,843</u>	
7 Total CIAC and Accum Amort		\$ (434,952)
8 Acquisition Adjustment		\$ (3,444,405)

TABLE 9
Calculation of MUC Acquisition Adjustment

1	Purchase Price		\$	500,000
2	Plant	\$	1,126,018	
3	Accum Depr	(108,396)		
4	Net Plant		\$	1,017,622
5	Less: CIAC	\$	(176,500)	
6	Accum Amort	5,222		
7	Total CIAC and Accum Amort		\$	(171,278)
8	Acquisition Adjustment		\$	(346,344)

The calculations above are based on DIUC's books and have not been adjusted to reflect the proper regulatory accounting and NARUC guidelines regarding acquisition adjustments. The plant reported to the DOR would have been almost \$3.8 million lower. This reduction would lower DIUC's annual property taxes about \$99,000 and the back taxes by about \$295,000 . The large negative acquisition adjustment means that DIUC purchased the utilities at a bargain price. Since the acquisition adjustment is part of plant and is represented as part of plant in the PSC Annual Report form, the taxes would have been lower. It should be noted that the PSC Annual Report has a special section (Schedule 2.03) in the Annual Report for reporting acquisition adjustments.

Q: SHOULD THE ACQUISITION ADJUSTMENT BE INCLUDED IN RATE BASE?

A: No. Troubled utilities usually become "troubled" because they have poor records, poor management, and/or limited resources. Consequently, troubled utilities are often acquired for less than the net original cost of its plant in service. The purchaser is

1 required by the NARUC USoA to record a negative acquisition adjustment on its
2 books. However, if a negative acquisition adjustment is included in its rate base for the
3 determination of rates, the utility's allowed return is reduced, which destroys any
4 economic incentive for financially sound utilities to acquire troubled utilities. Any
5 incentive for the financially sound utility to negotiate the lowest possible price is
6 negated, which results in financially sound utilities becoming unwilling to purchase
7 troubled ones. The message sent by the regulator, when a negative acquisition
8 adjustment is included in rate base in the determination of rates, is that the lower the
9 price paid for a troubled utility, the lower the future returns or available cash flow to
10 service new debt or future additions and replacements. Many Commissions exclude
11 both positive and negative acquisition adjustments in order to maintain a consistent
12 original cost standard. Other Commissions will consider acquisition adjustments on a
13 case-by-case basis and will include them only when good cause is demonstrated. As a
14 general rule of thumb, I believe including negative acquisition adjustments in rate base
15 will cause more harm than good, unless there is a good reason to do so.

16 **Q: IF THE COMMISSION ACCEPTS YOUR ADJUSTMENTS TO**
17 **ACCUMULATED DEPRECIATION AND CIAC, WOULD THERE BE**
18 **PROPERTY TAX SAVINGS?**

19 **A:** Yes. The savings would be comparable to the savings I discuss above, but about \$5
20 thousand to \$10 thousand less on an annual basis, based on my rough estimate.

21

1 Q: WHAT WOULD THE ACQUISITION ADJUSTMENTS BE WITH YOUR
2 RECOMMENDED ADJUSTMENTS TO ACCUMULATED DEPRECIATION
3 AND CIAC?

4 A: Assuming the same closing dates but higher accumulated depreciation balances to
5 reflect full deprecation and the HPUC CIAC, the calculations are presented in Tables
6 10 and 11, below.

TABLE 10
Calculation of HPUC Acquisition Adjustment

1 Purchase Price		\$ 1,565,387
2 Plant	\$ 5,891,173	
3 Accum Depr	<u>(1,689,765)</u>	
4 Net Plant		\$ 4,201,408
5 Less: CIAC	\$ (4,472,559)	
6 Accum Amort	<u>1,635,440</u>	
7 Total CIAC and Accum Amort		<u>\$ (2,837,119)</u>
8 Acquisition Adjustment		\$ 201,098

TABLE 11
Calculation of MUC Acquisition Adjustment

1 Purchase Price		\$ 500,000
2 Plant	\$ 1,126,018	
3 Accum Depr	<u>(415,509)</u>	
4 Net Plant		\$ 710,509
5 Less: CIAC	\$ (176,500)	
6 Accum Amort	<u>65,130</u>	
7 Total CIAC and Accum Amort		<u>\$ (111,370)</u>
8 Acquisition Adjustment		\$ (99,139)

9 The acquisition adjustments for the two utilities is a positive adjustment of about \$102
10 thousand. This further indicates that a fair price was paid for the utility.

Q: PLEASE EXPLAIN THE TWO DIFFERENT CALCULATIONS OF ACQUISITION ADJUSTMENTS.

A: The calculations in Table 12 and 13 below indicate that the HPUC and MUC combined net plant was purchased either at an approximately 65% discount or at a small premium of 5%. I am skeptical that HPI was willing to sell its utility at a 65% discount. I believe the developer only wanted to recover the plant investment that was made immediately prior to the sale or the plant that went into service during 2007. This plant was listed on page 3 of the Disclosure Statement referenced above. The schedule showed about \$1.4 million in newly constructed plant. The additional money paid most likely covered the seller's transaction costs.

TABLE 12
Bargain Purchase

1 Purchase Price		\$ 2,065,387
2 Plant	\$ 7,017,191	
3 Accum Depr	<u>(554,824)</u>	
4 Net Plant		\$ 6,462,367
5 Less: CIAC	\$ (647,295)	
6 Accum Amort	<u>41,065</u>	
7 Total CIAC and Accum Amort		\$ (606,230)
8 Acquisition Adjustment		<u>\$(3,790,750)</u>
9 Net Plant & CIAC		\$ 5,856,137
10 Bargain Purchase		-65%

TABLE 13
Small Premium Purchase

1	Purchase Price		\$ 2,065,387
2	Plant	\$ 7,017,191	
3	Accum Depr	<u>(2,105,274)</u>	
4	Net Plant		\$ 4,911,917
5	Less: CIAC	\$ (4,649,059)	
6	Accum Amort	<u>1,700,570</u>	
7	Total CIAC and Accum Amort		\$ (2,948,489)
8	Acquisition Adjustment		<u>\$ 101,959</u>
9	Net Plant & CIAC		\$ 1,963,428
10	Bargin Purchase		5%

Q: PLEASE ADDRESS YOUR PROPOSED ADJUSTMENT TO THE ANNUAL PROPERTY TAX AND THE BACK TAXES OR PAST PROPERTY TAXES.

A: Table 14 below presents my recalculation of property taxes, assuming my recommended changes to rate base. If the Company had followed GAAP, NARUC and regulatory accounting principles, the annual property taxes would be \$116 thousand lower than the Company's requested amount. Proper regulatory accounting would also reduce the back taxes owed to about \$125 thousand or \$402 thousand less than requested.

TABLE 14

Adjustment to Annual and Back Property Taxes Owed

Property Taxes with CIAC Adjust	2011	2012	2013	2014
1 Net Plant	4,703,358	4,552,231	4,526,446	5,437,761
2 Net CIAC	(2,773,722)	(2,678,977)	(2,544,518)	(2,450,673)
3 Net Acquisition Adjust.	(72,928)	(70,640)	(68,352)	(66,065)
4 Taxable Base	1,856,707	1,802,613	1,913,575	2,921,022
5 Assessment Ratio	10.5%	10.5%	10.5%	10.5%
6 Millage Rate	0.197540	0.200850	0.240033	0.248790
7 Tax Due	\$ 38,511	\$ 38,016	\$ 48,229	\$ 76,306
8 Total Back Taxes			\$ 124,756	
9 Requested 2014			526,864	\$ 192,301
10 Adjustment Back Taxes/Test Year			\$ (402,108)	\$ (115,995)

Q: PLEASE SUMMARIZE THE ADJUSTMENTS YOU ARE PROPOSING.

A: In Table 15, I summarize the plant adjustments I am recommending. As shown, I am recommending that the Rate Base, as proposed in the Company's filing, be reduced by \$3,745,530 from \$7,085,475 (shown on Schedule A-4, Pro Forma Present Rates) , representing reductions to the Water Rate Base of \$1,325,177, and a Sewer Rate Base of \$2,430,353.

TABLE 15

Proposed Adjustments to Rate Base

	DIUC Test Year 12/31/2014		
	Water	Sewer	Total
<i>Proposed Accumulated Depreciation</i>			
1 GAAP/Reg Accumulated Depr	\$ (1,111,996)	\$ (1,589,504)	\$ (2,701,499)
2 DIUC Accumulated Depr Expense	(382,950)	(407,074)	(790,024)
3 Adjustment to Accumulated Depr	\$ (729,047)	\$ (1,182,430)	\$ (1,911,475)
<i>Proposed CIAC</i>			
4 GAAP/Reg CIAC	\$ (1,845,899)	\$ (2,765,966)	\$ (4,611,864)
5 DIUC CIAC	(477,750)	(213,545)	(691,295)
6 Adjustment to CIAC	\$ (1,368,149)	\$ (2,552,421)	\$ (3,920,569)
<i>Proposed CIAC Amortization</i>			
7 GAAP/Reg CIAC Amortization	\$ 828,105	\$ 1,333,087	\$ 2,161,192
8 DIUC CIAC Amortization	56,088	18,589	74,677
9 Adjustment to CIAC Amortization	\$ 772,017	\$ 1,314,498	\$ 2,086,515
10 Total Adjustments to Rate Base	(1,325,177)	(2,420,353)	(3,745,530)

And in Table 16, below, I have summarized the expense Adjustments I am recommending, which are adjustments to depreciation expense, amortization expense, and property tax expense.

TABLE 16
Proposed Adjustments to Expenses

	DIUC Test Year 12/31/2014		
	Water	Sewer	Total
<i>Proposed Depreciation Expense</i>			
1 GAAP/Reg Depr Expense	\$ 50,466	\$ 42,530	\$ 92,996
2 Add: Depreciation Deferral (1)	20,171	24,993	45,163
3 Total Proposed Depr	\$ 70,636	\$ 67,523	\$ 138,159
4 DIUC Depr Expense	41,938	53,328	95,266
5 Adjustment to Accumulated Depr	\$ 28,698	\$ 14,195	\$ 42,893
<i>Proposed Property Tax Expense</i>			
6 Property Tax Under Adj. Plant	\$ 36,493	\$ 39,813	\$ 76,307
7 DIUC Property Tax Exp	91,967	100,334	192,301
8 Adjustment to Prop. Tax Exp	\$ (55,474)	\$ (60,521)	\$ (115,995)
9 Proposed Amort. Of Prop Tax (3)	\$ 7,797	\$ 7,797	\$ 15,594
10 DIUC Amort of Prop. Tax (2)	32,930	32,930	65,861
11 Adjustment to CIAC Amortization	\$ (25,133)	\$ (25,133)	\$ (50,267)
12 Total Adjustments to Expenses	(51,909)	(71,459)	(123,368)
(1) <i>Deferred Depreciation</i>	\$ 141,194	\$ 174,949	\$ 316,142
<i>Seven Year Recovery</i>	20,171	24,993	45,163
(2) <i>DIUC Property Tax Amortization</i>	\$ 263,442	\$ 263,442	\$ 526,884
<i>Eight Year Recovery</i>	32,930	32,930	65,861
(3) <i>Proposed Property Tax Amortization</i>	\$ 62,378	\$ 62,378	\$ 124,756
<i>Eight Year Recovery</i>	7,797	7,797	15,594

In short, I am recommending an increase in the Company's proposed Depreciation Expense of \$42,893, from \$95,266 to \$138,159 to reflect the GAAP depreciation expense and reduction related to the amortization of the CIAC adjustment and deferred depreciation expense. This includes an increase in depreciation to reflect the suspension of the UF adjusted depreciation rates of \$95,575, offset by an increase of CIAC amortization of \$97,845, plus the amortization of the deferred depreciation

1 expense of \$45,163 over seven years ($\$95,575 - \$97,845 + \$45,163 = \$42,893$). I am
2 also recommending the reduction in property tax Amortization Expense from \$65,861
3 to \$15,594, and a reduction in Property Taxes from \$192,301 to \$76,306. All of these
4 represent a total reduction in expenses of \$123,368.

5 **Q: DOES THIS CONCLUDE YOUR TESTIMONY?**

6 **A:** Yes, it does.

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[PURSUANT TO PREVIOUS INSTRUCTION, THE
PREFILED SURREBUTTAL TESTIMONY {W/CORRECTIONS}
OF CHARLES LOY FOLLOWS AT PGS 401-412]

MERITS HEARING - VOLUME 2 OF 2
10/28/15

PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

BEFORE
THE PUBLIC SERVICE COMMISSION OF **RECEIVED**
SOUTH CAROLINA **SEP 18 2015**
DOCKET NO. 2014-346-W/S **PSC SC**
MAIL / DMS

IN RE:)
Application of Daufuskie Island Utility) **SURREBUTTAL TESTIMONY OF**
Company, Inc. for Approval for Water) **CHARLES LOY**
and Sewer Rates, Terms and Conditions)

1 **Q: PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 **A:** My name is Charles Loy. My business address is 919 Congress, Suite 800 Austin,
3 Texas 78701. I am a Principal with GDS Associates, Inc. ("GDS"). GDS Associates,
4 Inc. ("GDS") is a utility consulting and engineering firm with its principal offices in
5 Marietta, GA. My business address is 919 Congress, Suite 800 Austin Texas 78701.

6 **Q: DID YOU SUBMIT DIRECT TESTIMONY IN THIS CASE?**

7 **A:** Yes.

8 **Q: HAVE YOU READ THE REBUTTAL TESTIMONY OF DIUC WITNESS**
9 **JOHN F. GUASTELLA?**

10 **A:** Yes.

11 **Q: WHAT TOPICS WILL YOUR SURREBUTTAL ADDRESS?**

12 **A:** I will address Mr. Gaustella's discussion of the system utilization factors and the
13 misclassified contributions in aid of construction (CIAC).

1 **Q: DOES MR. GAUSTELLA ADDRESS THE RECOMMENDATIONS IN YOUR**
2 **DIRECT TESTIMONY REGARDING THE PROPER REGULATORY**
3 **ACCOUNTING TREATMENT OF THE UTILIZATION FACTOR**
4 **METHODOLOGY?**

5 **A:** No he does not. Mr. Guastella does provide more background on the methodology
6 which he calls the "complete system analysis". Mr. Gaustella explains that the
7 methodology is not known by most experts because he developed it himself to address
8 the financing difficulties of "developer-related" or developer formed utilities.
9 (Guastella Rebuttal Testimony, p. 11, ll. 11-18). He explains that the methodology was
10 developed so "utility customers would not subsidize the cost of the real estate project
11 or even bear the risk of the success of the real estate project." (Guastella Rebuttal
12 Testimony, p. 12. ll. 2-4). This isolation from risk is accomplished by basing the
13 depreciation expense on the system utilization. According to Mr. Guastella, the
14 calculation results in less depreciation expense in the "growth years" and higher
15 depreciation as the system is built out. (Guastella Rebuttal Testimony, p. 12, ll. 8-12).
16 He claims the methodology prevents the book value from being overstated and the
17 developer utility will not be left in a weak financial position. He also claims the
18 methodology "preserves book value". To sum up, the "complete system analysis"
19 basically shifts or defers depreciation expense in the early "growth" years to be
20 recovered in the later years when the system is fully built out and there are more
21 customers to pay for the depreciation.

22

1 **Q: DOES THIS NEW UNDERSTANDING CHANGE YOUR OPINION ON THIS**
2 **METHDOLOGY?**

3 **A:** No. In essence, due to the lack of proper regulatory accounting, the “complete system
4 analysis” is a concealed request for rate base treatment of deferred depreciation
5 expense. This is because it is improperly reflected in the books for regulatory and rate
6 making purposes. Mr. Gaustella’s method overstates the net book value of plant
7 which results in higher returns for an extended period of time. It does more than just
8 “preserves book value”, it extends the book value beyond its useful life. If this
9 methodology is to be continued by this Commission, regulatory accounting should be
10 applied so the Commission understands exactly what it is approving, which is a
11 depreciation expense deferral balance or regulatory asset in rate base. As presented by
12 the Company, the “complete system analysis” significantly overstates rate base,
13 misapplies GAAP and regulatory accounting, and overstates net plant and returns for
14 rate making purposes.

15 **Q: WHAT ABOUT MR. GUASTELLA’S CLAIMS THAT IT KEEPS THE**
16 **UTILITY FROM A WEAK FINANCIAL POSITION AND ISOLATES**
17 **CUSTOMERS FROM THE DEVELOPER RISK?**

18 **A:** He does not provide any evidence that the methodology keeps the utility from a weak
19 financial position. I can only assume he is referring to the overstated rate base and
20 prolonged higher returns. Regardless, he provides absolutely no evidence why his
21 methodology isolates customers from developer risk. CIAC and Advances do a much
22 better job of isolating customers from developer risk. Developers contribute cost free
23 capital in the form of CIAC and advances in the form of interest free loans that are

1 paid or reimbursed through the utility "growth years" or as customers are added. From
 2 my understanding, the "complete system analysis" benefits the utility owners much
 3 more than the customers. The traditional CIAC/advances is the superior methodology
 4 for isolating developer risk.

5 **Q: WHAT IS THE APPROPRIATE REGULATORY ACCOUNTING**
 6 **TREATMENT UNDER THE "COMPLETE SYSTEM ANALYSIS" AS**
 7 **PROPOSED BY DIUC?**

8 **A:** As stated in my direct testimony, regardless of whether depreciation expense is
 9 deferred or not, the net plant still must be depreciated (using the approved depreciation
 10 rates) to reflect the appropriate age and condition of the utility net plant. Any deferred
 11 depreciation expense must be booked to a regulatory asset to be recovered later. DIUC
 12 is essentially requesting a \$1.9 million depreciation expense deferral to be recovered
 13 in future years while at the same time earning a return on net plant that is \$1.9 million
 14 higher than allowed under regulatory accounting principles. This Commission can
 15 accept this methodology; however, the proper regulatory accounting must be applied
 16 to reduce the net plant by the amount of the deferred depreciation expense. Otherwise,
 17 DIUC's methodology grants DIUC a windfall of ^{\$266,000}~~\$1,711,000~~. This is calculated by
 18 applying DIUC's requested rate of return to the \$1.9 million of deferred depreciation
 19 expense in rate base, resulting in \$266,000. By subtracting the deferred expense
 20 amount of \$95,000, as calculated properly under the "complete system analysis",
 21 DIUC receives ^{\$266,000}~~\$1,711,000~~ more in return revenues over the \$95,000 in deferred
 22 depreciation expense. Said another way, it is receiving a higher return of \$266,000 in
 23 exchange for \$95,000 less in depreciation expense. Further, it is important to

1 understand that the deferred depreciation expense will continue to earn a return until it
2 is recovered in future years.

3 **Q: ARE YOU ADVOCATING RATE BASE TREATMENT FOR THE**
4 **DEFERRED DEPRECIATION EXPENSE?**

5 **A:** No I am not. However, I believe that it is very important for this Commission to
6 understand that if it approves DIUC's "complete system analysis" methodology and its
7 accounting for recording it, the Commission is approving: 1) a return on the deferred
8 depreciation expense of \$316 thousand under DIUC ownership, 2) a return on the
9 deferred depreciation expense of \$1.6 million under IP/HPUC ownership and 3)
10 incorrect regulatory/GAAP accounting.

11 **Q: PLEASE SUMARIZE YOUR SURREBUTTAL ON THIS ISSUE.**

12 **A:** Mr. Gaustella does not explain why the accounting treatment I am recommending is
13 not correct or why his methodology is correct. Further, he offers no proof that this
14 methodology has been accepted at other Commissions. He merely claims I don't
15 understand developer utility problems. Developer utility problems are not the issue.
16 The issues this Commission should consider are: 1) DIUC seeks an inappropriate
17 return on deferred depreciation, 2) the regulatory accounting treatment for Mr.
18 Gaustella's methodology is an inappropriate expense deferral mechanism; and 3)
19 DIUC's books are incorrect for ratemaking and financial reporting purposes.
20

1 **Q: TURNING TO THE MISCLASSIFIED CIAC ISSUE YOU ADDRESSED IN**
 2 **YOUR DIRECT TESTIMONY, MR. GUASTELLA REGARDS YOUR**
 3 **ANALYSIS AS A "FABRICATION". PLEASE COMMENT.**

4 **A:** Mr. Guastella's testimony on this issue does not change my conclusion, or call into
 5 question my rationale in reaching that conclusion. Mr. Guastella believes my
 6 statement that International Paper, or Haig Point, Inc., expensed the utility property is
 7 "far-fetched," but he offers no reasonable basis to support that assertion. Mr. Gustella
 8 states "Under the tax code, one affiliate cannot expense plant for tax purposes and then
 9 transfer it to an affiliate who depreciates the cost that was already expensed." What
 10 International Paper and Haig Point, Inc. may have done (or may have been allowed to
 11 do), for tax purposes, is immaterial to my testimony, which addressed appropriate
 12 regulatory and GAAP accounting, not income tax accounting.

13 As a result, Mr. Guastella has offered nothing to rebut my conclusions.

14 **Q: PLEASE DISCUSS MR. GUASTELLA'S CONTENTION REGARDING CIAC.**

15 **A:** In his rebuttal testimony, Mr. Guastella states "In sum, there is absolutely no
 16 indication that there were customer contributions in aid of construction as defined in
 17 the NARUC USoA". I disagree with his conclusion. CIAC is defined in the NARUC
 18 USoA as:

19 "Any amount or item of money, services or property received by a utility, from
 20 any person or governmental agency, any portion of which is provided at no
 21 cost to the utility, which represents an addition or transfer to the capital of the
 22 utility, and which is utilized to offset the acquisition, improvement or
 23 construction costs of the utility's property, facilities, or equipment used to
 24 provide utility services to the public."

25 "Accounting for Public Utilities" by Robert L. Hahne, states:
 26

1 "Ratemaking treatment for contributions in aid of construction is a different
2 situation, because no obligation exists for the utility either to repay any funds
3 received or to reimburse parties donating physical property. The general rule is
4 that any such contributions should be excluded from rate base, since the related
5 plant investment has not been financed by the utility and customers should not
6 therefore be required to pay a return on the plant."

7 In 2005 IP transferred all its ownership rights to HPUC. In other words, it donated the
8 plant to HPUC. There was no obligation placed on HPUC to repay IP for this property.
9 Thus, per NARUC USoA, the plant should have been classified as CIAC. Instead,
10 HPUC booked one entry to plant and the offsetting entry to equity, rather than a CIAC
11 liability.

12 **Q: SINCE IP OWNED 100% OF HPUC, COULDN'T THIS JUST BE**
13 **CONSIDERED A TRANSFER OF EQUITY FROM ONE AFFILIATE TO**
14 **ANOTHER AFFILIATE?**

15 **A:** No. There is no evidence that the transfer required HPUC to reimburse or repay IP.
16 For financial reporting purposes, IP's value in the pre 2001 utility plant was zero in
17 2005. Annual Reports/10-Ks to the Security and Exchange Commission (SEC)
18 indicate the plant was written off by IP in 1997. Essentially, there was no equity to
19 record as none existed. From a regulatory accounting standpoint, the plant can only be
20 classified as a contribution or donation.

21

1 **Q: PLEASE EXPLAIN.**

2 **A: In the "Special Items Including Restructuring and Business Improvement Actions"**
3 **section of IP's 1999 SEC Form 10-K (Exhibit One), Note C in the write down**
4 **discussion section states:**

5 The Company is the developer of a residential golf community named Haig
6 Point at Daufuskie Island, S.C. As the developer, International Paper was
7 responsible for operating this community until a specified number of lots were
8 sold, at which time it would turn the community over to the homeowners. The
9 net book value of our investment in Haig Point was \$13 million at June 30,
10 1997. Given the continuing operating losses, \$5 million in 1997, an updated
11 marketing study, and the inability to find a buyer for this investment, *we*
12 *concluded that the investment was permanently impaired and wrote it down to*
13 *zero.* The operating loss in 1998 was \$500,000.

14
15 (Emphasis added).

16
17 Previous 10-Ks indicate that the value of Haig Point, Inc. was \$21 million in 1995.

18 The Company wrote its investment down in 1996 by \$8 million bringing the value to
19 \$13 million. The 1996 10-K stated the Company had made the decision to sell Haig
20 Point Inc. In 1997, IP decided to write the entire company off as a total loss, which
21 ended its venture into real estate development and utilities. The 1999 10-K reported
22 operating losses of \$1 million for Haig Point, Inc. From 2000-2004, the 10-Ks list
23 Haig Point as a "realty project." Thereafter, Haig Point disappears from the IP 10-Ks,
24 altogether. However, IP still had the obligation to serve that comes with owning a
25 water and sewer utility and, in 2004, Mr. Gaustella assisted HPUC with a rate case.

26 **Q: HPUC IS NOT MENTIONED IN THE 10-K. HOW DO YOU KNOW THE**
27 **UTILITY PLANT WAS WRITTEN OFF?**

28 **A: HPUC was owned 100% by Haig Point, Inc. and so would be included in the**
29 **information reported to the SEC in the Form 10-K.**

1 **Q: PLEASE SUMMARIZE THIS ISSUE.**

2 **A:** The plant transferred to HPUC from IP was transferred at no cost to HPUC, meeting
3 the definition of CIAC. Further, as my direct testimony indicates, CK Materials paid
4 paid IP an amount substantially less than the original cost plant recorded in the Annual
5 Reports to the Commission. As such, when CK Materials purchased the stock of
6 HPUC from IP, IP was not concerned about recovering any amount for the plant that
7 had been written off -- only the plant investment made after 2001. Neither the prior
8 owner, HPUC, nor the current owner DIUC, paid for or invested in utility plant that
9 went into service before 2001 and ratepayers should not provide a return to DIUC for
10 donated plant. DIUC should properly record the CIAC according to NARUC
11 guidelines.

12 **Q: ARE YOUR PROPOSED ADJUSTMENTS FOR PROPERTY TAXES AND**
13 **THE ACQUISITION ADJUSTMENT RELATED TO YOUR**
14 **RECOMMENDATION REGARDING CIAC?**

15 **A:** Yes. The major issue in this case is the importance of following NARUC, GAAP and
16 proper regulatory accounting. If DIUC had followed the proper regulatory accounting
17 guidelines, at the very least, its property taxes and associated liabilities would be
18 considerably less and the requested increase would be much less than the over 100%
19 the Company is currently requesting. It is understandable that DIUC (or CK Materials
20 at the time) may not have realized that a large part of the plant on the books of HPUC
21 was donated when it was acquired from IP.. DIUC should not be penalized for that.
22 Fortunately, for DIUC and the rate payers, DIUC's stockholder, CK Materials, paid a
23 price substantially lower than what is reflected in rate base. My viewpoint is

1 influenced by both the rate payers and the water utility clients I currently advise. I
 2 understand that it is very difficult to manage and operate a small IOU water and sewer
 3 company. However, it is important that proper regulatory accounting, as prescribed by
 4 NARUC and GAAP, is followed. Otherwise, as in this case, applying proper rate
 5 making standards gets complicated, which can lead to policy decisions that may not be
 6 in the public's interest.

7 **Q: WHAT WOULD YOU RECOMMEND TO THIS COMMISSION IN REGARD**
 8 **TO THE "COMPLETE SYSTEM ANALYSIS"?**

9 **A:** To properly reflect the rate impact of Mr. Gaustella's method, accumulated
 10 depreciation should be increased by \$1.9 million, which lowers property tax
 11 valuations. Two regulatory assets should be established: one for \$1.6 million to
 12 represent the deferred depreciation that would have occurred during the previous
 13 ownership and the other for \$316 thousand to represent the deferrals made under
 14 DIUC ownership. There are three questions the Commission should address regarding
 15 the "complete system analysis" methodology:

- 16 1. Is it reasonable for the Company to put in rate base the deferred depreciation
 17 expense that would have occurred under the previous owner had it not
 18 expensed or written off the utility plant?
- 19 2. Is it reasonable that the Company put in rate base the deferred depreciation
 20 expense occurring under its ownership?
- 21 3. Is it reasonable that the Company recover deferred depreciation expense that
 22 would have been deferred by the previous owner had it not expensed or written
 23 off the utility plant?

24
 25 I have presented my opinions regarding these questions. It is important that the
 26 Commission base its decision on a transparent explanation of Mr. Guastella's
 27 methodology and the impact these decisions will have on rates.

1 Q: WHAT WOULD YOU RECOMMEND THIS COMMISSION DO WITH
2 REGARD TO THE MISCLASSIFIED CIAC?

3 A: This issue reduces rate base by \$2.451 million, which also reduces property tax
4 valuations. Depreciation expense is reduced by approximately \$95 thousand, about the
5 same amount of the "complete system analysis" depreciation deferral. Further, the rate
6 of return and related income taxes will be reduced. The key questions the Commission
7 should ask and answer regarding this issue are:

- 8 1. Did International Paper intend to be in the water and sewer utility business or
9 was it just necessary for real estate sales?
- 10 2. Can a company transfer equity to a public utility when it is known that the
11 equity was written off and has a value of zero for financial reporting purposes?
- 12 3. Was the transfer of utility property from IP to HPUC a donation?

13
14 If the Commission's answer to question number one and two is "No", then the answer
15 to question number three should be "Yes".

16 Q: WHAT WOULD YOU RECOMMEND THIS COMMISSION DO WITH
17 REGARD TO THE UNRECORDED ACQUISITION ADJUSTMENTS?

18 A: The Commission should require the Company to properly record an acquisition
19 adjustment according to NARUC. In fact, the Commission Annual Report has a
20 special section for reporting acquisition adjustments. The main concern with the
21 acquisition adjustment should be how the previous two decisions will impact it. For
22 instance, if the Commission finds with the intervenors on the previous issues, the
23 acquisition adjustment will be relatively small and, other than it should be properly
24 reflected in the Commission Annual Reports, it should not be much of a concern. On
25 the other hand, if the Commission finds that IP did not donate the plant at issue and
26 CIAC was not misclassified, then a large negative acquisition adjustment should be

1 recorded. The Commission may find that, although the CIAC misclassification was
2 not made, the set of particular circumstances presented in this case requires it to
3 recognize all or part of the negative acquisition adjustment in rate base, in order to
4 satisfy the public interest. This can be reflected through a rate base reduction, or
5 amortization, or both. The question the Commission should ask when considering the
6 inclusion of a negative acquisition adjustment in rate base is: "Are the circumstances
7 in this case specific enough to meet the public interest and not discourage well
8 established financially sound utilities to purchase financially troubled utilities?" If the
9 answer is "Yes", I believe that such circumstances should be memorialized in an
10 Order for precedential reference. A negative acquisition adjustment should be included
11 in rate base only if there is a good reason to do so.

12 **Q: FINALLY, WHAT WOULD YOU RECOMMEND THIS COMMISSION DO**
13 **WITH REGARD TO THE PROPERTY TAX EXPENSE AND RELATED**
14 **LIABILITY ISSUE?**

15 **A:** The Commission's decisions, with respect to the previous issues and any other plant
16 value related issue, will determine how much property tax should be reflected in rates
17 and in the past due tax liability. I would expect that the Commission would require the
18 Company to re-file amended Annual Reports which should then be submitted to the
19 DOR for consideration in the property valuation of DIUC's utility plant. With lower
20 plant values reflected in the PSC Amended Annual Reports, the DOR should reduce
21 current and past DIUC plant valuations for the purpose of property tax valuation.

22 **Q: DOES THIS CONCLUDE YOUR SURREBUTTAL?**

23 **A:** Yes.

1 BY MR. PRINGLE:

2 Q Mr. Lanier, can you give a summary of your direct
3 testimony.

4 A [LANIER] Certainly.

5 In my direct testimony, I have incorporated the
6 rate base and expense adjustments that Mr. Loy just
7 described into the revenue requirements. I have
8 addressed the exponential growth in the company's
9 operating expenses. I have addressed specific expense
10 items, including proposing adjustments. I have proposed
11 an alternative capital structure, based on Mr. Loy's
12 plant and rate-base adjustments. I have recommended an
13 alternative return on equity and return on rate base,
14 and I have recommended alternative revenue requirements
15 and revenue increases.

16 The major points in my testimony are: that the
17 company's proposed increase of 109 percent is excessive,
18 it would represent rate shock, and would have adverse
19 effects on the development of the island; that most of
20 the requested increase is for return and related taxes;
21 that the company is not being operated in the most
22 efficient manner, and that the Commission should not
23 reward subpar performance with large returns to equity-
24 holders; that the company no longer needs to attract
25 capital as it did in 2012; that the company's requested

1 return on equity of 10.5 percent is excessive, and that
2 the company's requested increase would result in an
3 excessive operating margin of 17 percent.

4 After incorporating the plant and rate-base
5 adjustments and depreciation, amortization, and property
6 tax expense adjustments recommended by Mr. Loy, and my
7 own expense adjustments, I'm recommending an overall
8 revenue increase of 39.9 percent above present rates and
9 charges.

10 I have presented comparative evidence indicating
11 that the company's growth and expenses over the last
12 several years is excessive, representing 27.3 percent in
13 2013 and 11½ percent in 2014 – and noting, particularly,
14 they built in 3½ percent inflation in the Guastella
15 Associates management contract, regardless of actual
16 inflation rates – and recommending a reduction of almost
17 \$35,000 in power cost expense which is unsupported.

18 Based on Mr. Loy's proposed plant, CIAC, and
19 accumulated depreciation adjustments, the rate base
20 would be decreased by \$3,745,530. I've presented an
21 alternative capital structure as of year-end 2014 in
22 which the capital structure decreases from \$9.1 million
23 to \$3.25 million, with \$2.6 million representing actual
24 debt as of 12/31/14. I recommended a return on equity,
25 on the low end of the range of reasonableness, of 8.75

1 percent, compared to the company's requested, but
2 largely unsupported, requested return on equity of 10.5
3 percent.

4 I've pointed out that, even under the Florida
5 Public Service Commission leveraged return-on-equity
6 formula, which was cited by the company in its
7 application, that if a party proposed a return on equity
8 at variance from the leveraged formula result, their
9 return on equity would be determined based on the
10 evidence as presented. I then suggested that the
11 approved return on equity should be on the low end of
12 the reasonable range of approximately 8.75 percent, and
13 provided my reasons, including citing recent testimony
14 of ORS staff Witness Dr. Douglas Carlisle. I suggested
15 a proposed overall rate of return on rate base of 7.28
16 percent, which results in an overall revenue increase of
17 39.9 percent, which I believe to be very reasonable.
18 I've also suggested that control of expenses would help
19 to improve the company's return on equity.

20 Q One more question to follow up. Based upon the
21 reduction in rate base or the reduction in plant that's
22 reflected in testimony, what would the effect of that
23 reduction be on the personal property taxes that have
24 been the discussion all day today?

25 A [LANIER] Well if the adjustments in plant were made, the

1 property taxes should follow that and should decrease.

2 MR. PRINGLE: Okay.

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23 [PURSUANT TO PREVIOUS INSTRUCTION, THE

24 PREFILED DIRECT TESTIMONY {W/CORRECTIONS}

25 OF LYNN M. LANIER FOLLOWS AT PGS 417-448]

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

RE:

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

DIRECT TESTIMONY OF
LYNN M. LANIER

1 **Q: PLEASE STATE YOUR NAME, EMPLOYER AND BUSINESS ADDRESS.**

2 A: My name is Lynn M. Lanier and I am employed by GDS Associates, Inc. ("GDS"), a
3 utility consulting and engineering firm with its principal offices in Marietta, GA. I am a
4 Principal in the Firm. My business address is 1850 Parkway Place, Suite 800, Marietta,
5 GA 30067.

6 **Q: PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND:**

7 A: I hold a Bachelor of Science Degree in Industrial Management from the Georgia Institute
8 of Technology, with emphasis in economics and finance.

9 **Q: PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE.**

10 A: I have been employed in the utility business for my entire career of over 41 years. From
11 1972 to 1977, including part of the time while I was a student in college, I was employed
12 by Southern Engineering Company of Georgia as a utility rate analyst, where most of my
13 work was related to determining revenue requirements, cost allocation, and rate design,

1 primarily on behalf of utility companies, but also representing intervenors in rate cases at
2 the state and federal level. From 1977 to 1989, I was employed in various senior
3 management positions with electric cooperatives in Georgia and South Carolina,
4 including a 6 year stint as CEO of an electric cooperative in South Carolina. From 1989
5 until the present, I have been employed as a Senior Consultant with GDS Associates,
6 Inc., primarily in the areas of utility financial and rate projects, including revenue
7 requirements, cost of service, rate design (both wholesale and retail), and numerous other
8 miscellaneous rate and cost of service projects, including two recent water and sewer rate
9 cases before this Commission. In addition, since about 1995 I have been the Firm's
10 Practice Leader in the US Dept of Defense Utility Privatization Program, where I have
11 led the Firm's efforts in assisting electric and water/wastewater utilities in their efforts to
12 acquire electric, gas, water, and wastewater systems on DOD installations. In this regard,
13 we have represented several investor-owned water/wastewater utility companies and/or
14 affiliates. These projects require the development of projected revenue requirements in
15 order to establish pricing for the contract offer and valuation and assessment of the water
16 and wastewater assets, in order to establish the purchase price offered to the Government.
17 I have been a Principal in the Firm since 1995. My professional resume is included as
18 Exhibit 1.

19 **Q: HAVE YOU PREVIOUSLY PRESENTED TESTIMONY BEFORE THIS OR**
20 **OTHER REGULATORY COMMISSIONS, COURTS, ETC.?**

21 **A:** Yes. I have presented expert testimony before the state regulatory commissions in
22 Indiana, Louisiana, Michigan, Mississippi, Texas, South Carolina, Vermont, and

1 Virginia. In addition, I have presented testimony before the United States Tax Court. In
2 the 2011 Kiawah Island Utility, Inc. rate case before this Commission, I provided
3 testimony on several issues, including rate base, rate of return on rate base, return on
4 equity, revenue requirements, operating margin, etc., in the representation of a property
5 owner's group that had intervened in the Case. In the 2012 DIUC rate case before this
6 Commission, I presented direct and rebuttal testimony on a number of issues, including
7 rate of return on rate base, return on equity, overall revenue requirements, and alternate
8 rate designs. I have also presented testimony as a company witness before the South
9 Carolina Public Service Commission as a fact witness in a territorial matter and in a
10 matter pertaining to the acquisition of a small private power company while I was CEO of
11 Lynches River Electric Cooperative, Inc. in Pageland, SC.

12 **Q: WHAT HAS BEEN YOUR EXPERIENCE IN UTILITY RATE CASES AND**
13 **RELATED MATERS IN UNREGULATED JURISDICTIONS?**

14 **A:** I have already mentioned my experience in representing entities, primarily utility
15 companies or utility company affiliates, in pursuing utility privatization contracts on US
16 military bases. That work has included the development of proposals for these contracts
17 on behalf of clients, including the development of price proposals for electric, gas, water,
18 and wastewater systems. The systems range from small to relatively large and require the
19 development of the projected costs or revenue requirements, including profit or margin
20 levels, for the Price Proposals and the development of valuations of the assets for the
21 purpose of determining the purchase price to be offered to the Government. In addition,
22 beginning with my experience with Southern Engineering Company of Georgia in 1972

1 and continuing throughout my career in utility management positions and over the course
 2 of my career at GDS from 1989 until now, I have done a tremendous amount of rate work
 3 for electric cooperatives and a few municipal electric systems, and a few publicly owned
 4 gas and water/wastewater systems, throughout the US. Some of this was in a support role
 5 to other consultants within the firm. Presently, I and/or my firm represents and performs
 6 utility rate services for almost all of the 20 electric cooperatives in South Carolina. While
 7 they may not be subject to state regulatory commission rate regulation, the development
 8 of revenue requirements for electric cooperatives is very similar, if not virtually the same,
 9 as is done in the regulated arena, including the development of revenue requirements on
 10 the basis of rate of return on rate base.

11 **Q: WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS MATTER?**

12 **A:** The purpose of my testimony is to:

- 13 • Incorporate the rate base adjustments and expense adjustments proposed by my colleague
- 14 Mr. Charles Loy into our view of the Daufuskie Island Utility Company, Inc.'s (DIUC's
- 15 or "the Company's) revenue requirements;
- 16 • Address the growth in expenses;
- 17 • Address certain expense items;
- 18 • Propose an alternative capital structure;
- 19 • Recommend an alternative Return on Equity and Return on Rate Base; and
- 20 • Recommend alternative revenue requirements and overall revenue impacts.

1 Q: HAVE YOU REVIEWED THE RATE FILING APPLICATION OF DIUC IN
2 THIS CASE AND PARTICULARLY THE PROPOSED REVENUE
3 REQUIREMENTS, THE EQUITY RETURN REQUESTED, AND THE
4 OVERALL REVENUE INCREASE REQUESTED?

5 A: Yes I have.

6 Q: AND WHAT IS YOUR OVERALL ASSESSMENT OF THE COMPANY'S
7 FILING.

8 A: As I stated in my direct testimony in the 2012 DIUC rate case, I realize the Company
9 faces many challenges, although it appears that substantial improvements in the condition
10 of the systems and operations of the systems have been made since 2012. However, I
11 believe that the Company's requested increase of 108%, involving the increase of some
12 rates and charges by 2 to 3 times, is excessive and inappropriate at this time. The
13 Company's proposed increases would result in complete rate shock for the Company's
14 customers and the property owners to whom availability fees are charged. Furthermore,
15 such large rate increases and the resulting charges for water and sewer service and service
16 availability will further inhibit the prospects of economic growth and growth of DIUC
17 customers and consumption on Daufuskie Island, which the Company desperately needs
18 in order to achieve greater economies of scale. Also, in spite of the Company's claims
19 about improvements over the last three years, in my view, the Company is not being
20 operated in the most efficient and economical fashion and, in fact, has had several major
21 lapses in its operations. That being the case, I think it would be a serious mistake for the
22 Commission to grant even a significant portion of the Company's requested increase, as

1 that would not encourage the Company to improve its operations and management
2 practices and its overall efficiency. As was the case in the 2012 rate case, **most of the**
3 **Company's request is for the purpose of increasing the profit level or return on**
4 **equity**, although the Company also seeks to recover a higher level of expenses, which
5 include some notable and significant increases in a couple of items. In the last case, it
6 was obvious that the Company needed an injection of debt capital to make needed
7 improvements and to sustain operations, and additional revenues were needed, in part, to
8 attract the needed capital. The Company no longer has the need to attract capital that it
9 did in 2012, although the Company's manager, Mr. Guastella, says that the Company
10 needs to refinance its current debt and obtain additional debt from \$3.25 million to \$3.75
11 million. In my opinion, the stated need for additional debt is questionable and the
12 Company can improve its cash position by making changes in its operations and
13 management practices. Furthermore, if indeed the Company does need additional debt
14 funds, I believe the Company can obtain the debt capital that it may need without the
15 profit margin/return on equity that the Company is requesting.

16 **Q: HAVE YOU REVIEWED THE COMPANY'S RATE FILING APPLICATION**
17 **AND PARTICULARLY THE PROPOSED REVENUE REQUIREMENTS, THE**
18 **EQUITY RETURN REQUESTED, AND THE OVERALL REVENUE INCREASE**
19 **REQUESTED?**

20 Yes, I have. According to the Application and based on a projected 2015 Test Year, for
21 the combined water and sewer systems, DIUC is requesting adjusted operating expenses
22 of \$1,365,076 (including depreciation, amortization, and taxes) and proposed revenues of

1 \$1,182,301, resulting in an overall 108.9% increase in rates and charges. This request
2 results in an increase in the Company's Net Operating Income (i.e., income for return)
3 from the test year level of \$38,716 to \$618,595, which equates to an 8.73% Rate of
4 Return on the Company's claimed, but, I believe significantly inflated, rate base,
5 representing a Return on Equity of 10.5%. This proposed increase also involves
6 increases to residential customers of 117.1% and increases in availability charges of
7 109.3%, increases which are unheard-of in regulatory rate making.

8 Interestingly, the Company does not provide the Operating Margin calculation on any of
9 its income statement schedules in the application (i.e., A-4, WC, and SC), although the
10 Company and its experts are obviously aware of the requirements of SC Statute 58-5-
11 240(H), which requires that, in Water and Sewer Rate Cases, the Commission "specify"
12 an operating margin.

13 The determination of Operating Margin or Net Operating Income, involves the
14 consideration of annual interest expense. Since interest expense has been included on the
15 combined Capital Structure and Rate of Return schedule (Schedule A-3) and in the
16 revenue requirements calculations on Schedules W-F.1 and S-F.1, and the tax
17 calculations on W-C.1 and S-C.1 include the deduction for interest expense, it is only
18 necessary to deduct interest expense from Net Operating Income to determine Operating
19 Margin. As shown on my **Exhibit 2**, the Operating Margin would be a very healthy and,
20 in my opinion, excessive 17.0%.

21 **Q: DO YOU AGREE WITH THE SCHEDULES PREPARED BY GUASTELLA**
22 **ASSOCIATES IN SUPPORT OF THE COMPANY'S APPLICATION?**

1 A: No. I do not. My colleague, Mr. Loy, and I have thoroughly reviewed all of the
2 schedules included with the application prepared by Guastella Associates, LLC ("GA"),
3 as well as all the responses that the Company has made to questions and requests for
4 information by the Office of Regulatory Staff ("ORS") and by our clients, and we have
5 made a number of adjustments. In his testimony, Mr. Loy recommends a number of rate
6 base adjustments and a few related expense adjustments, the rationale for which he
7 provides in his testimony. In addition, I have made several revenue and expense
8 adjustments to the Company's proposed revenues (before increase) and expenses.

9 For the purposes of my testimony, I have prepared several financial schedules that are
10 similar to some of the Schedules prepared by GA, attached as **Exhibit 3**, and consisting
11 of 13 Schedules, as follows:

12 Combined System

13 C-1 Balance Sheets

14 C-2 Rate Base

15 C-3 Capital Structure and Rate of Return

16 C-4 Revenue Requirements

17 C-5 Expense Adjustments

18 Water System

19 W-1 Balance Sheets

1 W-2 Rate Base

2 W-3 Capital Structure and Rate of Return

3 W-4 Revenue Requirements

4 Sewer System

5 S-1 Balance Sheets

6 S-2 Rate Base

7 S-3 Capital Structure and Rate of Return

8 S-4 Revenue Requirements

9 We appreciate the Company providing the functional MicroSoft Excel Workbook used in
 10 the application and prepared by Guastella Associates, LLC ("GA") entitled
 11 "Schedules in Support of a Rate Increase" and dated June 2015. While we have referred
 12 to these schedules, except for the use of the GA Schedule A-4, in the
 13 creation of my **Exhibit 2**, we have not attempted to use or modify them in this case,
 14 to this point.

15 As reflected in my Schedules in **Exhibit 3**, I have incorporated Mr. Loy's Plant and Rate
 16 Base Adjustments, his expense adjustments, my revenue and expense adjustments,
 17 redeveloped the Rate Base and the Capital Structure/Cost of Capital schedules, and
 18 produced alternate versions of revenue requirements for the Combined System and the
 19 Water and Sewer Systems Separately. As shown on my Schedules C-4, W-4, and S-4, I
 20 **am proposing an overall revenue increase for the Combined System of 37.9%, for**

the Water System, ^{52.9%}~~50.2%~~, and for the Sewer System, ^{26%}~~23.2%~~, resulting in an overall revenue increase of approximately ^{\$429,442}~~\$408,000~~ over test year adjusted present revenues.

Q: WHAT REVENUE ADJUSTMENTS HAVE YOU MADE TO THE COMPANY'S ADJUSTED REVENUES?

A: Since the Commission only utilizes a historic test year, I have eliminated the Company's revenue adjustments associated with application of current rates and charges to the growth in customers and consumption expected by the Company in 2015. This results in an adjustment in present revenues from \$1,085,421 to \$1,076,463, a reduction of \$8,958, for the Combined System.

Q: WHAT ADJUSTMENTS HAVE BEEN MADE TO THE COMPANY'S OPERATING EXPENSES AND DEDUCTIONS?

A: As outlined in his testimony, Mr. Loy recommends adjustments to the Company's Pro Forma Adjusted expenses, as shown on Schedules A-4, W-C and S-C. Specifically, consistent with his proposed adjustments to rate base, Mr. Loy recommends increases in the Company's Depreciation Expense, Decreases in Amortization expense, and a reduction in the Company's requested property tax expense to reflect his proposed net utility plant balance as of 12/31/14, As shown in his direct testimony, on **Table 14**, Mr. Loy recalculated the Company's property taxes for years 2011-2014, and recalculated what the back-tax liability should be as of the end of 2014, to be amortized over the next 8 years, and also recalculated the 2015 property tax amount. These recalculations are

1 based on Mr. Loy's adjusted plant and rate base values. I have included the property tax
2 adjustments in my Schedule C-5, as Adjustments L-4(a) and L-5.

3 Mr. Loy has also proposed adjustments in the Company's depreciation expense and
4 amortization expense, consistent with his proposed adjustments to Rate Base. As shown
5 on **Table 16** in his Testimony, he recommends a net increase of \$42,893 in depreciation
6 expense for the combined system, representing \$28,698 for the Water System and
7 \$14,195 for the Sewer System. This adjustment actually reflects Annual Depreciation
8 Expense of \$190,841, off-set by a \$97,845 in CIAC Amortization, as shown on Mr.
9 Loy's **Table 7**, and also reflects the amortization of deferred depreciation expense that
10 Mr. Loy calculates and shown in his **Table 4**. I have shown these as separate items in my
11 adjustments shown on Schedule C-5, under adjustments L-3 and L-4.

12 As shown on his **Table 14**, Mr. Loy also proposes that the deferred property tax expense
13 also be reduced from \$526,864 as of 12/31/2014 to \$124,756, and that the amortization of
14 such expense be reduced from \$65,858 annually for 8 years to \$15,595 annually for 8
15 years. In addition, he proposes that the current year property tax expense be reduced
16 from \$192,301 as requested by the Company to \$76,306, all reflecting his recommended
17 changes in plant values and rate base. I have reproduced the adjustments in my Schedule
18 C-5.

19 In addition to Mr. Loy's proposed expense adjustments, I have specifically addressed the
20 general increases in operating expenses and the proposed increase in power cost,
21 specifically.

1 **Q: DO YOU HAVE ANY CONCERNS ABOUT THE COMPANY’S OVERAL**
2 **LEVEL OF OPERATING EXPENSES?**

3 A: Yes I do. Based on information provided by the Company in the GA *Schedules In*
4 *Support of a Rate Increase*, Schedule A-2, the Company’s Operating Expenses have
5 increased dramatically since 2009, and particularly since 2012. As shown in **Table 1**,
6 below, operating expenses for the combined system have increased a total of 81% since
7 2009, with dramatic increases of 25% in 2010, 27.3% in 2013, and 11.5% in 2014. And
8 for the Water System, in particular, the increases have been even more pronounced,
9 increasing 135% in the aggregate since 2009, with a 63% increase in 2010, a 26.4%
10 increase in 2013, and a 10.6% increase in 2014. Increases for the Sewer system have
11 been less dramatic, but with a 28.5% increase in 2013 and 12.8% increase in 2014. These
12 are unusually high percentage increases, particularly over the last few years, during
13 which inflation has remained relatively tamed, and during a time when most utility
14 companies have been able to contain expense growth in-line with general inflation rates.

15

TABLE 1

Increases in Operating Expenses

Operating Expenses						
	Water		Sewer		Combined	
Year	Amount	% Change	Amount	% Change	Amount	% Change
2009	\$200,864		\$271,573		\$472,437	
2010	\$327,999	63.3%	\$262,600	-3.3%	\$590,599	25.0%
2011	\$315,487	-3.8%	\$250,362	-4.7%	\$565,849	-4.2%
2012	\$338,308	7.2%	\$263,682	5.3%	\$601,990	6.4%
2013	\$427,489	26.4%	\$338,772	28.5%	\$766,261	27.3%
2014	\$472,592	10.6%	\$382,145	12.8%	\$854,737	11.5%
Total	135.3%		40.7%		80.9%	

Q: ARE THERE ANY STANDARDS OR GUIDELINES AGAINST WHICH DIUC'S EXPENSE GROWTH IN RECENT YEARS CAN BE MEASURED?

A: Yes. Actually, I think there are several. The Florida Public Service Commission ("FPSC") regulates a significant number of small water/wastewater investor owned utility companies and has developed some useful tools and guidelines to be used by the Commission and the utilities in the regulation of the companies. One of those is a guide for annual increases in expenses. The most recently published guide is dated March 2, 2015, which I have included as my **Exhibit 4**. As noted on this guide, the FPSC has determined that the guideline for annual increases in expenses for small water/wastewater companies is 0.56% for 2010, 1.18% for 2011, 2.41% for 2012, 1.63% for 2013, 1.41% for 2014, and 1.57% for 2015. By any standard of comparison, DIUC's operating expenses have far exceeded these guidelines.

1 Another basis of comparison is the Employment Cost Index (ECI), published by the
2 Bureau of Labor Statistics, which tracks labor and labor related costs of utility workers.
3 Since a large part of utility O&M expense is typically labor or labor related, this index
4 provides a reasonably good guide for operating expense increases.

5 The accuracy of this index as a measure of expected expense growth can perhaps be
6 enhanced by combining it with another index that measures capital costs or heavy
7 maintenance costs (costs associated with construction, but which also utilizes the same
8 type of labor and equipment as construction work). Perhaps the best of these is the
9 Handy Whitman Index, published by Whitman, Requart & Associates, for water and
10 wastewater utilities. Combining this with the ECI, by developing a composite reflecting
11 85% ECI and 15% H-W, based on 85% of DUIC's as being labor or labor related and
12 15% being Construction/Heavy Maintenance and Repair related, provides a composite
13 rate inflation rate. Another possible standard that is often cited as a broad based measure
14 of inflation is the GNP deflator, published by the US Department of Commerce. This
15 index measures the composite changes in prices for everything included in the
16 Government's measurement of Gross National Product.

17 In **Table 2**, below, I have included all of these measures of inflation. As shown, I have
18 averaged the three index values (FPSC, GNP, and Composite – ECI/HW, to arrive at a
19 composite for each year, resulting in percentages changes of 1.54% in 2010, 2.12% in
20 2011, 2.3% in 2012, 1.91% in 2013, and 1.75% in 2014, resulting in a 5-year average
21 growth rate of 1.92% per year and an overall compound growth rate from 2010 through
22 2014, also of 1.92%.

Also, since the ECI, H-W, and the ECI/H-W composite for 2012-2014 are similar, it can be inferred that 2015 would be similar to the last three years. Thus, for the composite, the 2015 projected percent increase would be approximately 2.0%.

Table 2

Comparative Indicators of Operating Expense Inflation

South Carolina - Water Wastewater Utilit	2010	2011	2012	2013	2014	5-yr Avg	Compound
85% Employment Cost Index ¹	2.03%	2.77%	2.44%	2.88%	2.48%	2.52%	2.52%
15% Handy Whitman ²	2.93%	5.89%	3.18%	0.57%	2.43%	3.00%	2.98%
A ECI/HW Blend: 0.85/0.15	2.17%	3.24%	2.55%	2.53%	2.47%	2.59%	2.59%
B Florida Public Service Commission	0.56%	1.18%	2.41%	1.63%	1.41%	1.44%	1.44%
C GNP Deflator ⁴	1.88%	1.94%	1.94%	1.56%	1.36%	1.74%	1.74%
Average (A, B & C)	1.54%	2.12%	2.30%	1.91%	1.75%	1.92%	1.92%

³ Florida Public Service Commission - March 2, 2015" - "The commission has established a price index increase or decrease for major categories of operating costs.... By keeping up with index and pass-through adjustments, utility operations can be maintained at a level sufficient to insure quality of service for the rate payers."	Employment Cost Index (www.bls.gov) ¹			Handy Whitman Index ²		GNP Deflator ⁴		
	Year	Qtr4	% Chng	Water	% Chng	Year	Qtr4	% Chng
	2009	113		2009		2009	100	
	2010	116	2.03%	2010	2.93%	2010	102	1.88%
	2011	119	2.77%	2011	5.89%	2011	104	1.94%
	2012	122	2.44%	2012	3.18%	2012	106	1.94%
	2013	125	2.88%	2013	0.57%	2013	108	1.56%
	2014	128	2.48%	2014	2.43%	2014	109	1.36%
(1) Employment Cost Index (Private Industry, Utilities), Series ID: CU20244000000001, Compensation: Wages and salaries, Sector: Private industry, Industry code: Utilities								
				W-2 South Atlantic Region Weighted by Account Values Water Index		Table 1.1.9. Implicit Price Deflators for Gross National Product Bureau of Economic Analysis		

In Table 3, below, I have applied the composite annual percentage increases to DIUC's operating expenses, beginning in 2009. As shown, for the Water System, the actual operating expense exceed the inflation adjusted expense level by over \$800,000 or 65% over the 2009-2014 period. While the situation is better for the Sewer System, the actual expense still exceeds the inflation adjusted expense level by 4% during this period, and for the Combined System, the actual expenses exceed the inflation adjusted expense by almost \$900,000 or 30% over this period. However, if the operating expenses of the

Sewer System can be maintained at level fairly comparable to inflation rates, it begs the question as to why the expenses of the water system cannot be better contained.

Table 3

Comparison of Actual Operating Expenses to Inflation Adjusted Expenses

Operating Expenses												
Water					Sewer				Combined			
Year	Actual Amount	Inflation Adjusted	Difference	% Diff	Actual Amount	Inflation Adjusted	Difference	% Diff	Actual Amount	Inflation Adjusted	Difference	% Diff
2009	\$200,864	\$200,864	\$0	0%	\$271,573	\$271,573	\$0	0%	\$472,437	\$472,437	\$0	0%
2010	\$327,999	\$203,949	\$124,050	61%	\$262,600	\$275,744	(\$13,144)	-5%	\$590,599	\$479,693	\$110,906	23%
2011	\$315,487	\$208,273	\$107,214	51%	\$250,362	\$281,590	(\$31,228)	-11%	\$565,849	\$489,862	\$75,987	16%
2012	\$338,308	\$213,061	\$125,247	59%	\$263,682	\$288,064	(\$24,382)	-8%	\$601,990	\$501,124	\$100,866	20%
2013	\$427,489	\$217,122	\$210,367	97%	\$338,772	\$293,554	\$45,218	15%	\$766,261	\$510,676	\$255,585	50%
2014	\$472,592	\$220,915	\$251,677	114%	\$382,145	\$298,682	\$83,463	28%	\$854,737	\$519,597	\$335,140	64%
Total	\$2,082,739	\$1,264,183	\$818,556	65%	\$1,769,134	\$1,709,206	\$59,928	4%	\$3,851,873	\$2,973,389	\$878,484	30%

As shown, by any of the individual measures and the composite measure of inflation, DIUC's increases in operating expenses for 2010, 2011, 2012, 2013, and 2014, are far in excess of the expected inflation rates for this period. While the Company may well have incurred unusual O&M expenses in certain years, the expense levels appear excessive, and if some of the expenses were one-time type expenses, they should perhaps have been accumulated and amortized over a reasonable period of time reflecting the period of expected benefit.

Q: ARE THERE ANY SPECIFIC ITEMS YOU CAN IDENTIFY WHICH RESULT IN HIGHER THAN EXPECTED EXPENSE INCREASES?

A: One example is the Guastella Associates management contract that includes a provision for an annual increase in fees of 3.5%, regardless of actual inflation levels. So while the inflation levels over the last three years have been less than 2.0% per year, the Company

1 has agreed to increases the management fee by 3.5% per year, obviously contributing to
2 the higher operating expense levels. While that is certainly the Company's choice, the
3 Commission should not be obligated to accommodate such increases in expenses in
4 higher authorized rate levels. This is one of those areas, where the Company should have
5 been more prudent and provided for an increase in the management fee, consistent with
6 actual inflation levels. Another example is the proposed adjustment for the cost of
7 electric power purchased from South Carolina Electric & Gas Co. ("SCE&G"). As
8 shown on Schedule A-4, the Company has requested an adjustment in power cost of
9 \$51,281 from \$115,437 in the 2014 test year to \$166,718, and increase of almost 50%. In
10 the description of this adjustment, the Company's applications states that this is for
11 higher power cost, including increased demand. At our request, the Company provided
12 billing histories for the period July 2014 – January, 2015, although the kWh energy
13 consumption and kW/kVA demands were not provided, as requested. An analysis of
14 these summaries, as reflected in my **Exhibit 3**, Schedule C-5, indicates that while there
15 has been some increase in the actual cost of power, the average bill for the 7 month
16 period provided, multiplied times 12, equals \$131,877. Thus, I have proposed an
17 adjustment to decrease the proposed cost of power by \$34,841, for the Combined System,
18 as shown on my Schedule C-4, and which is also reflected on Schedules W-4 and S-4.

19 **Q: SHOULD THE COMMISSION BE OBLIGATED TO GRANT THE COMPANY'S**
20 **REQUESTED EXPENSE LEVELS, IN ORDER TO PROVIDE A RATE LEVEL**
21 **TO ACHIEVE TARGETED RETURNS OR PROFIT LEVELS?**

1 A: No. First of all, it should be noted that the Settlement Agreement, approved by the
2 Commission in the 2012 rate case, granted the Company an increase in rates to provide
3 an overall revenue increase of \$291,485 or almost 38%, in addition to additional revenues
4 to be derived from the application of the Availability Fees to a number of lot owners,
5 who should be paying such fees. This increase was supposed to cover the Company's
6 claimed operating expenses, including adjustments made by the Company, and as
7 reduced by ORS, and also provided the opportunity for the Company to earn an 8.81%
8 Return on Equity, and a 16.64% Operating Margin. However, in the intervening period,
9 the Company has allowed its operating expenses to escalate at such a level as to
10 completely erode the ability to earn the returns from the Settlement Agreement. While
11 the Commission may have some obligation to provide the Company the "opportunity" to
12 earn specified return, it is not obligated to assure that the Company earn such returns, by
13 granting any and all claimed expenses. With the rate revenue increase authorized in the
14 2012 rate case, the Commission clearly provided the opportunity for the Company to earn
15 reasonably adequate returns, but the Company is responsible for failure to earn the
16 returns, through excessive expense growth. In three years, the Company has managed to
17 consume what it was granted for returns in uncontrollable expense growth.

18 **Q: ARE YOU RECOMMENDING ANY MORE SPECIFIC REDUCTIONS TO THE**
19 **COMPANY'S REQUESTED ADJUSTED EXPENSES?**

20 A: The ORS staff typically conducts an exhaustive audit of an applicant's claimed expenses
21 and carefully evaluates proposed expense adjustments. I and my colleagues and our
22 clients in this matter did not have the resources to conduct such extensive investigations

1 of specific expenses. However, I expect that the ORS staff will recommend reductions in
2 some of the Company's requested expenses and, in view of the Company's unusually
3 high growth in expense, I would support any reductions in expenses proposed by the
4 ORS staff.

5 **Q: DO YOU AGREE WITH THE COMPANY'S CLAIMED RATE BASE AND**
6 **CAPITAL STRUCTURE?**

7 A: No, I do not, based on Mr. Loy's testimony. As Mr. Loy has demonstrated in his
8 testimony, the Company's rate base is overstated. **Table 1** in his testimony summarizes
9 his adjustments to both the water and wastewater rate bases which he supports. These
10 adjustments are included in my Schedules C-1, W-1, and S-1, in my rate base
11 determination in my Schedules C-2, W-2, and S-2, and are also reflected in the total
12 capital amounts in the Capital Structure on Schedule C-3, W-3, and S-3. Based on his
13 proposed adjustments to accumulated depreciation and CIAC, Mr. Loy has proposed a
14 reduction in the Combined System Rate base of \$3,745,530, which reflects a reduction in
15 the Water System Rate Base of \$1,325,177, and a reduction in the Sewer System Rate
16 Base of \$2,420,353. The water system rate base, as adjusted, is \$1,909,974, while the
17 wastewater system rate base, as adjusted, is \$1,365,930, resulting in a combined rate base
18 of \$3,276,311. These reflect allowances for working capital based on adjusted expense
19 levels, as shown on my Schedules C-4, W-4, and S-4, which are subject to change, based
20 on further adjustments in expenses as may be proposed by the ORS staff or any other
21 intervenors.

1 In its application, the Company presents a combined capital structure on Schedule A-3,
2 consisting of \$3,750,000 in debt at an interest rate of 6.2% and equity of \$5, 358,573, for
3 a total capital structure of \$9,108,573. As stated by Mr. Guastella in his response to ORS
4 WWW Request 10.3, the Company has exhausted its available loan commitments of
5 \$2,750,000 in long-term debt and \$500,000 in a non-revolving line of credit and that the
6 Company is seeking to refinance the entire \$3,250,000 with a new loan of \$3,750,000,
7 which would provide additional funding of about \$600,000 for further capital
8 improvements and to pay off significant amounts of deferred expenses. First of all, the
9 Company has not stated what it needs the additional \$600,000 in debt capital for, but
10 more importantly, the debt, as of 12/31/14, totals \$2,615,950. Using a historic test year,
11 this should be the debt allowed in the capital structure, but even if the Company, since
12 12/31/14, has drawn down the remainder of its \$3,250,000 in available debt funds, the
13 debt in the capital structure should not exceed \$3,250,000. Thus, in the capital structure,
14 I propose a debt component of \$2, 615,950.

15 **Q: DO YOU AGREE WITH THE COMPANY'S REQUESTED RATE OF RETURN**
16 **AND RETURN ON EQUITY?**

17 **A:** No. I do not. As outlined in the responses to ORS's information requests, the Company
18 states that the stated rate for the long-term loan of \$2,750,000 and the line of credit of
19 \$500,000 is 5.29%, plus the cost of an interest rate swap, resulting in an equivalent fixed
20 rate of 6.2%. So while this rate is relatively high in the current interest rate environment,
21 this is probably a reasonable rate for DIUC, given its precarious financial state.

1 However, the requested return on equity is another matter. This is the same rate the
2 Company requested in its 2012 rate case, which was a specified rate, rather than a rate
3 developed through justification of the ROE required to meet its needs for profit margin
4 and to attract the needed debt capital. On schedule A-3, the Company shows a
5 calculation from a methodology purportedly endorsed by the Connecticut Department of
6 Public Utility Control ("DPUC") that begins with a raw ROE amount of 9.69%, to which
7 a small company adder of 50 basis points and a performance adder of 50 basis points are
8 added, arriving at a total of 10.69%. On this same schedule, there is a reference to a
9 "FPSC Leverage Graph Formula" rate, resulting in a calculated ROE of 9.47%%.

10 **Q: ARE YOU FAMILIAR WITH EITHER THE CONNECTICUT DPUC OR THE**
11 **FPSC LEVERAGE FORMULA?**

12 A: I am not familiar with the Connecticut DPUC formula and despite extensive search on
13 my part, I am unable to locate any reference to this formula, although I am not suggesting
14 it does not exist. But even if it does, I think the Company has an obligation to
15 demonstrate its applicability in deriving an appropriate ROE for its Application.

16 I am quite familiar with the FPSC leverage formula. Under Florida Statutes
17 [(367.081(4)(f))], the FPSC is required to establish a leverage formula for determining the
18 allowed ROE for small investor owned water and wastewater Companies each year. The
19 FPSC staff undertakes a study each year, not unlike a traditional ROE study done in most
20 regulatory jurisdictions, using the Discounted Cash Flow ("DCF") and Capital Asset
21 Pricing Model ("CAPM"), and arrives at a recommendation to the FPSC. The FPSC then

1 considers the recommendation and issues an order, which may or may not reflect the
2 FPSC's staff recommendation.

3 **Q: HAVE YOU BEEN ABLE TO DETERMINE THAT THE FORMULA AND THE**
4 **CALCULATED ROE FOR THE FPSC, SHOWN ON SCHEDULE A-3 IS**
5 **CORRECT AND APPROPRIATE FOR USE BY DIUC IN THIS MATTER?**

6 A: I have researched the FPSC website and located the 2015 FPSC staff report (dated June 4,
7 2015) to the Commission as well as the FPSC's order, dated July 2, 2015. Neither the
8 staff report nor the Commission's order, both of which I have included in my **Exhibit 5**
9 reflect the formula that was included on Schedule A-3, and furthermore, the
10 Commission's order notes that the approved formula has been unchanged since 2008,
11 although the Staff's 2015 report did include updated calculations, based on current data.
12 Interestingly, the staff's recalculated leverage formula suggests a range of ROE of 7.79%
13 at 100% equity to 11.51% for 40% equity or less. However, the FPSC decided to retain
14 the current formula, of 8.74% at 100% equity to 11.16% @ 40% equity and lower, basing
15 its decision on the belief that the calculated values for 2012, 2013, and 2014 (and also
16 2015) "were not optimal for determining the appropriate authorized ROE for WAW
17 utilities due to Federal Reserve monetary policies that resulted in historically low interest
18 rates." Use of the leverage formula by the FPSC is not automatic, though, as the July 2,
19 2015 orders states:

20 **"If one or more parties file testimony in opposition to the use of the**
21 **leverage formula, we will determine the appropriate ROE based on**
22 **the evidentiary record in that proceeding."** (emphasis added).

1 However, even if the FPSC's leverage formula, as reflected in the 2015 order, was used,
2 instead of the formula shown on Schedule A-3, the resulting ROE would not change very
3 much. The term "leverage" in the formula, though, reflects the use of a scale, where the
4 higher the equity level in the capital structure, the lower the allowed return. In any case,
5 though, while I am not necessarily suggesting whether the FPSC Leverage Formula is
6 appropriate or not in this case, the burden is on the applicant to demonstrate or support its
7 position on ROE, and simply including a formula on a schedule and a calculated number
8 is not sufficient rationale to support a ROE, particularly of 10.5% when the company is
9 requesting a revenue increase of over 100% in order to achieve such return.

10 **Q: DO YOU HAVE ANY OTHER SOURCES TO SUPPORT AN APPROPRIATE**
11 **ROE?**

12 **A:** Yes, ORS Cost of Capital Expert, Dr. Douglas Carlisle's most recent Cost of Capital
13 testimony in the most recent water/wastewater rate case that I could locate, the United
14 Utility Companies rate case, Dockets No.2013-199-WS and 2013-201-WS, indicated that
15 appropriate ROE's in that case, would be within the range of 8.86% and 9.60%, and the
16 Commission settled on 9.35%. I am expecting Dr. Carlisle to testify in this case and I
17 expect he will propose a range of ROE similar to what he proposed in the United Utility
18 Companies rate 2013 rate case.

1 **Q: ARE YOU SUGGESTING THAT THE APPROPRIATE ROE RANGE**
2 **RECOMMENDED BY DR. CARLISLE IN THE 2013 UNITED UTILITY**
3 **COMPANIES CASE WOULD BE APPROPRIATE FOR USE IN THIS CASE?**

4 **A:** Not necessarily, but it is a point of reference, and it is consistent with the FPSC leverage
5 formula results, at least on the high end of the range. Since interest rates have not
6 changed much since Dr. Carlisle's testimony in the 2013 United Utility Companies case
7 was submitted, I would not expect that the ROE range would have changed very much. I
8 do acknowledge that when the DCF (the prevailing method used for determining
9 appropriate ROE's) and the CAPM methodologies are applied in a specific rate case, the
10 results will not be the same for all companies, since a group of proxy companies are used
11 that have similar risk and growth profiles to the applicant company. Unfortunately, there
12 are not many publicly traded companies that are similar to DIUC, so using the DCF and
13 CAPM models presents a bit of a challenge. However, even in the FPSC leverage
14 formula, a proxy group of publicly traded natural gas companies is used, due the lack of
15 publicly available data for comparable water/wastewater companies, publicly traded. So
16 using proxies is widely used and accepted for determining appropriate ROEs. And I
17 would expect that the list of proxy companies used in the United Utility Companies rate
18 case would not be much different than what would be used in this case.

19 **Q: IN THIS CASE, DO YOU HAVE A RECOMMENDATION AS TO AN**
20 **APPROPRIATE ROE FOR DIUC?**

21 **A:** If Rate of Return on Rate Base is used as the criteria for determining the revenue
22 requirements and authorized increase in revenues, I believe an appropriate ROE should

1 be on the low end of the range of reasonableness. I believe that the Company has
 2 demonstrated a degree of irresponsibility in its operations since the rate increase
 3 authorized in 2012 and in the use of debt funds, in view of the critical need for cash. I
 4 also feel that the numerous lapses and surprises, such as the sale of the parcel of land
 5 where the elevated water tower is located, the enormous increase in property tax, the
 6 issues with DEHEC, and the inability to control operating expenses, clearly demonstrates
 7 that the Company really does not need and cannot be fully trusted to effectively utilize a
 8 revenue increase of the magnitude requested. Thus, I recommend a ROE in the range of
 9 8.5% to 9.0%, based on all factors considered, to the adjusted Rate Base. The adjusted
 10 Rate Base is shown on my Schedule C-2, reflecting Mr. Loy's proposed Rate Base
 11 adjustments. A revised Capital Structure and Cost of Capital Calculation is shown on my
 12 Schedule C-3 and reflects the use of an 8.75% ROE (the mid-point of the lower range of
 13 reasonableness) and Mr. Loy's Rate Base Adjustments, arriving at a total Cost of
 14 Capital/Rate of Return requirement of 7.28%. Together with my and Mr. Loy's
 15 recommendations as to revenue and expense adjustments, and applying this Rate of
 16 Return calculation to the adjusted Rate Base, the resulting revenue requirement for the
 17 Combined System would be $\frac{\$1,505,905}{\$1,484,806}$, representing an increase of $\frac{\$429,442}{\$408,343}$ in annual
 18 revenue, or an increase of $\frac{39.9\%}{37.9\%}$ over test year adjusted revenues. Based purely on the
 19 use revenue requirements calculations, this reflects an increase to Water revenues of
 20 $\frac{52.9\%}{50.2\%}$, as shown on my Schedule W-4, and an increase to Sewer revenues of $\frac{26\%}{23.2\%}$, as
 21 shown on my Schedule S-4.

1 **Q: DO YOU AGREE WITH THE COMPANY'S APPROACH OF USING RETURN**
2 **ON RATE BASE AS THE APPROPRIATE MANNER OF DETERMINING**
3 **WHAT THE COMPANY NEEDS IN TERMS OF AN EQUITY RETURN?**

4 A: While I agree that it is one approach, and a very well accepted approach, to determining
5 the equity return or profit margin for regulated utilities, it is not the only approach that
6 can be used or considered by this Commission in this case. While using Mr. Loy's
7 adjusted rate base amounts, together with the recommended adjustments in revenues and
8 in expenses and deductions for the water and sewer systems, and my recommended ROE,
9 results in the need for a smaller rate increase than the Company has requested, providing
10 the Company with an overall return on rate base of 7.28% and an ROE of 8.75% results
11 in a very reasonable increase in revenues.

12 **Q: WHY DO YOU FEEL THAT THIS RETURN ON EQUITY OF 8.75% IS**
13 **JUSTIFIED?**

14 A: In my opinion, DIUC is not being managed effectively or economically. As has been
15 revealed in the Company's filing, Mr. Guastella's firms, Guastella Associates, LLC and
16 G₂ have been hired to manage DIUC. I do not fault Mr. Guastella for taking the
17 assignment, but the fact that a small water and sewer utility company with less than 500
18 active customers (excluding irrigation customers which are largely duplicates) has to
19 resort to hiring a Boston based consulting firm to manage its affairs, is an indictment of
20 the inability or incapability of the parent/stockholders to manage the company. There are
21 also other indicators that the Company is not being managed well. For example, it has
22 come to light that the Company had not paid the taxes on a parcel of property on which a

1 water storage facility was located, and that this parcel was sold at auction by Beaufort
2 County for the satisfaction of taxes owed. This is obviously an embarrassing situation
3 and Mr. Guastella felt compelled to address it in his testimony. Mr. Guastella's reason
4 for why the auction took place is that the Company did not receive a notice by mail from
5 the County and, therefore, did not know that the auction was going to take place. It is a
6 taxpayer's responsibility to pay these taxes whether or not they receive a tax bill.
7 Consequently, the fact that the utility and G₂ may not have received a tax bill does not
8 justify its failure to timely pay the property taxes due. This is clear evidence of the
9 problems of a distant manager's ability to exercise oversight over the affairs and
10 activities of the Company. While Mr. Guastella says that he has talked with the
11 purchaser of the property, who seems reasonable, one would think that anyone holding
12 ownership of a piece of property that the Company obviously needs to reacquire would
13 use that leverage to extract a substantial price. And it would be completely unrealistic to
14 think otherwise. In fact, as Mr. Guastella acknowledges in his May 5, 2015 report,
15 entitled *Report on Capital Improvements*, the Company is now in court in an effort to
16 condemn the property in question, in the face of a demand for a \$1.0 million price for the
17 parcel. And Mr. Guastella also acknowledges that there has been a substantial cost to
18 DIUC in its efforts to reacquire the property.

19 Other indications that the Company is not well managed include the failure to pay taxes
20 on properties owned, frequent payment of late fees on bills for materials and supplies and
21 services, etc. So while the Commission should authorize a return on equity sufficient to
22 allow the Company to earn a margin or profit to provide reasonable security to a lender of
23 the Company's ability to make debt service payments, the Commission should not

1 authorize anything more at this time. This will give the Company the incentive to pursue
2 more effective and more economical management of DIUC. While the Company may
3 well need the services of a firm such as Guastella Associates from time to time, it should
4 not need to turn over the complete management of the Company to such a firm.

5 **Q: IS THERE ANY OTHER BASIS FOR AUTHORIZING SUCH A LOW RETURN**
6 **BY THE COMMISSION?**

7 A: Yes. On the night of September 15th, 2015, the Commission conducted a hearing on
8 Daufuskie Island. The hearing was well attended with numerous complaints voiced as to
9 lack of presence of Company management personnel, lack of responsiveness of
10 management personnel, and the shock of the proposed increase in rates and charges of
11 over 100% and far more than that for some charges.

12 Thus, in my opinion, the Commission has more than sufficient justification to award an
13 equity return on the low end of the scale.

14 **Q: HAVE YOU CALCULATED THE OPERATING MARGIN, BASED ON YOUR**
15 **RECOMMENDED RETURN ON EQUITY AND ALTERNATIVE PROPOSED**
16 **REVENUE INCREASE?**

17 A: Yes. As shown on my Schedules C-4, W-4, and S-4 of my Exhibit-3, based on my
18 proposed revenue requirement, the operating margin would be approximately 5.1% for
19 the Combined System, 7.1% for the Water System, and 2.8% for the Sewer System.

20

1 Q. **HOW ADEQUATE DO YOU THINK THE OPERATING MARGIN WOULD BE**
2 **UNDER YOUR RECOMMENDATIONS OF THE EQUITY RETURN?**

3 A: While I acknowledge that the resulting Operating Margins are on the low side, these are
4 also calculated vs large revenues, but since the Company has proposed the use of Rate of
5 Return on Rate Base, for determining Revenue Requirements, and since I believe that the
6 recommended equity return and overall rate of return on rate base, are reasonable in the
7 circumstances, relatively low operating margin percentages are the inevitable outcome.
8 Based on my Exhibit 2, and my calculation of the Operating Margin from the Company's
9 filing, the Operating Margin is only 17.0%, with unrealistic ROE and proposed revenue
10 increases. Since I would not expect the Commission to award the Company the entire
11 requested increase, the operating margin percentage would be expected to decline rather
12 precipitously with any reduction in revenues allowed by the Commission.

13 Q: **HOW DOES YOUR APPROACH TO THE DETERMINATION OF THE**
14 **REASONABLE AND NECESSARY RETURN DIFFER FROM THE APPROACH**
15 **AND RATIONALE OFFERED BY MR. GUASTELLA IN HIS TESTIMONY AND**
16 **EXHIBITS?**

17 A: In the Company's application, no support whatsoever was provided for the 10.5% ROE,
18 other than the two calculations shown on Schedule A-3, referencing a CPUC ROE
19 formula and the FPSC Leverage Formula. In his direct testimony, Mr. White simply
20 says, on page 5, lines 18-19, that

1 “a cost rate for debt of 6.2% and a cost rate for equity of 10.5% results in an
2 overall weighted cost of 8.73%”,

3 but he provides no justification for the 10.5% ROE.

4 Mr. Guastella states, in his testimony, on page 7, beginning on line 10,

5 “The proposed return on equity is 10.5% which is based on my experience and
6 judgement with respect to small water and sewer utilities, not on the typical
7 cost of capital methodologies. Small water and sewer utilities rarely, if ever,
8 obtain financing on the strength of their own financial condition, particularly
9 those as small as DIUC. A guide-post Supreme Court decision hold that the
10 return to the equity holder should be commensurate with risks on investments
11 in other enterprises having corresponding risks and that equity return should
12 be sufficient to assure confidence in the financial integrity of the enterprise, so
13 as to maintain its credit and attract capital. That standard is not satisfied if
14 DIUC’s equity return is determined by applying such typical rate of return
15 analyses as the discounted cash flow method or capital assets pricing model.
16 DIUC’s net income should have been a total of about \$418,000 if it achieved
17 the 8.81% (authorized return), but instead its actual net income was less than
18 \$90,000 for that period. ...The 10.5% equity rate of return I have used is
19 conservative and it is most probable that it also would not be fully achieved in
20 the future. ...the time has come when DIUC must be given a fair opportunity
21 to achieve a reasonable rate of return. Moreover, the allowance of a
22 reasonable rate of return is also essential for DIUC to meet coverage

1 requirements with respect to the proposed refinancing and not defaulting on
2 the repayment of its short term debt.”

3 Mr. Guastella has made a number of broad and sweeping statements, some of which may
4 be legitimate. However, he provides no support for his statements, other than to say his
5 opinion is based on his experience and judgement. He first says that the traditional Cost
6 of Equity methodologies (presumably DCF and CAPM), are not appropriate or adequate,
7 but in fact, they are used widely such as such as in South Carolina and by the FPSC, that
8 uses the Leverage Formula, which is based largely on DCF and CAPM and is applied to a
9 large number of small water and sewer utility companies. In his reference to the Supreme
10 Court decision, he makes no particular claim that DIUC has not or may not be awarded a
11 ROE sufficient to meet the Court’s standards and claims that the use of DCF or CAPM
12 would not provide an adequate ROE. But there is no basis for such claim. In regard to
13 his claim that the Company is unable to realize the return authorized in the 2012 rate
14 case, as I have noted earlier, the Company’s expenses have increased exponentially,
15 which has largely been the cause of earnings erosion. He makes the strong assertion,
16 almost demand, that it is time the Company was given a fair opportunity to earn a
17 reasonable return. Again, control of expenses would largely assure adequate returns.
18 And finally, he addresses the necessity of adequate returns to meet coverage requirements
19 with respect to the proposed refinancing, but he does not state what those coverage
20 requirements are or the degree to which they may or may not be covered with certain
21 revenue levels. I have noted in the information provided by the Company that the
22 SunTrust loan agreement calls for a 1.1 Debt Service Coverage, which is an extremely
23 low coverage requirement, and which may not be the requirement for the refinancing, but

1 again, he does not address the specific requirement. In my view, it is extremely
2 presumptuous of the Company's expert witnesses to expect the Commission to simply
3 accept a requested 10.5% return on equity, requiring over a 100% rate increase, without
4 any substantial justification whatsoever, other than a few vague assertions.

5 **Q. ARE YOU ADDRESSING THE COMPANY'S PROPOSED RATE DESIGN?**

6 A. While I did submit testimony in the 2012 Rate Case as to alternative rate designs, I am
7 not doing so in this case, at this time. In view of the great disparity between what the
8 Company is requesting in terms of increase in revenue vs what I am proposing, and the
9 impact that revenue requirement has on rate design, I am not suggesting a specific rate
10 design at this time. In the 2012 rate case, the Company proposed a uniform rate
11 structure, but in the Settlement Agreement, it was agreed that the separate rate schedules
12 would be maintained. In this case, the Company has again proposed a uniform rate
13 structure. This issue, alone, is a major factor in the ultimate rate design. Rate design also
14 has significant implications for differences in impacts on customers or specific charges
15 under the rate structure. Thus, I feel that the rate design issue could be better addressed,
16 once a determination of revenue requirement and revenue increase and the issue of
17 uniform rate structure are decided.

18 **Q: DOES THIS CONCLUDE YOUR TESTIMONY?**

19 A: Yes, it does.

1 MR. PRINGLE: All right. We tender these
2 witnesses for questions from any other parties.

3 CHAIRMAN HALL: Okay. Mr. Gressette or Mr.
4 Walker?

5 MR. WALKER: Thank you, Madam Chairman.

6 CROSS EXAMINATION

7 BY MR. WALKER:

8 Q I'm going to start by posing questions to Mr. Loy. Mr.
9 Loy, as I understand your testimony, one of the things
10 that you did categorically was to reject the utility
11 factor, the use factor?

12 A [LOY] Yes.

13 Q And you are aware that ORS used that factor, are you
14 not?

15 A [LOY] Yes, I'm aware of that.

16 Q So, you're at odds with ORS on this one, aren't you?
17 Even though your client has agreed to ORS's adjustments,
18 your own opinion is contrary to ORS's opinion, correct?

19 A [LOY] Well, let me say this. I'm not necessarily
20 against the utilization factor. Really, what I'm
21 against is how it's being recorded. If it's recorded –
22 the accounting that's behind it is done correctly, and
23 this Commission and the staff, you know, thinks it's the
24 thing to do, then that's fine with me. But I think it
25 should be correct- – it should be recorded correctly.

1 Q If the company had, in fact, taken depreciation at a
2 much greater rate as you're saying, without a
3 utilization factor at all, just went ahead and
4 depreciated it over the life without regard to the
5 number of users, then the current users and the
6 ratepayers would actually be paying more in a rate to
7 cover depreciation, because depreciation would be
8 greater, right?

9 A [LOY] That's correct, but that's what deferrals are for.
10 That's what this really is. It's kind of a deferral in
11 disguise. I mean, this is nothing unique about this.
12 It's done in a lot of places where there is more
13 depreciation expense than the customers can handle. And
14 so, you know, assuming that the plant is prudently
15 installed or it's prudently – it's a prudent investment,
16 then you could certainly defer that depreciation
17 expense, set up an asset account, and say, "You know,
18 the company is entitled to this at some point in time,
19 when the customers are here," and that's perfectly fine
20 to do that.

21 Q You were talking about Haig Point Utility and, in your
22 testimony, you talked about you believe the original
23 owner of Haig Point Utility/International Paper, and
24 later Haig Point, Inc., treated the utility plant in
25 HPUC as inventory and expensed these costs as

1 development costs. You say you believe, right? Is that
2 correct?

3 A [LOY] Yes, I believe.

4 Q You haven't reviewed those books, have you?

5 A [LOY] I have not reviewed International Paper's books.
6 However, I have reviewed their 10K, and their 10K says
7 they wrote it all off. All of it:

8 Q You have not reviewed their books, with respect to the
9 utility plant, the one that Mr. Gua- — excuse me — Mr.
10 White referred to when he transferred the values over,
11 did you?

12 A [LOY] I did not.

13 Q All right. Thank you, sir.

14 Mr. Lanier, good evening.

15 A [LANIER] Good evening again.

16 Q I'm going to try to make this quick.

17 A [LANIER] I'd appreciate that.

18 Q All right. You have made certain changes to your *pro*
19 *formas* to — was that in response to the ORS adjustments?
20 Did you get in line with ORS in some of those — what was
21 the provocation for those changes?

22 A [LANIER] It — I realized it in some discussions with
23 ORS, last, I think, Thursday a week ago.

24 Q You testified that the company no longer has the need to
25 attract capital, correct?

1 A [LANIER] I said the need to attract capital the way it
2 did in the last case.

3 Q But you understand that the – your understanding of what
4 the company is entitled to, to make, is that the
5 standard is it has to have the ability to attract – to
6 be strong enough financially to attract capital,
7 correct? That's the standard?

8 A [LANIER] If it needs to attract capital.

9 Q So are you saying that's what the legal standard is,
10 that it only has to have the strength to attract capital
11 if it needs capital? That's what you're saying?

12 A [LANIER] I'm saying there's a range of judgment that can
13 be applied, depending on the company's need to attract
14 capital. If it has a great need to attract capital, as
15 it did in the last case, there would be more of a
16 justification for possibly a higher return. At this
17 point, the company doesn't need to attract much capital.
18 In fact, there's no real indication as to what the
19 additional capital may even be used for. So at this
20 point in time, I don't think there's as much need for
21 the return that the company is requesting.

22 Q Well, you were here for Mr. Guastella's testimony. He
23 went over what that additional capital was going to be
24 used for in terms of the loan that he hopes he can
25 obtain from SunTrust for \$3,750,000. He identified the

1 uses of that money, didn't he?

2 A [LANIER] If he did, I did not hear clearly what the
3 additional amount that he's talking about – I'm talking
4 about the additional amount from \$3,250,000 to
5 \$3,750,000.

6 Q Well, I'm not going to get into a debate and debate
7 about that, because it's late. But I do want to say and
8 ask you that we heard testimony that the SunTrust line
9 of credit for \$500,000 is due on November 1st, have an
10 extension until April 1st, no source of funds to pay it.
11 And we've heard that the utility, aside from that, has
12 lost \$450,000 since the last rate case. So wouldn't you
13 say that constitutes a need for capital to get money
14 into the business?

15 A [LANIER] Not necessarily.

16 Q In part of your prepared testimony, you critique the
17 expenses by comparing them to some factors, some
18 regional factors about increases in expenses over the
19 last several years. Do you recall that part of your
20 prepared testimony?

21 A [LANIER] I do.

22 Q Well, you are aware that, in South Carolina, we use the
23 methodology of a test year with actual expenses and
24 revenues, as adjusted, are you not?

25 A [LANIER] I am.

1 **Q** And there's no provision in South Carolina that says the
2 expenses are determined by looking at a table and seeing
3 what's going on in the region or somewhere else,
4 correct?

5 **A** [LANIER] That's true, but that was not what my testimony
6 was.

7 **Q** You also criticized the company for allowing its
8 operating expenses to, as you say, "escalate." Now, I
9 know we've heard a lot about Mr. Guastella's contract; I
10 just want to put that over here [indicating], okay,
11 because that's been picked on a lot. I just want to
12 look at the rest of the expenses. These expenses are
13 all reasonable and necessary, the other expenses, were
14 they not – the expenses to repair the liner, the
15 expenses to do the other improvements, the expenses to
16 comply with DHEC requirements, the expenses to pay the
17 employees? All those things were reasonable and
18 necessary, were they not? They weren't discretionary;
19 it wasn't as though they were out saying, "Hmm, we'll
20 blow some money on this." They were all reasonable and
21 necessary, weren't they?

22 **A** [LANIER] I'm not saying that the improvements that were
23 made were not reasonable and that they were not
24 necessary. What I've said was that, when all of the
25 expenses are looked at, in total, that the increase over

1 the last several years has been very, very high. In my
2 view, excessive.

3 Q But even though they may be high, it's just a fact of
4 life, right?

5 A [LANIER] Well, that presumes that you can just spend any
6 amount that you want to spend and say that's a prudent
7 expense, and I don't —

8 Q Well, let me —

9 A [LANIER] — agree with that.

10 Q — back off and give a specific. We've heard — and
11 again, I don't want to spend a whole lot of time on it,
12 because everybody's ready to go. But we've heard about
13 a tax bill for over \$300,000 that was delivered after
14 the rate case, for prior years that had never been
15 assessed, and dropped in their lap. And we heard about
16 a negotiation where it was negotiated down to, say, 65
17 over eight years for through 2015. You would agree that
18 that's an expense the company owes, correct?

19 A [LANIER] No, I don't agree with that, at all.

20 Q You think they can just default on that agreement?

21 A [LANIER] I didn't say they needed to default on it.

22 Q Well, if they can't — if they — how can they not pay an
23 agreement with Beaufort County?

24 A [LANIER] I don't think that's the issue. I think the
25 issue is the tax that the company has been assessed and

1 why it has been assessed that tax. And the reason it's
2 been assessed that tax is because it has an inflated
3 value of plant, as Mr. Loy has mentioned, and when that
4 inflated value of plant, as reflected in the company's
5 annual reports, ended up in the hands of the Department
6 of Revenue, the Department of Revenue then assessed a
7 value of 10½ percent on the plant, and sent that to
8 Beaufort County.

9 Now, our view is the plant was overstated. So my
10 view is, they need to go back, change their annual
11 reports, refile with Department of Revenue, and seek to
12 have the Department of Revenue reduce the valuation.
13 Then go back to Beaufort County and seek to have the
14 assessment by the County reduced.

15 **Q** Right now, they've got a binding contract with Beaufort
16 County, which agreed to forgo a couple hundred thousand
17 and agreed to extend it over eight years. You're not
18 saying that's not a binding contract, are you?

19 **A** [LANIER] It might be in the context and in the time in
20 which it was created. However, the witness from
21 Beaufort County this morning pointed out that there
22 already had been one adjustment when the company went
23 back to DOR and asked to have its values reduced to the
24 rate-base value from the last case. So, if it's been
25 done once, it can be done twice. So, if the plant value

1 needs to be reduced, it needs to be reduced.

2 Q Have you talked to DOR?

3 A [LANIER] No, I haven't.

4 Q So you don't know. You're just speculating, aren't you?

5 A [LANIER] Well, I'm speculating, based on the evidence
6 that they've already made one adjustment.

7 Q Turning to the interest rate, you are aware that ORS is
8 simply applying the nominal interest rate, what they've
9 projected to be 5.29 percent?

10 A [LANIER] I am.

11 Q But you agree that there would be costs incurred in
12 obtaining a refinancing, do you not?

13 A [LANIER] I would expect there would be some costs
14 associated with that. But those costs don't necessarily
15 have to be reflected in the interest rate. There are
16 other ways that can be addressed.

17 Q One way to do it is to reflect it in the interest rate,
18 the effective interest rate. That is the accepted
19 method, is it not?

20 A [LANIER] I can't even say it's the accepted method.

21 Q That's one way to do it, isn't it?

22 A [LANIER] It may be one way to do it.

23 Q It's the way it was done last time, by this Commission.
24 You also opine as to a rate of return, and you say it's
25 on the low range of reasonableness, correct?

1 A [LANIER] I did.

2 Q Now, as I understand economics or finance, I always
3 understood the greater the risk, the greater the return.
4 Do you understand that to be one of the fundamental
5 rules of investment?

6 A [LANIER] I wouldn't disagree with that.

7 Q So here we have a very small utility that's struggled,
8 that has not balanced its books, basically, in the sense
9 of being in the black consistently, that has had a
10 history of problems that are being straightened out.
11 You would consider this, in terms of a utility, a fairly
12 high-risk investment, would you not, if you were a bank?
13 After all, they were turned down by – one, two – three,
14 before they got to SunTrust – or two, before they got to
15 SunTrust.

16 A [LANIER] I don't know that I would particularly assign
17 it a terribly high risk.

18 Q You don't think it's high-risk, from everything you
19 heard about the future real estate on Daufuskie Island,
20 about how hard it's been for them to make money? You
21 don't think that this utility is a high risk for a
22 lender, or more important, for somebody investing for a
23 rate of return on their equity investment? It's a high
24 risk, isn't it?

25 A [LANIER] It might be somewhat higher than the risk of

1 other investments, but I wouldn't put it at the extreme.

2 Q It's certainly not on the low end of risk.

3 A [LANIER] Well, I don't know that I would necessarily
4 agree with that. You know, risk is a factor in return-
5 on-equity determinations. And, certainly, the higher
6 risk that you assign, the higher cost of capital or
7 return on equity you might arrive at.

8 Q That's all I have at this time. Thank you, sir.

9 Mr. Jue, don't want to leave you out.

10 A [JUE] Thanks.

11 Q I'll be very quick. You been mainly on the field side of
12 water and sewer companies, have you not, in terms of -

13 A [JUE] "Field" being what? Operating?

14 Q Yes.

15 A [JUE] No, I managed, I would say, a \$½ billion dollar
16 water-and-sewer system.

17 Q That was Beaufort-Jasper?

18 A [JUE] City of Savannah.

19 Q Okay. Very good. But you have never been qualified as
20 an expert in depreciation in any proceeding, have you?

21 A [JUE] No.

22 MR. WALKER: Thank you. That's all I have.

23 CHAIRMAN HALL: Okay. We'll take a break and
24 come back at 6:40.

25 [WHEREUPON, a recess was taken from 6:25

1 to 6:40 p.m.]

2 CHAIRMAN HALL: Be seated. Thank you.

3 Commissioners, questions for this panel?

4 Commissioner Fleming.

5 EXAMINATION

6 BY COMMISSIONER FLEMING:

7 Q Good evening.

8 A [LANIER] Good evening.

9 Q Mr. Lanier.

10 A [LANIER] Yes.

11 Q Could you talk about your basis for the ROE that you
12 have given?

13 A [LANIER] That I had recommended in my testimony?

14 Q Uh-huh?

15 A [LANIER] Certainly. What I had said in my testimony was
16 that I thought the company should be given an ROE on the
17 lower end of reasonableness. And as I said at length in
18 my testimony, I thought the basis for that was because
19 the company has had many lapses, and it's already been
20 discussed here today that, many times, it seems that
21 they're a day late and a dollar short with things. And
22 I don't see how you reward a company with high rates of
23 return when there's just a long list of issues in their
24 past where they could have and should have done a better
25 job.

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1 Q Okay. And your analysis of the company's expenses, did
2 you give any consideration of where the island – that it
3 is an island, and the lack of availability of
4 traditional transportation methods?

5 A [LANIER] I'm aware of that. But my point is, the
6 company has been in business for quite some time, and I
7 would expect that its cost structure has already
8 reflected a higher cost of operation. I don't deny that
9 at all. I have been to Daufuskie Island; I know exactly
10 what the situation is. But when you see increases like
11 they have had over the last several years, it's just
12 hard to understand how you can have that much of an
13 increase. So you've got that cost built into it, but
14 it's that cost plus these significant increases in
15 recent years.

16 Q Okay. And when you talked about being – it could be run
17 more efficiently, are you talking about in reference to
18 the costs, the expenses, that they have incurred?

19 A [LANIER] Yes.

20 Q And lack of – I mean, being, as you said, a day late and
21 a –

22 A [LANIER] A dollar short –

23 Q – dollar short?

24 A [LANIER] – and a day late?

25 Q So that's –

1 A [LANIER] Yes, I think their expenses of their operations
2 are excessive.

3 Q Any particular area that stands out, or just across the
4 board?

5 A [LANIER] Well, I think the management costs are
6 excessive. I think they could manage that company for
7 less. You know, there are companies around Daufuskie
8 Island, well-established companies, that might be
9 willing to manage or participate or take some role in
10 the management of the company, but there's been no
11 evidence that any of that has been pursued, at least not
12 in recent years. So I think there are other options
13 that are available to the company that would result in a
14 more efficient operation.

15 COMMISSIONER FLEMING: Okay, thank you.

16 CHAIRMAN HALL: Commissioner Whitfield.

17 VICE CHAIRMAN WHITFIELD: Thank you, Madam
18 Chairman.

19 EXAMINATION

20 BY VICE CHAIRMAN WHITFIELD:

21 Q I know the hour is late, but I do have a question for
22 you, Mr. Lanier. I didn't want to pass this opportunity
23 up. We've heard some comments and things today about
24 the viability of the company and the potential of the
25 company, Daufuskie Island Utility not making it, that

1 sort of thing. And you've done a lot of work on this
2 case, as you have in others. In your opinion, what's
3 the risk of the company not making it, depending on what
4 we do here?

5 A [LANIER] Well, let me put it this way: If you look at
6 the company's Schedule A(4), and you look at the return,
7 which I think is \$618,000, and the income taxes
8 associated with that, I think, are about \$240,000, and
9 there are other taxes associated with that. So, of the
10 approximately \$2.2 million in revenue, approximately
11 \$800,000 is return and taxes on return. So that says to
12 me that there is a lot of room for them to get by with
13 less without being forced into bankruptcy.

14 Q Thank you for that answer, and that was pretty succinct
15 and concise. With your knowledge of other water
16 utilities – I guess Kiawah Island has been referenced –
17 are you familiar with the tax assessments assigned by
18 the Department of Revenue on assets of that utility, or
19 in comparison to this one? Could you comment on that,
20 or is that not in your realm?

21 A [LANIER] I actually testified in the last Kiawah Island
22 rate case, but I, frankly, cannot recall the tax issue
23 in that case. But I believe it was mentioned here today
24 that it was acknowledged that Mr. Guastella was aware
25 that Kiawah was paying fairly significant property taxes

1 on its utility personal property. So it's hard for me
2 to believe that, if you're a consultant for a company
3 where you know that, that you wouldn't be aware of the
4 fact that you should be paying those taxes on Daufuskie
5 - DIUC.

6 VICE CHAIRMAN WHITFIELD: Thank you, Mr.
7 Lanier.

8 That's all I have, Madam Chairman.

9 CHAIRMAN HALL: All right. Commissioners, any
10 other questions?

11 [No response]

12 Okay, Mr. Pringle?

13 MR. PRINGLE: I do not have any redirect.

14 CHAIRMAN HALL: Okay. All right. This panel
15 is excused. And thank you, gentlemen.

16 [WHEREUPON, the witnesses were excused.]

17 Mr. Pringle?

18 MR. PRINGLE: The Intervenors do not have any
19 additional witnesses to call. I think we got the
20 testimony and exhibits in. I don't think there are
21 any other exhibits floating around, so I'll turn it
22 over to the ORS.

23 CHAIRMAN HALL: Okay. All right. Ms. Hudson,
24 you're up.

25 MS. HUDSON: Good evening. The Office of

1 Regulatory Staff calls its panel of Dr. Douglas
2 Carlisle, Ms. Ivana Gearheart, and Mr. Willie
3 Morgan.

4 As they take their seats, thank you for
5 allowing us to utilize the panel. We appreciate
6 it.

7 [Witnesses affirmed]

8 MR. PRINGLE: Madam Chair, can I jump in real
9 quick and ask if it would be all right if my —

10 CHAIRMAN HALL: Yeah, they're excused.

11 MR. PRINGLE: Okay.

12 CHAIRMAN HALL: They're already gone.

13 MR. PRINGLE: Well, I —

14 [Laughter]

15 CHAIRMAN HALL: Have a safe trip back, Mr.
16 Lanier.

17 MR. PRINGLE: Another *nunc pro tunc* ruling.

18 THEREUPON came,

19 D O U G L A S H . C A R L I S L E , J R . , P H . D . ,

20 I V A N A C . G E A R H E A R T ,

21 W I L L I E J . M O R G A N ,

22 called as witnesses on behalf of the South Carolina Office of
23 Regulatory Staff, who, having been first duly affirmed, were
24 examined and testified as follows:

25 <

DIRECT EXAMINATION

BY MS. HUDSON:

Q Dr. Carlisle, would you please state your full name and occupation?

A [CARLISLE] My name is Douglas H. Carlisle, Jr., and I am the economist at the Office of Regulatory Staff.

Q Are you the same Douglas Carlisle who prefiled 14 pages of direct testimony and 10 exhibits in this case on October 2, 2015?

A [CARLISLE] Yes, I am.

Q Do you have any changes to either your testimony or your exhibits?

A [CARLISLE] No, I do not.

MS. HUDSON: Madam Chairman, we ask that Dr. Carlisle's testimony be treated as if it were read orally from the stand and that his 10 exhibits be marked for identification and entered into the record as the next hearing exhibit.

CHAIRMAN HALL: All right. Dr. Carlisle's testimony will be read into the record as if given orally.

[See pgs 470-484]

His exhibits will be Hearing Exhibit No. 17.

[WHEREUPON, Exhibit No. 17 was marked and received in evidence.]

1 MS. HUDSON: Thank you.

2 BY MS. HUDSON:

3 Q Dr. Carlisle, would you summarize your testimony for the
4 Commission?

5 A [CARLISLE] Gladly.

6 Good evening, Madam Chairman, Vice Chairman, and
7 Commissioners. The following summarizes my analysis and
8 recommended return on equity for Daufuskie Island
9 Utility Company, based upon the company's Application to
10 be treated on an ROE basis and compared to companies
11 with publicly traded stock.

12 I use three methods, or models – Discounted Cash
13 Flow, Capital Asset Pricing, and Comparable Earnings –
14 whose results produced ROEs of 9.71, 9.30, and 8.91
15 percent, respectively. The average and midpoint of the
16 range from 9.71 and 8.91 percent are 9.31 percent, which
17 is my point recommendation. The settlement agreement
18 contains an ROE of 9.28 percent, which is well within my
19 range and very close to the averages of my methods. I
20 am, therefore, quite comfortable with the settlement and
21 endorse it.

22 My analysis also dealt with the company's filed
23 capital structure, which is hypothetical and, within the
24 bounds of proper balance of debt and equity, indicates a
25 lower ROE than filed would be appropriate. Accordingly,

1 I recommend a capital structure of 54 percent equity and
2 46 percent debt, based on those publicly traded water
3 companies, as shown in Exhibit DHC-1.

4 This concludes my summary of direct testimony.
5 Thank you.

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23 [PURSUANT TO PREVIOUS INSTRUCTION, THE
24 PREFILED DIRECT TESTIMONY OF DOUGLAS H.
25 CARLISLE, JR., Ph.D., FOLLOWS AT PGS 469-483]

THE OFFICE OF REGULATORY STAFF

DIRECT TESTIMONY & EXHIBITS

OF

DR. DOUGLAS H. CARLISLE

OCTOBER 2, 2015



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**

DIRECT TESTIMONY OF DR. DOUGLAS H. CARLISLE

ON BEHALF OF

THE OFFICE OF REGULATORY STAFF

DOCKET NO. 2014-346-WS

**IN RE: APPLICATION OF DAUFUSKIE ISLAND UTILITY COMPANY,
INC. FOR APPROVAL OF AN INCREASE FOR WATER AND SEWER
RATES, TERMS AND CONDITIONS**

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is Dr. Douglas H. Carlisle, Jr. I am an Economist at the South Carolina Office of Regulatory Staff ("ORS"). My business address is 1401 Main Street, Suite 900, Columbia, South Carolina 29201.

Q. WOULD YOU PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND YOUR BUSINESS EXPERIENCE?

A. I received a Bachelor of Arts from Brown University, a Master's Degree in Public Administration and a Ph.D. in Government and International Relations from the University of Virginia. After graduate school, I worked as an evaluator and evaluator-in-charge for about 7 years at the United States Government Accountability Office in Washington, D.C. Afterwards, I began working for the State of South Carolina in different capacities, and before joining ORS, I worked five years for the State Chief Economist as an analyst in the Economic Research Section, which served as an adjunct to the Board of Economic Advisors. I assumed my current position with ORS in March of 2005. I am a Certified Rate of Return Analyst and a board member of the Society of

**THE OFFICE OF REGULATORY STAFF
1401 Main street, Suite 900
Columbia, SC 29201**

1 Utility Regulatory Financial Analysts. I have previously testified before this Commission
2 concerning rate of return ("ROR").

3 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

4 **A.** My purpose is to recommend an appropriate return on equity ("ROE") from an
5 appropriate ROE range because Daufuskie Island Utility Company, Inc. ("DIUC" or "the
6 Company") requested rates based on ROE.

7 **Q. WHAT IS YOUR RECOMMENDED ROE?**

8 **A.** I recommend an ROE of 9.31%, based on the calculated average from the range
9 8.91% (Exhibit DHC-10, pg. 3 of 3) to 9.71% (Exhibit DHC-7).

10 **Q. WHAT STANDARDS GOVERN RATE OF RETURN?**

11 **A.** The Supreme Court of the United States set standards in two landmark decisions.
12 In the first case, involving a water company, the Court declared:

13 *A public utility is entitled to such rates as will permit it to earn a*
14 *return on the value of the property which it employs for the*
15 *convenience of the public equal to that generally being made at the*
16 *same time and in the same general part of the country on*
17 *investments in other business undertakings which are attended by*
18 *corresponding risks and uncertainties; but it has no constitutional*
19 *right to profits such as are realized or anticipated in highly*
20 *profitable or speculative ventures. The return should be*
21 *reasonably sufficient to assure confidence in the financial*
22 *soundness of the utility and should be adequate, under efficient*

1 *and economical management, to maintain and support its credit*

2 *and enable it to raise money for the proper discharge of its duties.¹*

3 The Bluefield decision was later reinforced by the decision in another case,
4 Federal Power Commission v. Hope Natural Gas Company:

5 *The fixing of "just and reasonable" rates, involves a balancing of the*
6 *investor and consumer interests.... From the investor or company point of*
7 *view it is important that there be enough revenue not only for operating*
8 *expenses but also for the capital cost of the business. These include*
9 *service on the debt and dividends on the stock.... By that standard the*
10 *return to the equity owner should be commensurate with returns on*
11 *investments in other enterprises having corresponding risks. That return,*
12 *moreover, should be sufficient to assure confidence in the financial*
13 *integrity of the enterprise, so as to maintain its credit and attract capital.²*

14 **Capital Structure**

15 **Q. DO YOU HAVE CONCERNS ABOUT THE CAPITAL STRUCTURE SET**
16 **FORTH BY DIUC IN ITS APPLICATION?**

17 **A.** Yes. I have two concerns related to the method DIUC used to calculate the capital
18 structure for this case: 1) the Company included pro-forma long-term debt in its
19 long-term debt calculation; and 2) the Company proposed in its Application to use an
20 inflated equity amount. Both of these items increase the return on equity.

¹ *Bluefield Water Works & Improvement Company. v. Public Service Commission of West Virginia*, 262 U.S. 679, 692-3 (1923).

² *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 603 (1944).

1 **Q. WHY DOES INCLUDING A PRO-FORMA ADJUSTMENT TO LONG-TERM**
2 **DEBT CONCERN ORS?**

3 **A.** ORS includes known and measurable adjustments. In contrast, DIUC's
4 adjustment to long-term debt is pro forma and based on the cost of debt DIUC expects to
5 receive. The outcome of DIUC's negotiations with banks or lenders is unknown at this
6 time and the Company may not obtain the exact financing indicated in its proposed pro-
7 forma adjustment; therefore, this debt should not be included.

8 **Q. WHY IS USING A CAPITAL STRUCTURE WITH AN INFLATED EQUITY**
9 **AMOUNT A CONCERN FOR ORS?**

10 **A.** The capital structure filed in DIUC's application of 41.2% Long-Term Debt and
11 58.8% Equity is weighted heavily toward equity, which is more expensive than debt. The
12 ROE should be lower because more equity equals less risk. Debt must be paid and is
13 secured by company assets in the event of a default. However, dividends from equity
14 investments may be reduced or even suspended as holders of equity take lower priority
15 than holders of debt.

16 As an alternative, DIUC could use a hypothetical capital structure until such time
17 as the sources of capital for the Company begin to approximate that of a company with
18 traded stock. Such a hypothetical capital structure should adhere to the standard of
19 comparability.

20 **Q. WHAT CAPITAL STRUCTURE DO YOU RECOMMEND FOR DIUC?**

21 **A.** I recommend using the average capital structure used by water companies in the
22 United States with publicly traded stock (Common Equity). That ratio is 46%
23 Long-Term Debt and 54% Common Equity (see Exhibit DHC-1)

1 **Debt Rate**

2 **Q. DO YOU HAVE A CONCERN RELATED TO THE DEBT RATE USED BY**
3 **DIUC?**

4 **A.** Yes. The Company included \$372,879.71 in financing fees from Guastella
5 Associates, LLC ("GA") in the calculation of its debt rate. As a percentage of total debt,
6 the GA fees are 13.56%. This proportion and the source of the fee are not appropriate for
7 inclusion in the capital structure. Due to the large amount of GA's fees, compared to the
8 total debt, and because the fees originate from GA and not from a lending institution, I
9 am not incorporating this amount into the debt rate, presented as 6.20% by DIUC. I
10 recommend using the actual debt rate, 5.29%, which is the interest rate the Company
11 pays on its debt.

12 **Appropriate Return on Equity**

13 **Q. DOES DIUC HAVE TRADED COMMON STOCK?**

14 **A.** No, the Company's stock is entirely held by Daufuskie Island Utility Holding
15 Company, LLC.

16 **Q. IF NEITHER THE COMPANY NOR ITS PARENT HAS TRADED STOCK, HOW**
17 **DID YOU PERFORM YOUR ANALYSIS TO RECOMMEND AN ROE?**

18 **A.** To develop an ROE recommendation for DIUC, I evaluated the return
19 requirements of investors on the common stock of two groups: publicly held water and
20 sewerage service companies and a Comparable Earnings Model ("CEM") group. I then
21 applied to the first group, two known and generally accepted methods for determining a
22 recommended ROE, the Discounted Cash Flow ("DCF") Model and Capital Asset
23 Pricing Methods ("CAP-M").

1 **Q. WHY DID YOU EXAMINE DATA ON COMPANIES WITH TRADED STOCK?**

2 **A.** First, DIUC asked for its rates to be determined based on ROE using the rate-of-
3 return on rate-base methodology. Second, there is more data on publicly traded
4 companies than on private held companies. Specifically, I used publicly traded water
5 utilities since they are in the same line of business as DIUC and share similar risks.

6 **Q. HOW DID YOU SELECT THE COMPANIES AND GROUPS?**

7 **A.** For my DCF analysis I selected companies classified as "water utilities" by Value
8 Line or by *Yahoo! Finance* that engage in water distribution to customers and obtain most
9 of their revenues from utility services, which include water and sewerage. For my CEM
10 analysis I selected companies with comparable betas ("β's") to those of the companies in
11 my DCF proxy group.

12 **DCF Analysis**

13 **Q. WHAT IS THE PURPOSE OF YOUR DCF ANALYSIS?**

14 **A.** The purpose of my DCF analysis is to determine the appropriate ROE for DIUC
15 by determining what the composite return in perpetuity would be for a comparable group
16 of companies, based on investors' present-day valuation of these companies' future
17 dividend payments. The idea behind the DCF is that investors value a stock for its
18 potential perpetual future flow of cash in the form of dividends. Under the DCF model,
19 potential investors discount the value of these dividends to present value.

20 **Q. WHAT IS THE FIRST STEP IN YOUR DCF ANALYSIS?**

21 **A.** I created a proxy group of companies that have traded stock. The purpose is to
22 determine the value of equity for water companies with equity traded in the market.

1 Value Line includes nine companies in its water sector and those became my proxy group
2 (Exhibits DHC-1 and DHC-2).

3 **Q. HOW DID YOU PERFORM YOUR DCF ANALYSIS ON THE PROXY GROUP?**

4 A. I obtained historical data for Earnings per Share ("EPS"), Dividends per Share
5 ("DPS"), Sales/Revenue and Book Value per Share ("BVPS") from Value Line to
6 determine the historical growth rate of the proxy group. I used three-, five- and ten-year
7 periods to span fluctuations brought on by economic cycles and to provide for longer-
8 and shorter-term perspectives. I next took the mean or simple, "arithmetic" average and
9 the compound annual growth rate or "geometric" average of the water companies in my
10 proxy group for each period for each indicator of growth and calculated the average and
11 the median of the two kinds of averages. I then averaged all the periods to come up with
12 a historical growth rate. Next, I obtained estimates of future growth rates from Value
13 Line, *Yahoo! Finance* and *Zacks*, took the mean and median of each estimate and then
14 averaged all the estimates to come up with a future growth rate for each indicator of
15 growth. I then averaged the historical and future rates for each company and then
16 averaged all the indicators to come up with an overall indicated growth rate (Exhibits
17 DHC-3 through DHC-7). I added the dividend yield, adjusted for tax consequences, to
18 the growth calculation.

19 My last step was the dividend adjustment. I applied the rate of growth to the
20 dividend yield to produce an adjusted dividend yield of 3.76%. (Exhibit DHC-7).

21 **Q. HOW DID YOU CALCULATE THE DCF?**

22 A. There are two components, dividend yield, which indicates an investor's return
23 relative to investment, and growth, which indicates future return. The best general

1 formula relating these components is:

2 $K = \text{DIV}_1/P_0 + g$

3 K is the cost of equity; DIV is the annualized dividend paid in the next period; P
4 is the price of the investment; and, g is the growth rate of the investment.

5 **Q. EXPLAIN HOW YOU ARRIVED AT THE DIVIDEND YIELD PORTION OF**
6 **THE DCF CALCULATION.**

7 **A.** The traditional method of calculating the dividend yield involves using the most
8 current price of stock and the expected dividend. Volatility in the stock market
9 sometimes raises questions about whether using current prices accurately represents the
10 current situation of the stock. Fortunately, Value Line provides a dividend yield that
11 takes an average of recent stock prices, and I accept the calculation methodology used by
12 Value Line.

13 **Q. WHAT MAKES THE CALCULATION OF THE EXPECTED DIVIDEND**
14 **DIFFICULT?**

15 **A.** The problem of the timing of dividends poses a problem for two reasons. First,
16 not all companies increase their dividends at the same time. Second, only current
17 information is available yet expected dividends are needed for the calculation.

18 Because dividends are expectational and the "next year" or next twelve months
19 has not happened yet, the increased payments that tend to continue into the next year do
20 not get counted. The potential undercount in dividends amounts to one-and-a-half times
21 the dividend growth. To prevent potential undercounting, I use the following formula to
22 calculate the appropriate ROE under the DCF:

23 $K = ((\text{DIV}_1/P_0) * (1+.5g)) + g$

1 The part of this equation inside all the parentheses is called the “adjusted dividend
2 yield.”

3 **Q. HOW DID YOU ARRIVE AT THE GROWTH “g” COMPONENT FOR YOUR**
4 **DCF?**

5 **A.** The growth component generates more controversy than any other part of the
6 DCF equation, but, in the long run, dividends, earnings, book value and revenues are all
7 indicative of future growth and so I averaged the growth for all of them with analysts’
8 estimates for all of them. Investors know historical trends have a bearing on future
9 returns, so publications and on-line data frequently feature some or all of these statistics.
10 It is unlikely that utilities will dramatically depart from their past growth rates, which
11 form a basis for future ones. On the other hand, investors know that a mere straight-line
12 projection from the past is unlikely to provide an accurate guide to the future. Combining
13 the four factors, both historically and expectationally, allows one to arrive at an
14 appropriate rate of growth, which is the “g” component in the DCF.

15 **Q. WHAT WAS THE RESULT OF YOUR ANALYSIS?**

16 **A.** I calculated the cost of equity under my DCF analysis to be 9.71% (Exhibit
17 DHC-7).

18 **CAP-M Analysis**

19 **Q. WHAT IS THE BASIS FOR THE CAP-M?**

20 **A.** The CAP-M rests upon several assumptions. The first is that investments with
21 any degree of risk must bring a higher return than virtually risk-free investments. Due to
22 this assumption, CAP-M is a type of risk premium approach to the cost of equity. The

1 other central assumption the CAP-M relies upon is that risk particular to one company
2 can be neutralized by investing in a variety of companies or “diversified portfolio.”

3 **Q. HOW DOES CAP-M INDICATE AN APPROPRIATE ROE?**

4 A. The CAP-M analysis is a two-step process. The first step is to determine the
5 difference between a risk-free rate (R_f) and a market rate (R_m) of return. This difference
6 is the equity risk premium (“ERP”). The second step is to adjust the risk premium for a
7 company’s risk relative to the market. This adjusted risk premium plus the risk-free rate
8 produces an ROE reflective of the company being analyzed.

9 **Q. WHAT DID YOU USE FOR THE RISK-FREE RATE IN YOUR ANALYSIS?**

10 A. I used the 30-Year U.S. Treasury Bond rate as projected 1½ years out by *Blue*
11 *Chip*TM (Exhibit DHC-8). I regard the CAP-M as a long-term analysis and U.S. Treasury
12 Bonds as free of risk. I use a short projection because investors are aware in the current
13 environment that bond yields are bound to rise in the long term. Investors also know that
14 ten years ago longer-term projections of 2015 bond yields were not accurate, so longer
15 projections are not as credible.

16 **Q. WHAT DID YOU USE AS THE MARKET RATE?**

17 A. I used the data from 2014 Ibbotson SBBI Classic Yearbook (“SBBI”) because it is
18 an available compendium of long-term equity returns. I averaged the long-term returns
19 of each decile of publicly-traded companies and obtained a compound annual growth rate
20 to arrive at an ERP. The reason for using the compound annual growth rate or geometric
21 mean, rather than the simple average, is that a simple average exaggerates growth when it
22 is irregular.

1 adjusted downward to recognize lower risk in order to arrive at an appropriate return for a
2 regulated company.

3 **Q. HOW DID YOU SELECT COMPARABLE COMPANIES FOR YOUR CEM**
4 **ANALYSIS?**

5 **A.** I used Value Line's data and screened for companies whose current Value Line
6 β 's were in the range of the Proxy Group's β 's. For these companies, I also obtained the
7 ten-year β 's, which allowed me to eliminate all companies within the initial selection
8 whose β 's had been more than 15 basis points higher or lower than the range of the Proxy
9 Group. I used 15 basis points because some water companies in the past have in the past
10 ranged up to a β of .80, which means using more leeway than 15 basis points would make
11 a company as risky as the overall market, i.e. β would equal 1.00. Since water companies
12 are a safer investment than the average company, it would not make sense to allow
13 variation that permitted a historical variation in β up to 1.00. This approach produced a
14 CEM Group of 106 companies whose β 's were similar to the Proxy Group (Exhibit
15 DHC-10).

16 **Q. HOW DID YOU PERFORM YOUR ANALYSIS ON YOUR CEM GROUP?**

17 **A.** I obtained data for 10-year book value growth rates and expected future book
18 value growth rates for the CEM Group. I then averaged the CEM Group's 10-year book
19 value growth rate and the expected future book value growth rate. To control for the
20 effect of extreme values, I also calculated the mean for the past and predicted future book
21 value growth rates. I averaged the means with the medians, thereby allowing some
22 influence of extreme values.

1 Once I had obtained this initial result, I stratified the result by β ranges and
2 averaged the ranges. I then weighted each range by the proportion of companies in my
3 Proxy Group with the respective β ranges. Finally I averaged the three different
4 calculations to produce the ROE indicated by my CEM analysis (Exhibit DHC-10, p 3
5 of 3).

6 **Q. WHY DID YOU USE BOTH CURRENT AND ESTIMATED BOOK VALUES**
7 **FOR THE CALCULATION?**

8 **A.** The CEM focuses on the growth in book value as a predictor of future growth in
9 earnings. The growth in book value of a company over a ten-year period indicates
10 growth in the future. Returns from investments and an improved capital position of a
11 company in only one or two years can mean that earnings growth arising from growth in
12 book value may extend into the future.

13 **Q. EXPLAIN WHY YOU DID NOT USE SIMPLE AVERAGES IN YOUR CEM**
14 **CALCULATION.**

15 **A.** I made these computations to ensure comparability. I stratified my CEM Group
16 by β and then weighted it by the distribution within my Proxy Group. Over time, risk
17 varies; so, even though I stratified and weighted the result for one average, some
18 companies "migrated" from higher to lower risk or vice versa within the CEM Group and
19 there is a possibility of distortion due to weighting. At the same time, there is a threat of
20 distortion without performing the calculation to weighting. A third possibility, that the
21 CEM Group is representative without either stratification or weighting exists. Since each
22 of these three threats may exist in the future, the best defense is to perform the CEM

1 calculations to defend against all three threats and average them. This is what I did.
2 (Exhibit DHC-10, p. 3 of 3).

3 **Q. WHAT WAS THE RESULT OF YOUR CEM ANALYSIS?**

4 **A.** My CEM analysis produced an indicated ROE of 8.91% (Exhibit DHC-10, p.3
5 of 3).

6 **Conclusion**

7 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

8 **A.** Yes.

1 BY MS. HUDSON:

2 Q Ms. Gearhart, would you please state your full name and
3 occupation?

4 A [GEARHEART] Sure. My name is Ivana Gearhart, and I'm
5 employed by the South Carolina Office of Regulatory
6 Staff as an audit manager.

7 Q Are you the same Ms. Gearhart who prefiled 12 pages of
8 direct testimony and eight exhibits in this case on
9 October 2, 2016_[sic]?

10 A [GEARHEART] Yes, I am.

11 Q Do you have any changes to either the testimony or the
12 exhibits?

13 A [GEARHEART] No, I don't.

14 MS. HUDSON: Madam Chairman, we ask that Ms.
15 Gearhart's direct testimony be treated as if it
16 were read orally from the stand, and that her eight
17 exhibits be marked for identification and entered
18 into the record as the next hearing exhibit.

19 CHAIRMAN HALL: All right. Ms. Gearheart's
20 testimony will be entered as if given orally.

21 [See pgs 488-500]

22 Her exhibits will be Hearing Exhibit No. 18.

23 [WHEREUPON, Exhibit No. 18 was marked and
24 received in evidence.]

25 <

1 BY MS. HUDSON:

2 Q Ms. Gearheart, did you prepare or cause to be prepared
3 Exhibits -2, -3, and -4 of the settlement agreement that
4 was entered as Hearing Exhibit No. 3 today?

5 A [GEARHEART] I updated my exhibits, Settlement Exhibits
6 -3, -4, and -5.

7 Q I'm sorry. I'm sorry. Correct, and I meant to say
8 Settlement Agreement Exhibit -3, -4, and -5. Are those
9 the –

10 A [GEARHEART] Correct.

11 Q – ones you caused to be prepared?

12 A [GEARHEART] That's right.

13 Q Thank you. And will you please summarize your testimony
14 for the Commission?

15 A [GEARHEART] Sure.

16 Good evening, Madam Chairman and members of the
17 Commission. The purpose of my testimony is to set forth
18 the findings and recommendations resulting from ORS's
19 review of the company's Application.

20 ORS verified operating experience and the rate
21 base, per the company's Application, tested the
22 underlying transactions, and adjusted as necessary to
23 normalize the test year. The proposed adjustments are
24 listed in Audit Exhibit ICG-4.

25 I have provided updated exhibits as part of the

1 settlement agreement, to reflect the terms of the
2 settling parties agreed on. This concludes my summary.
3 Thank you.

4 **Q** Thank you, Ms. Gearhart. And you passed the test of
5 good listening, earlier.

6 [Laughter]

7 **A** Thank you.

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23 [PURSUANT TO PREVIOUS INSTRUCTION, THE
24 PREFILED DIRECT TESTIMONY OF IVANA C.
25 GEARHEART FOLLOWS AT PGS 487-499]

THE OFFICE OF REGULATORY STAFF
DIRECT TESTIMONY & EXHIBITS
OF
IVANA C. GEARHEART
OCTOBER 2, 2015



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**

1 **DIRECT TESTIMONY OF**
2 **IVANA C. GEARHEART**
3 **ON BEHALF OF**
4 **THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF**
5 **DOCKET NO. 2014-346-WS**
6 **IN RE: APPLICATION OF**
7 **DAUFUSKIE ISLAND UTILITY COMPANY, INCORPORATED**
8 **FOR APPROVAL OF AN INCREASE FOR WATER AND SEWER RATES,**
9 **TERMS AND CONDITIONS**

10

11 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND OCCUPATION.**

12 **A.**My name is Ivana C. Gearheart. My business address is 1401 Main Street, Suite
13 900, Columbia, South Carolina, 29201. I am employed by the South Carolina Office of
14 Regulatory Staff ("ORS") as an Audit Manager.

15 **Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

16 **A.**I received a Master's Degree in Business Administration with an emphasis in
17 Accounting from Winthrop University in 2006. Prior to joining ORS, I held a variety of
18 positions in finance, accounting, and auditing. I began my employment as an auditor
19 with ORS in June 2011 and participated in audits of utility companies, which include
20 water and wastewater rate cases. I was promoted to the Audit Manager for water and
21 wastewater cases in 2014 and have previously testified before the Public Service
22 Commission of South Carolina ("Commission").

23 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

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1 A. The purpose of my testimony is to set forth the findings and recommendations
2 resulting from ORS's examination of the Application of Daufuskie Island Utility Company,
3 Inc. ("DIUC" or "Company") in this docket, 2014-346-WS. DIUC filed the Application on
4 June 9, 2015.

5 **Q. PLEASE DESCRIBE THE PROCEDURES USED TO EXAMINE THE**
6 **APPLICATION OF DIUC.**

7 A. ORS's examination of the Company's Application for Approval of Water and
8 Sewer Rates, Terms and Conditions ("Application") consisted of three major steps. In
9 step one, ORS verified that the operating experience and rate base, reported by DIUC in
10 its Application, were supported by DIUC's accounting books and records for the twelve
11 months ended December 31, 2014, the test year chosen by DIUC ("test year"). In the
12 second step, ORS tested the underlying transactions in the books and records for the test
13 year to ensure that the transactions were adequately supported, had a stated business
14 purpose, were allowable for ratemaking purposes, and were properly recorded. Lastly,
15 ORS's examination consisted of adjusting, as necessary, the revenues, expenditures, and
16 capital investments to normalize the Company's operating experience and rate base, in
17 accordance with generally accepted regulatory principles and prior Commission orders.

18 **Q. PLEASE IDENTIFY THE EXHIBITS ATTACHED TO YOUR TESTIMONY.**

19 A. I have attached the following exhibits to my testimony relating to the Application:
20

- 21 • Audit Exhibit ICG-1: Operating Experience, Rate Base and Rates of Return for
 Combined Operations
- 22 • Audit Exhibit ICG-2: Operating Experience, Rate Base and Rates of Return for
23 Water Operations

- 1 • Audit Exhibit ICG-3: Operating Experience, Rate Base and Rates of Return for
- 2 Sewer Operations
- 3 • Audit Exhibit ICG-4: Explanation of Accounting and Pro Forma Adjustments
- 4 • Audit Exhibit ICG-5: Computation of Depreciation and Amortization Expense
- 5 • Audit Exhibit ICG-6: Computation of Income Taxes
- 6 • Audit Exhibit ICG-7: Cash Working Capital Allowance
- 7 • Audit Exhibit ICG-8: Return on Equity

8 These exhibits were either prepared by me or were prepared under my direction and
9 supervision in compliance with recognized accounting and regulatory procedures for
10 water and wastewater utility rate cases. These exhibits show various aspects of the
11 Company's operations and financial position.

12 **Q. PLEASE DESCRIBE THE FORMAT OF AUDIT EXHIBIT ICG-1 AND**
13 **ELABORATE ON THE CALCULATIONS.**

14 **A.** Audit Exhibit ICG-1 details the Company's combined operating experience, rate
15 base and rates of return for water and sewer operations for the test year. The exhibit's
16 format is designed to reflect the Application per books, ORS's proposed accounting and
17 pro forma adjustments to normalize the results of the Company's test year operations, and
18 calculate the impact of DUIC's proposed increase on the normalized test year.
19 Column (1) details the Application per books amounts reported by DIUC for the test year
20 ended December 31, 2014.
21 Column (2) details ORS's proposed accounting and pro forma adjustments designed to
22 normalize the Application per books. An explanation of each adjustment is contained in
23 Audit Exhibit ICG-4.

Column (3) details ORS's results for a normalized test year for DIUC by adding columns (1) and (2). After the accounting and pro forma adjustments, net income for return of (\$28,421) was computed using total operating revenues of \$1,073,577, less total operating expenses of \$1,102,061, plus customer growth of \$63. Total Rate Base of \$4,981,166 produced a Return on Rate Base of -0.57%. As shown on Audit Exhibit ICG-8, the resulting Return on Equity ("ROE") was -5.56%.

Column (4) details the Company's proposed increase recalculated by ORS and the calculation of taxes and customer growth associated with the proposed increase. An explanation of each adjustment is contained in Audit Exhibit ICG-4.

Column (5) details the effect of the Company's proposed increase by adding columns (3) and (4). Net income for return of \$647,827 was computed using total operating revenues of \$2,177,363, less total operating expenses of \$1,531,799 plus customer growth of \$2,263. Total Rate Base of \$4,981,166 produced a Return on Rate Base of 13.01%. As shown on Audit Exhibit ICG-8, the resulting ROE was 19.58%.

Q. PLEASE EXPLAIN THE ADJUSTMENTS IN AUDIT EXHIBIT ICG-4.

A. For comparative purposes, ORS's and the Company's proposed adjustments are both presented in Audit Exhibit ICG-4.

Adjustment 1 – The ORS Water and Wastewater Department proposes to annualize water and sewer service revenues for the test year. Details of the adjustments totaling \$1,016 are reflected in the direct testimony and exhibits of ORS witness Morgan.

Adjustment 2 – The ORS Water and Wastewater Department proposes to adjust Availability Billing Revenue for the test year. Details of the adjustment for (\$3,905) are reflected in the direct testimony and exhibits of ORS witness Morgan.

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1 Adjustment 3 – The ORS Water and Wastewater Department proposes to adjust
2 miscellaneous revenues for the test year. Details of the adjustment for \$4 are reflected in
3 the direct testimony and exhibits of ORS witness Morgan.

4 Adjustment 4 – ORS's operation and maintenance expense adjustments total (\$31,228)
5 and are comprised of the following:

6 Adjustment 4(a) – ORS proposes to annualize the latest available salary information as of
7 June 2015 for DIUC's four (4) full-time employees and one (1) part-time employee. In
8 addition, ORS included average overtime wages for 2.5 years. ORS computed annualized
9 salaries of \$176,590, less per book salaries of \$156,602, for a payroll adjustment of
10 \$19,988.

11 Adjustment 4(b) – ORS proposes an adjustment to employee benefits for adjusted
12 salaries. ORS computed annualized employee benefits of \$6,200, less per book employee
13 benefits amount of \$8,980, for an adjustment of (\$2,780).

14 Adjustment 4(c) – ORS does not propose an adjustment to the Officer & Director Fees
15 account since these fees are already included in the per book amounts.

16 Adjustment 4(d) – ORS proposes to adjust purchased power by \$14,744 to reflect the
17 twelve most recent months of power expenses. Adjusted power expenses amount to
18 \$130,181 for the test year, less per book amount \$115,437 for an adjustment of \$14,744.

19 Adjustment 4(e) – ORS does not propose to adjust chemicals expense for increased
20 demand as the impact is not known and measurable.

21 Adjustment 4(f) – ORS does not propose to adjust operating supply costs for an increase
22 in customers. ORS adjusts for customer growth in adjustment 9. ORS also proposes to
23 remove undocumented operating supply expenses of (\$21).

1 Adjustment 4(g) – ORS proposes to adjust outside services for management fees to
2 reflect the previously Commission approved amount of \$132,211. During the review,
3 ORS did not find that the management services provided by Guastella and Associates
4 (“GA”) increased and did not find the requested increase justifiable. This resulted in an
5 ORS proposed adjustment of (\$25,439) to the per book amount of \$157,650.

6 Adjustment 4(h) – ORS does not propose to adjust outside services for engineering
7 expenses to reflect a four-year average cost. ORS uses the amount reflected in the test
8 year for engineering services of \$10,137.

9 Adjustment 4(i) – ORS does not propose to increase transportation costs to reflect an
10 increase in employees as the costs are not known and measurable.

11 Adjustment 4(j) – ORS proposes to adjust bad debt expense at a rate of 0.5% applied to
12 pro forma revenues. ORS computed total bad debt expense of (\$105,384), less the per
13 book amount of (\$105,668), for a total adjustment of (\$284).

14 Adjustment 4(k) – ORS proposes to adjust insurance expense to reflect the most recent
15 actual bills. ORS computed total insurance expenses of \$38,911, less the per book
16 amount of \$30,205, for a total adjustment of \$8,706.

17 Adjustment 4(l) – ORS agrees with DIUC’s adjustment of (\$109) to Regulatory Expense
18 for the most recent SC Department of Health and Environmental Control (“DHEC”)
19 drinking water annual fees and DHEC land application permits.

20 Adjustment 4(m) – ORS proposes to remove non-allowable expenses of (\$21,466). The
21 non-allowable expenses included a contract fee to GA for 20% of Net Operating Income,
22 legal expenses related to the property tax appeal and tax sale of a water tower, and

1 undocumented expenses. Additionally test year rate case expenses of (\$24,567) are
2 removed and amortized in adjustment 6(a). The total adjustment is (\$46,033).

3 Adjustment 5 – The Depreciation Expense and Amortization of Contributions in Aid of
4 Construction (“CIAC”) adjustment of (\$2,002) is comprised of the following:

5 Adjustment 5(a) - ORS proposes an adjustment of (\$2,096) to depreciation expense.
6 ORS proposes to annualize depreciation expense and adjust for known and measurable
7 plant in service as of July 31, 2015. The details of this adjustment are shown in Audit
8 Exhibit ICG-5. Depreciable plant includes expenditures approved in the most recent
9 DIUC rate case Docket No. 2011-229-WS and plant additions and retirements since that
10 case that were properly supported and verified to the Company’s books and records. ORS
11 proposes to allocate depreciation expense on plant used by current customers using
12 utilization factors computed as total current customers to total customers the system can
13 serve at maximum capacity. This methodology was approved by the Commission in
14 Docket No. 2011-229-WS. Depreciation rates were provided by the ORS Water and
15 Wastewater Department. ORS’s total depreciation expense amounted to \$74,206, less the
16 per book amount of \$76,302, for a total adjustment of (\$2,096).

17 Adjustment 5(b) – ORS proposes to adjust amortization of CIAC based on updated
18 depreciation and utilization rates provided by ORS’s Water and Wastewater Department.
19 The details of the amortization of CIAC adjustment are shown in Audit Exhibit ICG-5.
20 ORS’s total amortization of CIAC adjustment amounts to \$94.

21 Adjustment 6 – The amortization adjustment of (\$42,308) is comprised of the following:

22 Adjustment 6(a) – ORS proposes to adjust amortization expense for rate case expenses
23 totaling \$97,500 amortized over five (5) years. These expenses include current rate case

1 expenses of \$75,000 and unamortized rate case expenses of \$22,500 from the previous
2 rate case. Current rate case expenses included the preparation of the application by GA,
3 developing rate models, calculating test year data, filing other rate case documents and
4 legal expenses. ORS's amortization expense adjustment amounted to \$19,500 (\$97,500/5
5 years), less per book amount of \$ 92,420, for total adjustment of (\$72,920).

6 Adjustment 6(b) – ORS proposes to adjust amortization expense for property taxes of
7 \$244,899 amortized over eight (8) years for an annual amortization of property taxes of
8 \$30,612. These are property taxes for the 2012 and 2013 calendar years not recovered in
9 the previous docket. The Company received reassessment for property taxes in August
10 2012 from Beaufort County. In accordance with the settlement for the previous rate case
11 Docket No. 2011-229-WS, the Company agreed not to file an application for an increase
12 before July 1, 2014. Therefore ORS proposes the Company be allowed to recover the
13 property taxes for 2012 and 2013. The adjustment amount as well as the amortization
14 period is based on the settlement reached between Beaufort County and DIUC to satisfy
15 the amounts owed by the Company.

16 Adjustment 7 – The Taxes Other Than Income Taxes adjustment of \$139,849 is
17 comprised of the following:

18 Adjustment 7(a) – ORS proposes to add gross receipts and utility/commission taxes
19 associated with adjusted total operating revenue. ORS used a factor of .00856574, which
20 is comprised of the PSC and ORS factor of .00556574 and the Department of Revenue's
21 factor of .003. ORS computed total gross receipts and utility/commission taxes of \$9,196,
22 less per books amount of \$6,048, for total adjustment of \$3,148.

1 Adjustment 7(b) – ORS proposes an adjustment to property taxes to reflect the test year
2 normal level which was based on the actual tax bills/assessment. Total test year taxes
3 amounted to \$140,881 less the per book amount of \$4,210, for an adjustment of
4 \$136,671.

5 Adjustment 7(c) – ORS proposes an adjustment to payroll taxes. This amount was
6 calculated on the adjusted salaries and benefits. The payroll taxes include FICA and both
7 state and federal unemployment taxes. Total test year taxes amounted to \$13,213, less
8 per books amount of \$13,183, for an adjustment of \$30.

9 Adjustment 8 – ORS does not propose an adjustment for state and federal income taxes
10 after accounting and pro forma adjustments since taxable income is negative. See Audit
11 Exhibit ICG-6.

12 Adjustment 9 – ORS proposes to adjust customer growth after the accounting and pro
13 forma adjustments. The growth factors of 0.18519% for water operations and 0.48985%
14 for sewer operations were provided by ORS witness Willie Morgan. Positive growth was
15 only calculated for the sewer operations. This resulted in an adjustment of \$63.

16 Adjustment 10 – ORS proposes to adjust gross plant in service by (\$1,624,696) to reflect
17 capital improvements, non-allowable plant, adjustments from the previous case not made
18 by DIUC and retirements through July 31, 2015.

19 Adjustments 11 – ORS proposes to adjust accumulated depreciation on pro forma plant by
20 (\$141,198) to reflect depreciation and utilization rates as recommended by the ORS
21 Water/Wastewater Department.

22 Adjustment 12 – ORS proposes to adjust Construction Work in Progress (“CWIP”) by
23 (\$254,853) to reflect completed projects transferred to plant in service of \$225,342 and

1 non-allowable expenses of \$29,511 removed from CWIP related to legal cost for
2 condemnation of the water tower.

3 Adjustment 13 – ORS does not propose to increase CIAC for customer growth. This type
4 of adjustment has not been approved by the Commission in prior cases.

5 Adjustment 14 – ORS proposes to increase accumulated amortization of CIAC. ORS
6 computed total accumulated amortization of CIAC of \$69,482, less per book amount of
7 \$69,269, resulted in an adjustment of \$213.

8 Adjustment 15 – ORS proposes to adjust cash working capital after accounting and pro
9 forma adjustments using an allowable rate of 20% ($1/5$ of Operating & Maintenance
10 expenses) based on the quarterly billing cycle. The formula is based on the average
11 number of days per billing cycle, plus a 30-day collection period, divided by 360 days
12 ($45 + 30 / 360 = 20\%$). ORS proposes to increase cash working capital by \$87,676.
13 Details of this adjustment are included in Audit Exhibit ICG-7.

14 Adjustment 16 – ORS does not propose to include the unamortized balance of rate case
15 expense in rate base. This type of adjustment has not been approved by the Commission
16 in prior cases.

17 Adjustment 17 – ORS proposes to synchronize allowable interest expense to reflect the rate
18 base after accounting and pro forma adjustments, using the capitalization ratio of 54% for
19 equity and 46% for debt and a cost of debt of 5.29%. ORS computed an adjustment of
20 (\$56,314), resulting in allowable interest expense of \$121,212. See Audit Exhibit ICG-8 for
21 ORS's computation of interest expense. Details of the Company's capital structure can be
22 found in the testimony of ORS witness Dr. Douglas H. Carlisle.

1 Adjustment 18 – Based upon ORS Water and Wastewater Department calculations, the
2 Company's proposed rates would produce additional revenues of \$363,937 for residential,
3 \$135,500 for commercial and \$101,988 for irrigation for a total adjustment of \$601,425.

4 Details of these adjustments are shown in the direct testimony of ORS witness Morgan.

5 Adjustment 19 – ORS proposes to adjust availability billing revenue for the Company's
6 proposed rate increase. Details of the adjustment for \$482,793 are shown in the direct
7 testimony of ORS witness Morgan.

8 Adjustment 20 – ORS proposes to adjust miscellaneous other revenue for the Company's
9 proposed rate increase. Details of the adjustment for \$19,568 are shown in the direct
10 testimony of ORS witness Morgan.

11 Adjustment 21 – ORS proposes to adjust bed debt for the Company's proposed rate
12 increase. The adjustment of \$108,349 was provided by ORS witness Morgan.

13 Adjustment 22 – ORS proposes to adjust gross receipts and utility/commission taxes for the
14 Company's proposed rate increase. ORS used a factor of .00856574, which is comprised of
15 the PSC and ORS factor of .00556574 and the Department of Revenue's factor of .003.

16 ORS's proposes to increase gross receipts taxes by \$9,455.

17 Adjustment 23 – ORS proposes to adjust income taxes for the Company's proposed
18 increase by \$311,934. See Audit Exhibit ICG-6 for the computation of income taxes.

19 Adjustment 24 – ORS proposes to adjust customer growth after the proposed increase
20 resulting in an adjustment of \$2,200. The growth factors of 0.18519% for water operations
21 and 0.48985% for sewer operations were provided by ORS witness Morgan.

22 **Q. PLEASE DESCRIBE THE REMAINING AUDIT EXHIBITS.**

1 **A.** Audit Exhibit ICG-5 shows ORS's calculation of depreciation expense and
2 amortization of CIAC. Audit Exhibit ICG-6 shows ORS's computation of income taxes.
3 Audit Exhibit ICG-7 shows the calculation of the cash working capital allowance. Audit
4 Exhibit ICG-8 shows the calculation of return on common equity.

5 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

6 **A.** Yes.

1 BY MS. HUDSON:

2 Q Mr. Morgan, would you please state your full name and
3 occupation?

4 A [MORGAN] My name is Willie Morgan, and I am the deputy
5 director for the Water and Wastewater Department with
6 the Office of Regulatory Staff.

7 Q Have you been able to say that title before the
8 Commission, before tonight?

9 A [MORGAN] No, I have not.

10 Q Are you the same Willie Morgan who prefiled eight pages
11 of direct testimony and eight exhibits in this case on
12 October 2, 2015?

13 A [MORGAN] Yes, I am.

14 Q Do you have any changes to your direct testimony or
15 exhibits?

16 A [MORGAN] No, I do not.

17 Q And did you also cause three pages of surrebuttal
18 testimony and two exhibits to be filed in this case on
19 October 16, 2015?

20 A [MORGAN] Yes.

21 Q Do you have any changes to your surrebuttal testimony or
22 exhibits?

23 A [MORGAN] No, I do not.

24 MS. HUDSON: Madam Chairman, we would ask that
25 Mr. Morgan's direct and surrebuttal testimony be

1 treated as if it were read orally from the stand,
2 and that his eight direct exhibits and two
3 surrebuttal exhibits be marked for identification
4 and entered into the record as a composite hearing
5 exhibit.

6 CHAIRMAN HALL: Okay. The direct and
7 surrebuttal testimony of the new deputy director
8 for the Water and Wastewater Department, Mr.
9 Morgan, will be read into the record as if given
10 orally.

11 [See pgs 505-513 - Direct]

12 [See pgs 515-518 - Surrebuttal]

13 His exhibits will be Hearing Exhibit Nos. 19
14 and 20.

15 [WHEREUPON, Exhibit Nos. 19 and 20 were
16 marked and received in evidence.]

17 MS. HUDSON: And I presume that –

18 CHAIRMAN HALL: Congratulations, Mr. Morgan.

19 MS. HUDSON: – No. 20 is the surrebuttal?

20 CHAIRMAN HALL: No. 20 is the surrebuttal.

21 MS. HUDSON: Okay.

22 BY MS. HUDSON:

23 Q And for housekeeping matters, Mr. Morgan, did you also
24 prepare or cause to be prepared Exhibits -1 and -2 of
25 the settlement agreement that was entered as Hearing

1 Exhibit 3 today?

2 A [MORGAN] Yes, that's correct.

3 Q Will you please summarize your testimony?

4 A [MORGAN] Thank you.

5 Good evening, Madam Chair, Vice Chairman, and other
6 Commissioners. I thank you for the opportunity to
7 provide you with ORS' review of DIUC's request for
8 adjustments of rates and charges for both water and
9 sewer service.

10 DIUC supplies its customers with potable water of
11 over 60 million gallons annually. During the ORS
12 inspection, all water and wastewater collection and
13 treatment systems were operating adequately and in
14 accordance with DHEC Rules and Regulations.

15 ORS calculated test-year service revenues for
16 combined operations, as adjusted, of \$557,620. At
17 DIUC's proposed rates, combined service operating
18 revenues, as suggested, would total \$1,159,045.

19 On October 16th, I filed surrebuttal testimony on
20 the continued uncertainty of the ownership of the
21 storage tank property. Due to the uncertainty, ORS is
22 not comfortable with including the elevated storage tank
23 in rate base.

24 ORS and the three property owners' associations
25 reached a settlement where ORS agreed to accept the bad-

1 debt methodology proposed in the Application and the
2 property owners accepted the remaining ORS adjustments.
3 The result is a revenue increase of \$462,798, an
4 operating margin of 16.18 percent, and an ROE of 9.28
5 percent. ORS respectfully requests that the settlement
6 be approved by the Commission.

7 Thank you, and that concludes a summary of my
8 direct and surrebuttal testimony.

9 MS. HUDSON: Thank you, Mr. Morgan.

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23 [PURSUANT TO PREVIOUS INSTRUCTION, THE
24 PREFILED DIRECT TESTIMONY OF WILLIE J.
25 MORGAN FOLLOWS AT PGS 504-512]

THE OFFICE OF REGULATORY STAFF

DIRECT TESTIMONY & EXHIBITS

OF

WILLIE J. MORGAN, P.E.

OCTOBER 2, 2015



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**

DIRECT TESTIMONY OF WILLIE J. MORGAN, P.E.

ON BEHALF OF

THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF

DOCKET NO. 2014-346-WS

**IN RE: APPLICATION OF DAUFUSKIE ISLAND UTILITY COMPANY,
INCORPORATED FOR APPROVAL OF AN INCREASE FOR WATER AND
SEWER RATES, TERMS AND CONDITIONS**

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION.

A. My name is Willie J. Morgan, and my business address is 1401 Main Street, Suite 900, Columbia, South Carolina 29201. I am employed by the South Carolina Office of Regulatory Staff ("ORS") as the Deputy Director for the Water and Wastewater Department.

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A. I received a Bachelor of Science Degree in Engineering from the University of South Carolina in 1985 and a Master of Arts Degree in Management from Webster University in 2000. I am a licensed Professional Engineer registered in the State of South Carolina. I was employed by the South Carolina Department of Health and Environmental Control ("DHEC") as an Environmental Engineer Associate. Later, I was promoted to the position of Permitting Liaison where I assisted industries and the public with environmental permitting requirements in the State of South Carolina. This assistance included providing information about air quality, solid and hazardous waste

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1 management, and water and wastewater management requirements. I was employed by
2 DHEC for nineteen years. In October 2004, I joined ORS as the Program Manager for
3 the Water and Wastewater Department. Collectively, I have over twenty-nine years of
4 regulatory compliance experience providing assistance and oversight for water and
5 wastewater facilities and services.

6 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

7 **A.** The purpose of my testimony is to set forth the ORS staff findings relative to my
8 review of the rate increase application submitted by Daufuskie Island Utility Company,
9 Inc. ("DIUC"). Specifically, I will focus on DIUC's compliance with the Public Service
10 Commission of South Carolina ("Commission") rules and regulations, ORS's Business
11 Compliance Review of DIUC's water and wastewater system, test-year revenue and
12 proposed revenue, and performance bond requirement.

13 **Q. ARE THE FINDINGS OF YOUR REVIEW CONTAINED IN THIS TESTIMONY**
14 **AND ACCOMPANYING EXHIBITS?**

15 **A.** Yes, my testimony and the attached exhibits detail ORS's findings and
16 recommendations.

17 **Q. PLEASE EXPLAIN HOW YOU COMPILED INFORMATION FOR YOUR**
18 **TESTIMONY AND EXHIBITS.**

19 **A.** I utilized ORS's Business Office Compliance Review results, information
20 provided by DIUC in its application and additional information provided by DIUC during
21 the course of our business review and facility site inspections. I also reviewed DIUC's
22 financial statements and performance bond documents submitted to the Commission.

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1 **Q. PLEASE PROVIDE AN OVERVIEW OF THE LOCATIONS, SERVICE TYPES**
2 **AND CUSTOMER BASE SERVED BY DIUC.**

3 **A.** DIUC is a public utility providing water supply/distribution services and
4 wastewater collection/treatment services to residential and commercial customers on
5 Daufuskie Island located in Beaufort County, South Carolina. As a subsidiary of
6 Daufuskie Island Utility Holding Company, LLC, DIUC's operations are classified by
7 the National Association of Regulatory Utility Commissioners ("NARUC") as a Class B
8 water utility and wastewater utility according to water and sewer revenues reported on its
9 application for the test year ending December 31, 2014. ORS determined that DIUC
10 provides water supply/distribution services to 680 active residential and commercial
11 service units and wastewater collection/treatment services to 493 active residential and
12 commercial service units.

13 **Q. PLEASE EXPLAIN EXHIBIT WJM-1.**

14 **A.** Exhibit WJM-1 provides a summary of the Business Office Compliance Review
15 completed by ORS and a summary of the water supply/distribution and wastewater
16 collection/treatment systems inspected by ORS on August 12, 2015. DIUC is in
17 compliance with the Annual Report requirement and payment of its Gross Receipts
18 assessment.

19 DIUC provides fire protection service to its customers through the use of 212 fire
20 hydrants. The utility has several upgrades proposed for its water and sewer systems.
21 These upgrades include the addition of automated read meters, purchase and installation
22 of a back-up power generator, interconnection of the Haig Point and Melrose water

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1 systems, additional lift station repairs and upgrades, complete erosion control in areas
2 cleared during liner installation, building secondary fencing around aeration and effluent
3 lagoons, installing "Curbing" between the road and the aeration lagoon, and
4 repairing/painting of buildings and fencing at well sites. DIUC works diligently to
5 maintain the water and wastewater facilities to ensure continuous service to its customers.

6 **Q. DOES ORS RECOMMEND ANY ADJUSTMENTS TO THE TEST YEAR**
7 **REVENUES OF DIUC?**

8 **A.** Yes. ORS completed a review of DIUC's customers' water consumption, base
9 facility charge ("BFC") revenue calculations, and its sewer revenue calculations for the
10 test year. Based on that review, ORS made revenue adjustments totaling (\$2,885) as
11 shown on Audit Exhibit ICG-1 provided by ORS witness Ivana C. Gearheart. These
12 revenue adjustments normalize the customer billing information provided by DIUC.

13 **Q. EXPLAIN THE TEST YEAR REVENUE CALCULATED BY ORS FOR DIUC.**

14 **A.** Commission approved rates were applied in ORS's revenue calculation to all
15 units receiving service. ORS completed a review of DIUC's customer water and
16 wastewater revenue calculations for the test year. Exhibit WJM-2 summarizes DIUC's
17 service revenues for the test year ending December 31, 2014. ORS used DIUC's current
18 and proposed rates as reflected in the Application for each calculation. ORS calculated
19 test year revenue based on customer billing information provided in the Application,
20 information from the site visit, and supplemental data provided by DIUC. In summary,
21 ORS calculated DIUC's test year service revenue for water operations of \$311,665, as
22 adjusted. ORS calculated DIUC's test year service revenue for wastewater operations of

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1 \$245,955, as adjusted. For comparison purposes, ORS calculated DIUC's proposed
2 water service revenues of \$635,647, as adjusted. ORS calculated DIUC's proposed
3 wastewater service revenues of \$523,398, as adjusted.

4 ORS did not factor customer growth into these revenue comparisons. As shown
5 in Exhibit WJM-3, the projected growth for DIUC for water and wastewater service is
6 0.328% annually.

7 ORS proposes a (\$3,905) adjustment to DIUC's test year Availability Billing
8 revenues based on DIUC's revenue records and other supporting documentation. DIUC's
9 total Availability Billing revenue at current rates was determined to be \$485,760 and
10 \$968,553 using the proposed rates. ORS calculated the total "Miscellaneous Other
11 Revenue" for the test year, as adjusted, as \$30,197. ORS calculated proposed
12 "Miscellaneous Other Revenue" for DIUC, as adjusted, of \$49,765 using DIUC's
13 proposed rates.

14 ORS's review of DIUC's test year revenue indicates DIUC charged an incorrect
15 commodity rate to its sewer customers in the Melrose service area. Sewer customers
16 were charged a commodity rate of \$1.95 per 1,000 gallons of usage versus the approved
17 rate of \$1.77 per 1,000 gallons. As of the date of this testimony, ORS does not have
18 verification that DIUC has corrected the commodity rate error. ORS understands DIUC
19 plans to credit these customers for the overcharges dating back to the initial billing period
20 of October 2012. As of the date of this testimony, ORS does not have verification that a
21 billing credit for the overcharges has been issued by DIUC.

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1 **Q. EXPLAIN THE LATE FEES ADJUSTMENT IN THE MISCELLANEOUS**
2 **OTHER REVENUE CATEGORY ON EXHIBIT WJM-2.**

3 **A.** ORS proposes an adjustment to Late Fees revenue of \$19,568. The adjustment is
4 made to synchronize Late Fees to the rates proposed by the utility. This adjustment is
5 reflected in ORS Audit Exhibit ICG-1 provided by ORS witness Ivana C. Gearheart.

6 **Q. PLEASE EXPLAIN EXHIBIT WJM-4 OF YOUR REPORT.**

7 **A.** Exhibit WJM-4 is a comparison of DIUC's current Commission approved rates
8 and its proposed rates.

9 **Q. PLEASE EXPLAIN THE STATUS OF THE PERFORMANCE BOND FOR DIUC.**

10 **A.** DIUC has a current performance bond for utility operations in the form of an
11 Insurance Certificate from The Hanover Insurance Company in the amount of \$350,000
12 for water and \$350,000 for sewer operations. Based on the expenses from the test year
13 and using the criteria set forth in 10 S.C. Code Ann. Regs. 103-512.3.1 and 103-712.3.1,
14 ORS determined that the face amount of DIUC's bond should remain at \$350,000 for
15 water operations and \$350,000 for wastewater operations (Exhibit WJM-5). DIUC's
16 adjusted bonding criteria expenses for the test year were \$571,209 for water operations
17 and \$530,882 for wastewater operations. Combined bonding criteria expenses, as
18 adjusted totaled \$1,102,091 for the test year ending December 31, 2014. ORS
19 respectfully requests that the Commission require DIUC to continue to maintain the
20 performance bond amount for water operations of \$350,000 and for wastewater
21 operations of \$350,000.

22 **Q. PLEASE EXPLAIN EXHIBIT WJM-6.**

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1 **A.** Exhibit WJM-6 demonstrates the effect of the proposed rate increase on DIUC's
2 highest billed customers. Their individual quarterly service bills range from \$436.86 per
3 quarter to \$1,124.59 per quarter under currently approved rates. At the rates proposed by
4 DIUC, their quarterly service bills would range from \$931.20 per quarter to \$1,944.77
5 per quarter.

6 **Q. WHAT IS THE CURRENT STATUS OF THE REAL ESTATE PROPERTY**
7 **ASSOCIATED WITH THE ELEVATED STORAGE TANK?**

8 **A:** According to the records of Beaufort County, the real estate property and its
9 appurtenances which include a 125,000 gallon elevated storage tank and well site (Well
10 #5 site) located in Haig Point and the 10,000 gallon ground level storage tank and well
11 site (Well #1 site) located in Bloody Point are not owned by DIUC. Beaufort County
12 records show the property associated with the 125,000 gallon elevated storage tank and
13 its appurtenances continue to be owned by an entity that is not related to the utility. This
14 property was forfeited through a delinquent tax sale in 2011 and the utility continues with
15 its litigation efforts to recover the property. Exhibit WJM-7 shows confirmation of the
16 tax sale of this property and the current ownership status. Beaufort County records
17 indicate the real estate property associated with the 10,000 gallon storage tank as being
18 owned by one of the customers of DIUC. Exhibit WJM-8 shows the current ownership
19 status of the real estate property associated with the well site (Well #1 site) located in
20 Bloody Point. These two (2) assets were not included in ORS's rate base calculations.

21 **Q. DO THE DHEC OPERATING PERMITS FOR THE WATER AND**
22 **WASTEWATER SYSTEMS NEED TO BE UPDATED?**

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1 A. Yes. According to records provided to ORS by DIUC and information obtained
2 from DHEC, CK Materials, LLC, Daufuskie Island Properties, LLC, and other entities
3 are listed as the Permittee or owner of the water and wastewater permits issued by
4 DHEC. None of these entities have been identified by DIUC in this rate case filing as
5 being a current owner, affiliate, or subsidiary of DIUC. These entities listed on the
6 DHEC permits are as follows: CK Materials LLC; Haig Point/Melrose Wastewater
7 Treatment Company, Inc.; Daufuskie Island Properties, LLC; and Daufuskie Island Club
8 Development. DIUC should correct this matter with DHEC as soon as possible.

9 Q. **DOES THIS CONCLUDE YOUR TESTIMONY?**

10 A. Yes it does.

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[PURSUANT TO PREVIOUS INSTRUCTION, THE
PREFILED SURREBUTTAL TESTIMONY OF WILLIE J.
MORGAN FOLLOWS AT PGS 514-517]

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PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

**THE OFFICE OF REGULATORY STAFF
SURREBUTTAL TESTIMONY & EXHIBITS
OF
WILLIE J. MORGAN, P.E.**

OCTOBER 16, 2015



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**

SURREBUTTAL TESTIMONY OF

WILLIE J. MORGAN, P.E.

ON BEHALF OF

THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF

DOCKET NO. 2014-346-WS

**IN RE: APPLICATION OF DAUFUSKIE ISLAND UTILITY COMPANY,
INCORPORATED FOR APPROVAL OF AN INCREASE FOR WATER AND
SEWER RATES, TERMS AND CONDITIONS**

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION.

A. My name is Willie J. Morgan, and my business address is 1401 Main Street, Suite 900, Columbia, South Carolina 29201. I am employed by the South Carolina Office of Regulatory Staff ("ORS") as the Deputy Director for the Water and Wastewater Department.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY IN THIS PROCEEDING?

A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimony of Daufuskie Island Utility Company, Inc. ("DIUC") related to the ownership of the property identified as the Elevated Storage Tank Site.

Q. WHAT IS YOUR RESPONSE TO DIUC'S REBUTTAL TESTIMONY CONCERNING THE ELEVATED STORAGE TANK?

A. DIUC witness, Mr. John Guastella, asserts in his rebuttal testimony that even though DIUC has lost ownership of the land property associated with the elevated storage

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1 tank through a Beaufort County tax sale in 2011, DIUC has retained ownership of the
2 elevated storage tank and DIUC should be allowed to earn a return on the water
3 infrastructure. In addition, Mr. Guastella states that DIUC is paying Utility Taxes on the
4 water infrastructure which includes the elevated storage tank (Guastella Rebuttal page 5,
5 lines 1 and 2).

6 Based on ORS conversations with the SC Department of Revenue ("DOR"),
7 Beaufort County and DIUC, I understand that DOR utilizes the utility plant-in-service
8 values DIUC lists on Schedule 201 of the Water Annual Report to value the amount of
9 property subject to tax by Beaufort County. On 2015, DIUC submitted Revised Water
10 Annual Reports to ORS and the Commission for prior years 2012 and 2013. Surrebuttal
11 Exhibit WJM-1 includes both the Original and Revised Water Annual Reports filed by
12 DIUC for the years 2012 and 2013. In the Revised Water Annual Reports filed by DIUC,
13 it appears DIUC made adjustments on Schedule 201 (Utility Plant-in-Service). The value
14 of the adjustment of the utility plant-in-service is approximately (\$1,110,715) for 2012
15 and (\$893,781) for 2013. These amounts appear to correspond to the plant asset value of
16 \$863,379 removed by ORS for the elevated storage tank in Docket No. 2011-229-WS.

17 It is my understanding that DIUC specifically filed Revised Water Annual
18 Reports for 2012 and 2013 with ORS and the Commission to reflect the rate base allowed
19 in Docket No. 2011-229-WS which would likely result in a reduction of the property
20 valuation computed by DOR for DIUC. It appears that the Water Annual Report filed by
21 DIUC for 2014 also includes the adjusted plant-in-service values which may be related to
22 the elevated storage tank (Surrebuttal Exhibit WJM-2). DIUC should not be allowed to
23 earn a return on the elevated storage tank for ratemaking purposes while at the same time

1 having taken action that could reduce property taxes by revising annual reports to deduct
2 a value corresponding to the elevated storage tank value.

3 Based on the Revised and 2014 Annual Reports and the fact that ORS is not
4 convinced that DIUC is the owner of the Elevated Storage Site or its appurtenances, it is
5 ORS's position that DIUC should not be allowed to earn a return on it. ORS has included
6 expenses related to operations and maintenance of the elevated storage tank as the tank is
7 being used to provide service to the DIUC customers.

8 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

9 **A.** Yes it does.

1 BY MS. HUDSON:

2 Q Dr. Carlisle, earlier, Mr. Guastella testified that a
3 number on page five of your testimony is incorrect. Do
4 you agree?

5 A [CARLISLE] No, I do not.

6 Q Why not?

7 A [CARLISLE] I think, perhaps, there was some ambiguity in
8 the interpretation of what I said. What I meant to
9 indicate on page four of my testimony was that the
10 entire, I think it was \$372,000 had been incurred as a
11 result of inactions of Guastella Associates and not that
12 Guastella Associates had pocketed the money. I believe
13 their portion was about 40 percent of that amount.

14 Q Ms. Gearhart, I'm going to ask you about the taxes. Did
15 ORS include an amount for property taxes for 2012?

16 A [GEARHEART] Yes.

17 Q What about for 2013?

18 A [GEARHEART] Yes.

19 Q What about 2014?

20 A [GEARHEART] Yes.

21 Q What about 2015?

22 A [GEARHEART] No, we did not.

23 Q Why?

24 A [GEARHEART] Because that's a future year, they were not
25 billed, and we don't know what the cost is going to be.

1 Plus, the test year of the company was 2014, and the
2 normal procedure for ORS is to include one full year of
3 the property taxes, going forward, in the expenses.

4 Q If ORS uses a test year, and that test year was 2014,
5 why did we allow 2012 and 2013 taxes?

6 A [GEARHEART] Based on the settlement agreement in the
7 last rate case between the company and the Intervenor,
8 ORS feels that the company didn't have the chance to
9 come for the rate increase, as the settlement stated
10 that they cannot come for the rate increase until, I
11 believe, June 2014. So that's why ORS included 2012 and
12 2013 taxes to be recovered over eight years.

13 Q And the limitation you're referring to in the
14 settlement, it was the settlement signed in the last
15 rate case?

16 A [GEARHEART] That's correct.

17 Q Mr. Morgan, there was some testimony from the company
18 earlier tonight about bankruptcy. Does ORS have a
19 statutory duty to protect the public interest?

20 A [MORGAN] Yes.

21 Q Would ORS make a recommendation to cause financial
22 instability of any of the companies that we look over?

23 A [MORGAN] No, we would not.

24 MS. HUDSON: Thank you.

25 Madam Chair, our witnesses are available for

1 questioning.

2 CHAIRMAN HALL: All right. Mr. Gressette and
3 Mr. Walker?

4 MR. WALKER: Thank you.

5 CROSS EXAMINATION

6 BY MR. WALKER:

7 Q Good evening, panel.

8 A [PANEL] Good evening.

9 Q I'll start with Dr. Carlisle. As I heard your
10 testimony, your group that you derived your ROE from was
11 comprised completely of publicly traded companies,
12 correct?

13 A [CARLISLE] Yes, that is inherent in coming in for an
14 ROE.

15 Q Right. And those companies range in size, or their
16 annual revenues, from somewhere around \$57 million to \$2
17 billion? Is that correct?

18 A [CARLISLE] That sounds fair, yeah.

19 Q And would you agree that those companies should not have
20 as much of a challenge attracting capital as Daufuskie
21 Island Utility, based on everything you've heard about
22 the ups and downs of this utility company today?

23 A [CARLISLE] Is this a question about the quality of their
24 management?

25 Q No, I'm talking about the finances of the company.

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1 You've heard about the finances of the company. ORS has
2 examined the finances of the company. ORS prepared a
3 report and it's in – I think it's Ms. Gearhart's
4 testimony, where she actually says what the rate of
5 return is, currently, after adjustment. There's an
6 overall negative rate of return or a marginal fraction,
7 less than a percent? That's what I'm talking about.
8 Since credit is based on financial ability, I'm asking
9 you, wouldn't you agree that those companies of that
10 financial strength have an easier time attracting
11 capital and obtaining credit than Daufuskie Island
12 Utility?

13 A [CARLISLE] Those particular companies, I think, do. But
14 if you're asking me if publicly traded companies,
15 generally, do, then the answer is no.

16 Q I just meant those companies –

17 A [CARLISLE] Those companies.

18 Q – that you used.

19 A [CARLISLE] I would think they would have an easier time,
20 yes.

21 Q Okay, thank you.

22 A [CARLISLE] And, therefore, they would get a lower
23 return.

24 Q But your – well, that was not my question.

25 [Laughter]

1 A [CARLISLE] Oh, I'm sorry.

2 Q I realize you want to argue the case, but I was trying
3 to wrap up the questions – but we'll keep going. That
4 was a hit after the ball was down.

5 A I'm not the University of Miami.

6 Q Well, you're entitled to that after last weekend.

7 Anyway, all right. Ms. Gearhart, moving on to you
8 and to pick up where I left off with a point to Dr.
9 Carlisle, and that is: You audited the books of
10 Daufuskie Island Utility, in order to make adjustments –
11 to verify and to make adjustments; is that correct?

12 A [GEARHEART] We didn't audit the books. We reviewed the
13 Application and we tested underlying transactions from
14 the books and records of the company.

15 Q Yes. That was a misnomer. So you took a look at what
16 was submitted and then you tested – random-tested – and
17 made adjustments, based on –

18 A [GEARHEART] Correct.

19 Q – what you thought was reasonable and necessary?

20 A [GEARHEART] That's correct.

21 Q And when you made those adjustments, you made them in
22 good faith, did you not, that those adjustments were
23 correct?

24 A [GEARHEART] That's correct?

25 Q And one of your adjustments was to increase bad-debt

1 expense over what the company suggested, correct?

2 A [GEARHEART] That's correct.

3 Q And the company had put in a bad-debt amount for the
4 test year of something like \$20-\$30,000, roughly?
5 Something like that?

6 A [GEARHEART] I don't recall, but if you say so.

7 Q And your adjustment was to take the bad-debt expense for
8 the test year to over \$100,000 dollars, based on your
9 testing of the bad debt of the company, correct?

10 A [GEARHEART] The bad-debt numbers or percentage is
11 recommended by the Water and Wastewater Department of
12 ORS, so it would be probably better answered by Mr.
13 Morgan.

14 Q All right. You – in your adjustments, you did not allow
15 any interest expense, other than nominal interest
16 expense, correct? You did not use effective interest
17 rate?

18 A [GEARHEART] I used the interest – the cost of debt
19 recommended by Dr. Carlisle.

20 Q All right. Gosh, I thought I was through with you
21 [indicating].

22 [Laughter]

23 Okay. Well, then, I won't continue on anymore with
24 you, on that.

25 A [GEARHEART] Well, thank you.

1 Q All right. But I would like to ask you about your
2 adjustments to plant-in-service. And as I understand
3 it, part of that adjustment to plant-in-service – and
4 that was a pretty big one, like \$1,4-\$1,500,000, wasn't
5 it?

6 A [GEARHEART] Yes, it was.

7 Q So, and a big chunk of that was based, as I understand
8 it, on Mr. Morgan's view that the utility facilities on
9 the elevated storage tank should not be included because
10 of the – quote – "uncertainty" about legal title to the
11 land, correct?

12 A [GEARHEART] Actually, the base of the adjustment, or the
13 biggest part of the adjustment is carried over from the
14 last rate-case filing, when these adjustments were not
15 made on the books of the company. So ORS's procedure
16 for calculating plant-in-service is to roll forward
17 plant-in-service from the last rate case.

18 Q Are you aware of the settlement agreement that was
19 signed, that said that those values do not apply to
20 future rate cases?

21 A [GEARHEART] I wasn't part of that case.

22 Q Did you review that settlement agreement before you made
23 that adjustment?

24 A [GEARHEART] I looked at it, but our standard procedures
25 are to roll forward the plant ORS calculated in the last

1 rate case.

2 **Q** So, and I am looking at that settlement agreement. And
3 to save time, I'll read you part of paragraph three, on
4 page two: "The parties agree and stipulate that DIUC
5 shall be allowed to set rates and charges on a rate base
6 of \$5 million. This stipulated rate base shall not be
7 binding in future proceedings; instead, those
8 proceedings will be determined based on the evidence
9 presented in each docket and the applicable law." So
10 based on your understanding of that provision, DIUC was
11 not limited to \$5 million of rate base, simply because
12 it agreed to it as part of a settlement of the last rate
13 case, correct?

14 **MS. HUDSON:** Madam Chair, I think I can help
15 here. I think, when counsel is saying "last rate
16 case" –

17 **CHAIRMAN HALL:** Mic, Ms. Hudson. Sorry.

18 **MS. HUDSON:** [Indicating.] When we're talking
19 about the last rate case, we have two rate bases.
20 We have the settlement agreement rate base and we
21 had the ORS rate base that our Audit Department
22 calculated in the last rate case. So when you're
23 saying the rate base in the last case, know that
24 there are two: the one that was agreed upon in the
25 settlement agreement, and the one that our Audit

1 Department tests from the books and records and
2 carries forward.

3 **BY MR. WALKER:**

4 **Q** The adjustment that you made said "undocumented costs,"
5 I think, or something like that, did it not?

6 **A** [GEARHEART] Yes, it did.

7 **Q** And what research did you do to determine documentation
8 of those costs of that plant-in-service?

9 **A** [GEARHEART] Those adjustments were simply carried over
10 from the last rate case, and we do not retest or retry
11 anything that was approved in the last rate case. But
12 I'm sure that ORS had an exit conference at that time
13 with the company and provided them with detail of what
14 these expenses were for or which undocumented assets –

15 **Q** You were –

16 **A** [GEARHEART] – were –

17 **Q** – here today for Mr. White's testimony, were you not?

18 **A** [GEARHEART] Yes.

19 **Q** And were you here for his testimony where he said that,
20 when the utility was purchased, when Haig Point Utility
21 was purchased by CK Materials in either 2007 or 2008,
22 that the values that were on Haig Point Utility's books
23 were carried over? Were you here for that testimony?

24 **A** [GEARHEART] I was here for that, but I have no knowledge
25 of that, so I just would have to take his word for it.

1 Q And if his testimony was correct that there were values
2 on the books of Haig Point Utility, then that would be
3 documentation, some documentation, of those costs,
4 correct?

5 A [GEARHEART] What utilities, or any company, puts on
6 their books and records has to be verified. If we
7 cannot verify the original cost or ownership of the
8 asset, then we have to take the company's word for it,
9 what it was.

10 Q Well --

11 A [GEARHEART] The purpose of the review or of the audit is
12 to test the underlying transactions on the books. So I
13 don't agree that general ledger is documentation of what
14 the value of the asset was, because we cannot prove, we
15 cannot verify what the company paid for the asset if we
16 don't have an invoice.

17 Q Well, according to the system of accounting that you
18 use, if there's not an invoice for a particular piece of
19 equipment, then a reasonable estimate is to be used,
20 correct?

21 A [GEARHEART] I'm not aware of that.

22 Q Well, did you read Mr. Loy's testimony where he cited to
23 the accounting rules -- and I'm less familiar with the
24 acronym than everybody in this room -- that if there is
25 not a documented invoice and it is in service, then a

1 reasonable estimate should be used of that plant?

2 A [GEARHEART] I am not aware that ORS adopted that, and
3 our proceeding is that, if we cannot verify the asset
4 with an invoice, we just don't feel comfortable putting
5 that asset into plant-in-service, because it would be -
6 you can ask three people to make estimate what the cost
7 should be, and you might come up with three different
8 answers.

9 Q Aside from the organizational - you had prepared a
10 schedule, which is your Exhibit ICG-5, that's a
11 depreciation expense adjustment, that includes your
12 adjustments to plant-in-service, as well as your
13 adjustment to depreciation, because that would
14 necessarily be reduced by a reduction to the plant-in-
15 service. If you'd turn to that page, I see the first
16 two are organizational costs, which we talked about,
17 land and land rights, and some \$73,000 and \$56,000,
18 respectively. But as to the remainder of this plant
19 that you did an adjustment for in your column second-to-
20 the-right, all of that plant is plant that's actually
21 used, correct? It's used and useful, and being used as
22 facilities of the utility today, is it not?

23 A [GEARHEART] That's correct.

24 Q So it's used and useful?

25 A [GEARHEART] Yes.

- 1 Q And the reason you eliminated it was because you were
2 not provided an invoice for the original cost.
- 3 A [GEARHEART] Or the title of the ownership.
- 4 Q And aside from – when we're talking about title, in your
5 mind does that only apply to the Bloody Point wastewater
6 sale, that we heard about earlier, and the elevated
7 storage tank real property?
- 8 A [GEARHEART] I don't understand the question. I'm sorry.
9 Can you repeat it?
- 10 Q Are you suggesting that there's a question of title to
11 every one of your adjustments –
- 12 A [GEARHEART] No.
- 13 Q – to plant-in-service?
- 14 A [GEARHEART] The main disagreement in this proceeding is
15 the elevated storage tank, which was removed in the last
16 rate case. And since then, we did not receive any proof
17 of ownership, so ORS did not feel comfortable putting it
18 back in plant-in-service and let the customers pay for
19 it, or let the company earn a return on assets they
20 don't own.
- 21 Q I understand. But if they own it, they should receive a
22 return on it, according to ORS.
- 23 A [GEARHEART] If they own it, yes.
- 24 Q All right. And to go back to what I was asking you
25 earlier, do you agree that NARUC Uniform System of

1 Accounts requires an estimate of plant values when there
2 is no supporting documentation available, and that
3 original cost studies have been adopted – have been an
4 accepted methodology to establish these values, as
5 indicated in the prefiled testimony of Mr. Loy, on page
6 19, and also the rebuttal testimony of Mr. Guastella, at
7 pages six and top of seven?

8 MS. HUDSON: Madam Chair, I think I heard a
9 compound question in there, and I would object and
10 ask that it be rephrased.

11 MR. WALKER: All right. I will.

12 BY MR. WALKER:

13 Q My apologies. I'll break it down. Would you agree that
14 NARUC Uniform System of Accounts requires an estimate of
15 plant values when there is no supporting documentation
16 available?

17 A [GEARHEART] I don't know.

18 Q You're not familiar with that?

19 A [GEARHEART] I'm not familiar with that part.

20 Q Did you read the testimony of Mr. Loy where he referred
21 to NARUC Uniform System of Accounts requiring that an
22 estimate be made when there is not documentation?

23 A [GEARHEART] I recall – I read his testimony, but I don't
24 recall him saying that.

25 Q Do you recall reading Mr. Guastella's testimony where he

1 agreed with that point of Mr. Loy, on page six of his
2 rebuttal testimony?

3 **A** [GEARHEART] No, I don't recall that.

4 **Q** And to go over your adjustment for property taxes, for
5 the property tax amortization agreement that we heard
6 about, or the property tax agreement with Beaufort
7 County, the utility had an expense of \$65,856 being the
8 amount that is committed in the agreement, and ORS
9 adjusted that down to \$30,612, correct?

10 **A** [GEARHEART] That's correct. But we also allowed the
11 utility to – we also included a full year of taxes for
12 test year, for 2014, in the expenses going on annually,
13 going on forward annually.

14 **Q** And for the moving-forward basis, Daufuskie Island
15 Utility estimated the tax bill, based on the
16 communications with DOR – going forward, not the past
17 years on the installment – at \$188,093, and ORS is
18 proposing that that be adjusted down to \$136,671,
19 correct?

20 **A** [GEARHEART] I'm thinking it's \$140,000. There was \$4000
21 on the books, so it was \$140,000.

22 **Q** That's right. That's right.

23 **A** [GEARHEART] That's correct.

24 **Q** Now, I'm going to have to go back to Dr. Carlisle on the
25 interest expense. Dr. Carlisle, the only interest

1 expense that you suggested be considered is the actual
2 interest paid on the loan, correct?

3 A [CARLISLE] Yes.

4 Q All right. You were here for the testimony about all
5 the hurdles that Daufuskie Island Utility had to jump
6 over to get this loan, were you not?

7 A [CARLISLE] I heard that stated.

8 Q All right. Would you agree that there are costs to
9 obtaining a loan, other than just paying interest once
10 the loan is closed?

11 A [CARLISLE] Yes.

12 Q Do you agree that the reasonable costs of securing and
13 closing a loan should be included as an expense of an
14 interest – either an expense of the utility or figured
15 into the effective interest rate?

16 A [CARLISLE] I agree that it could be an expense. I
17 disagree with the second part of the question because
18 that is a misuse of the term "effective interest rate."
19 That is not the correct definition for "effective
20 interest rate."

21 Q What would you call it?

22 A [CARLISLE] I would call it an expense incurred outside
23 the test year, imported into the capital structure to
24 recover by amortization.

25 Q So you would amortize those loan-closing expenses –

1 A [CARLISLE] No.

2 Q You would not?

3 A [CARLISLE] No.

4 Q What would you do with them? How would you treat them?

5 A [CARLISLE] I would disregard them.

6 Q Even though they're actual and incurred?

7 A [CARLISLE] Actual incurred expenses outside the test
8 year.

9 Q Are you – so there should be no recovery at all for
10 them, even though they were amortized based on the books
11 of the company over the life of the loan. You heard –

12 A [CARLISLE] They are being imported into the capital
13 structure through debt, and mischaracterized as an
14 effective interest rate. That is not the definition of
15 "effective interest rate," and it's a misuse of the
16 term.

17 Q I wanted to get away from a fight over the definition of
18 "effective interest rate."

19 A [CARLISLE] Well, it's been used several times, and it's
20 been – the other one has been characterized – 5.29 has
21 been characterized as "nominal." That's not correct.
22 "Nominal" means it does not recognize compounding,
23 whereas the 5.29, I verified in the spreadsheet that it
24 does, in fact, recognize compounding. And, therefore,
25 5.29 is the effective interest rate. The other is

1 simply adding an amortization, with no compounding –
2 because I asked about compounding, and the company said,
3 "No, this will not be compounded," which is a direct
4 contradiction of the term "effective interest rate,"
5 because effective interest rate recognizes compounding.

6 Q You heard that the bank – that the utility went to –
7 thought they had a loan from CoBank. That crashed.

8 A [CARLISLE] [Nodding head.]

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

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

21 Q Were you aware of discovery requests that were
22 propounded by ORS that would have covered the loan
23 documents –

24 CHAIRMAN HALL: Mr. Walker, can you get back
25 to your microphone, please?

1 MR. WALKER: All right [indicating]. I'm
2 sorry.
3 BY MR. WALKER:
4 Q Are you aware of data requests and other information
5 requests by ORS that would've included information on
6 those closing costs?
7 A [CARLISLE] I'm not sure what you're talking of, no.
8 Q Okay. And have you ever reviewed the closing binder
9 that is three pages of closing documents – two pages of
10 closing document – no, three pages of closing documents?
11 A [CARLISLE] No.
12 Q Mr. Morgan, really quickly.
13 A [MORGAN] Okay.
14 Q As I understand it, and I've reviewed one of your
15 exhibits to your rebuttal testimony, you would agree
16 that the property card for the land that is the elevated
17 storage tank only shows a valuation of the land and a
18 utility shed, correct?
19 A [MORGAN] As far as the information that's on that
20 document in my exhibit, that's what's presented.
21 Q And that is a document of what the Assessor has
22 assessed, correct, the land value and the improvement of
23 the shed?
24 A [MORGAN] I'm not sure if that's – I'm not sure what they
25 based it on.

1 Q In your initial testimony, you felt that those
2 improvements, the facilities on that parcel, should not
3 be included because of the uncertainty about the legal
4 title, correct?

5 A [MORGAN] Based on just my review of it, it would appear
6 it would include all of the appurtenances, which would
7 be everything else that's on that piece of property.

8 Q That was based on your review?

9 A [MORGAN] Yes, sir.

10 Q And then in your rebuttal testimony, you brought up that
11 you felt that the company shouldn't be allowed to
12 recover on it because of the adjusted filing it made
13 with the Department of Revenue, correct?

14 A [MORGAN] The annual reports were filed with our office,
15 and copies of those were obtained by the Department of
16 Revenue.

17 Q You attached to your rebuttal testimony the original
18 return to the Department of Revenue for 2012-2013 and
19 the revised returns for 2012 and 2013, correct?

20 A [MORGAN] Could you repeat that?

21 Q I'm sorry. Your rebuttal testimony included, as
22 attachments, a portion of the return to the Department
23 of Revenue for 2012 and 2013, as well as the revised
24 return. And that would be your exhibits –

25 MS. HUDSON: I'd just like to point out I

1 think counsel is referring to surrebuttal
2 testimony.

3 MR. WALKER: Surrebuttal. I'm sorry.

4 CHAIRMAN HALL: Okay.

5 WITNESS MORGAN: I was about to correct him.

6 MR. WALKER: Surrebuttal testimony.

7 WITNESS MORGAN: But those are the annual -
8 copies of portions of the annual report provided to
9 our agency, which, of course, are provided to the
10 Public Service Commission.

11 BY MR. WALKER:

12 Q And you will agree that the adjustment that was made in
13 order to bring the plant-in-service down to \$5 million,
14 per the last rate case, was done on basically a *pro rata*
15 basis down the column, correct?

16 A [MORGAN] I don't know that.

17 MR. WALKER: All right. I won't pursue it
18 more, because the Commission can look at it and see
19 that.

20 Thank you, very much. I think that's all I
21 have.

22 CHAIRMAN HALL: Okay, Mr. Walker.

23 Commissioners? Commissioner Elam.

24 <

25 <

EXAMINATION**BY COMMISSIONER ELAM:****Q** Good evening. Mr. Morgan.**A** [MORGAN] Yes, sir.

Q On page seven of your prefiled direct testimony, you state at line eight that, "According to the records of Beaufort County, the real estate property and its appurtenances, which include," and this is about the elevated tank, the elevated storage tank, "which include a 125,000-gallon elevated storage tank and well site...located in Haig Point and the 10,000-gallon ground-level storage tank and well site...located in Bloody Point," and you say, "are not owned by DIUC," correct?

A [MORGAN] Yes, sir.

Q Okay. Does the utility have access to the two wells mentioned in your testimony there?

A [MORGAN] As far as I am aware, they do have access.

Q All right. Are both wells currently used by the company in providing service to its customers?

A [MORGAN] They were in use during our inspection.

Q How did Bloody Point Properties, LLC, become the owner of Well Site #1?

A [MORGAN] I'm not exactly sure how they became the owner. I saw it on various documents, but I'm not sure how they

1 actually became the owners.

2 **Q** That's fine. That's fine.

3 Ms. Gearheart, did ORS review the management
4 agreement between the company and Guastella Associates?

5 **A** [GEARHEART] Yes, we did.

6 **Q** And what is your recommendation?

7 **A** [GEARHEART] Our recommendation was to include the
8 management fees, in the amount of roughly \$132,000.

9 **Q** And that was a reduction from what the company was
10 asking?

11 **A** [GEARHEART] Yes.

12 **COMMISSIONER ELAM:** Thank you. Nothing
13 further.

14 **CHAIRMAN HALL:** Commissioner Whitfield.

15 **VICE CHAIRMAN WHITFIELD:** You caught me a
16 little quick there.

17 **CHAIRMAN HALL:** Sorry. You had your light on.

18 **VICE CHAIRMAN WHITFIELD:** I didn't think I
19 did, but anyway.

20 **EXAMINATION**

21 **BY VICE CHAIRMAN WHITFIELD:**

22 **Q** I've got one quick question for you, Ms. Gearheart. Did
23 – I think you stated to Mr. Walker a little bit ago that
24 ORS didn't really audit the company's books; they
25 reviewed them, I think was the word you used. Is that

1 right?

2 A [GEARHEART] That's right.

3 Q And I think we heard testimony earlier in the day that
4 the records are in Boston or New York – wherever Mr.
5 White, I think, happens to be, they seem to kind of
6 travel with him a little bit. And I guess I want to get
7 your opinion on that. Is ORS confident in continuing to
8 allow the company to maintain its records out of state?
9 Does ORS feel that's appropriate?

10 A [GEARHEART] We don't have any problem with that, as far
11 as they can provide us what we ask for.

12 Q And you felt like – of course, you said you just
13 reviewed. You didn't go to any – it's not like other
14 utilities where you go to the site and you do your
15 audit. You just would call this more of a review than
16 an audit. Is that right?

17 A [GEARHEART] That's right.

18 VICE CHAIRMAN WHITFIELD: Okay. Thank you.
19 That's all I have, Madam Chairman.

20 CHAIRMAN HALL: All right. Commissioner
21 Randall.

22 COMMISSIONER RANDALL: Madam Chair, I know
23 you're going to hate this, but I had a question for
24 Ms. Gearheart and for Dr. Carlisle, and Ms. Hudson
25 asked both of them. So, I don't have any. But I

1 do like to talk on the microphone, so –

2 [Laughter]

3 CHAIRMAN HALL: Turn it off. Turn it off.

4 MS. HUDSON: I have to –

5 CHAIRMAN HALL: Commissioner Fleming.

6 MS. HUDSON: – say, I'm so sorry.

7 COMMISSIONER RANDALL: That's quite all right.

8 COMMISSIONER FLEMING: Took away his moment in
9 the spotlight.

10 EXAMINATION

11 BY COMMISSIONER FLEMING:

12 Q Ms. Gearheart, in the company's previous case, ORS
13 adjustments adopted by the settlement agreement included
14 rate-case expenses of \$75,000 amortized over five years,
15 and in this case, you are proposing the same amount of
16 expenses – \$75,000 – plus unamortized rate-case expenses
17 of \$22,500 from the previous case, for a total of
18 \$97,500 amortized over five years. Why are the current
19 rate-case expenses of \$75,000 included in the current
20 case exactly the same amount as in the previous case?

21 A [GEARHEART] Because ORS felt it appropriate to limit the
22 rate-case expenses to \$75,000 for the current rate –
23 current proceeding.

24 Q Okay. I see some unhappy looks over there, compared to
25 what we discussed earlier. Did you examine invoices and

1 other evidence that document the expenditure of \$75,000
2 in the current rate case?

3 A [GEARHEART] Yes. The invoices submitted were, I
4 believe, \$471,000. From that — now, I don't know if
5 these are exact numbers, but I believe \$120,000 were
6 from GA Associates, and the rest were legal fees from
7 the lawyers.

8 Q All right. Thank you. And Mr. Morgan.

9 A [MORGAN] Yes, ma'am.

10 Q Now, what is that title again?

11 A [MORGAN] It's deputy director for the Water and
12 Wastewater Department.

13 Q Congratulations.

14 A [MORGAN] Thank you.

15 CHAIRMAN HALL: All right. Commissioners, any
16 other questions?

17 [No response]

18 Okay.

19 EXAMINATION

20 BY CHAIRMAN HALL:

21 Q Ms. Gearheart, I just have one. Is the complete system
22 utilization method used by the company in compliance
23 with regulatory accounting and the NARUC system? The
24 complete system utilization method that the company is
25 using, is it in compliance with the NARUC system and

1 regulatory accounting?

2 A [GEARHEART] When the company came and proposed a
3 utilization factor in the previous cases, ORS felt that
4 it was beneficial to the customers and allowed this
5 utilization. Basically, what it means is the asset is
6 depreciated at the slower rate because, instead of
7 depreciating 100 percent which should be depreciated,
8 it's depreciated based on the utilization factor which
9 was, I believe, 38 percent and 42 percent, for sewer and
10 water. So, in essence, it does prolong the depreciation
11 and recovery of the asset.

12 Q Okay. But it is in compliance with NARUC and general
13 regulatory accounting?

14 A [GEARHEART] I believe so.

15 CHAIRMAN HALL: All right. Ms. Hudson, any
16 redirect.

17 MS. HUDSON: No redirect.

18 CHAIRMAN HALL: Okay. This panel can be
19 excused, then.

20 [WHEREUPON, the witnesses were excused.]

21 All right. Let's go over some housekeeping
22 matters.. Proposed orders, November 25th, if that's
23 still okay with everyone?

24 Okay, we'll go over the exhibits. Mr. Butler.
25 I'm sorry. Ms. Hudson?

1 MS. HUDSON: May our witnesses be excused?

2 CHAIRMAN HALL: Oh, I'm sorry. Yes. Oh, yes,
3 your witnesses – all witnesses may be excused.

4 [Witness(es) excused]

5 MR. BUTLER: Madam Chairman, the exhibits are
6 numbered as follows: Exhibit No. 1 would be the
7 sign-in sheets from the night hearing at Daufuskie
8 Island. Exhibit No. 2 was from Mr. Andy Mason at
9 the night hearing, written comments submitted in
10 conjunction with his testimony. Exhibit 3 is the
11 settlement agreement and attached settlement
12 exhibits. Exhibit No. 4 is Public Witness
13 Delaney's plat, I believe it was. Exhibit 5, Ms.
14 Walls' prefiled rebuttal Exhibit A. Exhibit 6 was
15 the tax bill from 2015, from the Assessor of
16 Beaufort County. Exhibit 7 is Guastella prefiled
17 direct exhibits. Exhibit 8, Mr. Guastella's
18 prefiled rebuttal exhibits. Exhibit 9 is the
19 management agreement between the company and
20 Guastella Associates. Exhibit 10 was the
21 collection of interrogatory responses and other
22 discovery materials of ORS and the Intervenors.
23 Exhibit 11, Mr. Vogel's exhibit. Exhibit 12, Mr.
24 Egly's exhibits. Exhibit 13 – and forgive me if I
25 forget how to pronounce this gentleman's name, but

1 Exhibit 13 is Mr. J-u-e's exhibit. Exhibit 14, Mr.
2 Lanier's exhibit. Exhibit 15 appears to be the
3 surrebuttal exhibits of Mr. Loy. Exhibit 16 was
4 the direct exhibits of Mr. Loy. Exhibit 17, Dr.
5 Carlisle's exhibits. Exhibit 18, Ms. Gearheart's
6 exhibits. Exhibit 19, Mr. Morgan's direct
7 exhibits. And Exhibit 20, Madam Chairman, was Mr.
8 Morgan's surrebuttal exhibits. And that does
9 complete the list of exhibits.

10 CHAIRMAN HALL: All right. Any exceptions to
11 that list?

12 [No response]

13 Okay. Any other matters we need to take up
14 before we adjourn?

15 [No response]

16 No. Okay. All right. Before Benghazi, so,
17 thank you. Good night.

18 [WHEREUPON, at 7:35 p.m., the hearing in
19 the above-entitled matter was adjourned.]

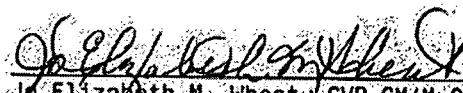
20 _____
21 [WHEREUPON, Late-Filed Hearing Exhibit
22 No. 6 shall be marked and received in
23 evidence upon receipt of same: _____]
24 _____
25

C E R T I F I C A T E

I, Jo Elizabeth M. Wheat, CVR-CM-GNSC, Notary Public in and for the State of South Carolina, do hereby certify that the foregoing is, to the best of my skill and ability, a true and correct transcript of all the proceedings had and testimony adduced in a hearing held in the above-captioned matter before the PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA;

That the witnesses appearing during said hearing were sworn or affirmed by me to state the truth, the whole truth, and nothing but the truth;

IN WITNESS WHEREOF, I have hereunto set my hand and seal, on this the 15th day of November, 2015.


Jo Elizabeth M. Wheat, CVR-CM/M-GNSC
Hearings Reporter, PSC/SC
My Commission Expires: January 27, 2021

MERITS HEARING - VOLUME 2 OF 2
10/28/15

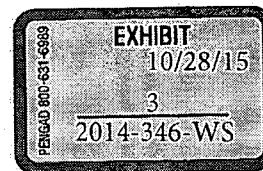
PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

HEARING EXHIBITS 3 ~ 20

{Merits Hearing of October 28, 2015}

In the matter of 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*

BEFORE
THE PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA
DOCKET NO. 2014-346-WS
OCTOBER 27, 2014



IN RE:

Application of Daufuskie Island Utility	)	
Company, Incorporated for Approval	)	
of an Increase for Water and Sewer Rates,	)	SETTLEMENT AGREEMENT
Terms and Conditions	)	
_____	)	

This Settlement Agreement is made by and among 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 the Office of Regulatory Staff of South Carolina ("ORS"), (all hereinafter collectively referred to as the "Parties" or sometimes individually as a "Party").

WHEREAS, on June 11, 2015, DIUC filed with the Public Service Commission of South Carolina ("Commission") an Application for Approval of an Adjustment in Rates and Charges for Water and Sewer Services ("Application");

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

WHEREAS, the other parties in this case, Daufuskie Island Utility Company, Incorporated ("DIUC" or "the Company") and Beach Field Properties, LLC ("Beach Field"), are not signatories to this Settlement Agreement;

WHEREAS, the above-captioned proceeding has been established by the Public Service Commission of South Carolina (the "Commission") pursuant to the procedure established in S.C.

Code Ann. § 58-5-240 (Supp. 2014) and 10 S.C. Code Ann. Regs. 103-503, 103-512.4.A, 103-703 and 103-712.4.A;

WHEREAS, as calculated by ORS, the Company provides water supply/distribution services to 680 active residential and commercial service units and wastewater collection/treatment services to 493 active residential and commercial service units, all of which is located on Daufuskie Island, in Beaufort County, South Carolina;

WHEREAS, ORS examined the books and records of the Company relative to the issues raised in the Application and conducted financial, business, and site inspections of DIUC; and

WHEREAS, the Parties have engaged in discussions to determine whether a settlement in this proceeding would be in their best interests and in the public interest;

NOW, THEREFORE, the Parties hereby stipulate and agree to the following terms, which, if adopted by the Commission in its Order addressing the merits of this proceeding, will result in rates and charges for water and wastewater service which are adequate, just, reasonable, nondiscriminatory, and supported by the evidence of record of this proceeding, and which will allow the Company the opportunity to earn a reasonable operating margin.

1. The Parties agree to stipulate into the record the pre-filed testimonies and exhibits of the following without objection or cross examination:

A. ORS

1. Douglas H. Carlisle (direct)
2. Ivana C. Gearheart (direct)
3. Willie J. Morgan (direct and surrebuttal)

B. HPCCA, MPOA, and BPPOA

1. Lynn M. Lanier (direct)
2. Charles Loy (direct and surrebuttal)

Page 2 of 7

3. Paul Vogel (direct)
4. Tony Simonelli (direct)
5. Doug Egly (direct)
6. Harry Jue (direct)

2. By and between these Parties, the Parties agree that no other evidence will be offered in the proceeding by the Parties other than the stipulated testimony and exhibits and this Settlement Agreement unless the additional evidence is in support of the Settlement Agreement or to respond to Commission questions. The Parties agree that nothing herein will preclude each party from advancing its respective positions in the event that the Commission does not approve the Settlement Agreement.

3. The Parties stipulate and agree to the rate schedule attached hereto and incorporated herein by reference as Settlement Agreement Exhibit 1. Settlement Agreement Exhibit 2 shows the percentage increase for the rates.

4. The Parties agree that the rates in Settlement Agreement Exhibits 1 and 2 along with the adjustments and revenues in Settlement Agreement Exhibits 3, 4 and 5 are fair, just, and reasonable to customers of the Company's system while also providing the opportunity to earn a fair operating margin which produces additional revenues of \$462,798. The Parties stipulate that the resultant operating margin is 16.18% with a return on equity of 9.28%.

5. The Parties agree to accept all adjustments and recommendations in ORS's testimony and exhibits, as modified by this Settlement Agreement and its Exhibits.

6. 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.

7. ORS is charged by law with the duty to represent the public interest of South Carolina pursuant to S.C. Code Ann. § 58-4-10(B) (Supp. 2014). S.C. Code § 58-4-10(B)(1) through (3) reads in part as follows:

... 'public interest' means a balancing of the following:

- (1) concerns of the using and consuming public with respect to public utility services, regardless of the class of customer;
- (2) economic development and job attraction and retention in South Carolina; and
- (3) preservation of the financial integrity of the State's public utilities and continued investment in and maintenance of utility facilities so as to provide reliable and high quality utility services.

ORS believes the agreement reached between the Parties serves the public interest as defined above. The terms of this Settlement Agreement balance the concerns of the using public while preserving the financial integrity of the Company. ORS also believes the Settlement Agreement promotes economic development within the State of South Carolina. The Parties stipulate and agree to these findings.

8. The Parties agree that by signing this Settlement Agreement, it will not constrain, inhibit or impair in any way their arguments or positions they may choose to make in future Commission 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.

9. This Settlement Agreement shall be interpreted according to South Carolina law.

10. This Settlement Agreement shall bind and inure to the benefit of each of the signatories hereto and their representatives, predecessors, successors, assigns, agents, shareholders, officers, directors (in their individual and representative capacities), subsidiaries, affiliates, parent corporations, if any, joint ventures, heirs, executors, administrators, trustees, and attorneys.

11. 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.

12. The Parties represent that the terms of this Settlement Agreement are based upon full and accurate information known as of the date this Settlement Agreement is executed. If, after execution, either Party is made aware of information that conflicts, nullifies, or is otherwise materially different than that information upon which this Settlement Agreement is based, either Party may withdraw from the Settlement Agreement with written notice to the other Party.

[PARTY SIGNATURES TO FOLLOW ON SEPARATE PAGES]

Representing and binding the South Carolina Office of Regulatory Staff

Shannon B. Hudson

Shannon Bowyer Hudson, Esquire

Andrew M. Bateman, Esquire

South Carolina Office of Regulatory Staff

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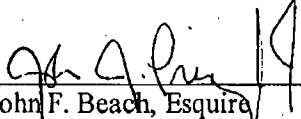
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**Representing and binding the Haig Point Club and Community Association, Inc., Melrose
Property Owner's Association, Inc., and the Bloody Point Property Owner's Association:**



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**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*
<u>Total Equity Investment</u>				
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.

DAUFUSKIE ISLAND UTILITY COMPANY, INC.
2014-346-WS
REVENUE IMPACT ANALYSIS

Settlement EXHIBIT WJM-2

Calculated DIUC Test Year Revenue Overview

	Customer Type	Customer Classification	Consumption in Gallons	Usage Charge per 1,000 gallons	Service Units	Base Facility Charge (BFC)	Test Year Calculated Revenues ¹
WATER	Haig Point	3/4" Residential			1,061	\$62.09	\$65,877
	RESIDENTIAL	0 to 22,500 gallons	8,360,179	\$2.76			\$23,074
	WATER	Over 22,500 gallons	3,192,728	\$2.76			\$8,812
	Haig Point				727		
	RESIDENTIAL &	0 to 18,000 gallons	8,367,838	\$2.76			\$23,095
	COMMERCIAL	18,001 to 60,000 gallons	9,829,270	\$3.09			\$30,372
	IRRIGATION	Over 60,000 gallons	10,049,342	\$3.50			\$35,173
	Melrose	3/4" Residential			452	\$80.72	\$36,485
	RESIDENTIAL	0 to 22,500 gallons	4,105,940	\$0.00			\$0
	WATER	Over 22,500 gallons	2,177,808	\$2.44			\$5,314
	Melrose				100		
	RESIDENTIAL &	0 to 18,000 gallons	1,368,330	\$1.66			\$2,271
	COMMERCIAL	18,001 to 60,000 gallons	2,002,230	\$1.66			\$3,324
	IRRIGATION	Over 60,000 gallons	2,986,298	\$1.66			\$4,957
	Haig Point	Commercial			106	\$86.93	\$9,215
SEWER	COMMERCIAL	0 to 22,500 gallons	2,413,190	\$2.76			\$6,660
	WATER	Over 22,500 gallons	2,132,690	\$2.76			\$5,886
	Melrose	Commercial			329	\$136.60	\$44,941
	COMMERCIAL	0 to 22,500 gallons	1,752,659	\$0.00			\$0
	WATER	Over 22,500 gallons	2,544,703	\$2.44			\$6,209
		Water Service Total	61,283,205		2,775		\$311,665
	Haig Point	Residential			1,061	\$110.38	\$117,113
	RESIDENTIAL SEWER	0 to 22,500 gallons	8,360,179	\$1.32			\$11,035
		Over 22,500 gallons	3,192,728	\$1.32			\$4,214
	Melrose	Residential			448	\$80.72	\$36,163
	RESIDENTIAL SEWER	0 to 22,500 gallons	3,926,008	\$0.00			\$0
		Over 22,500 gallons	2,296,390	\$1.77			\$4,065
	Haig Point	Commercial			102	\$178.21	\$18,177
	COMMERCIAL	0 to 22,500 gallons	2,362,530	\$1.32			\$3,119
	SEWER	Over 22,500 gallons	2,132,690	\$1.32			\$2,815
	Melrose	Commercial			329	\$136.60	\$44,941
	COMMERCIAL	0 to 22,500 gallons	1,559,487	\$0.00			\$0
	SEWER	Over 22,500 gallons	2,436,565	\$1.77			\$4,313
		Sewer Service Total	26,266,577		1,940		\$245,955
Total Residential Water and Sewer Service Revenue							\$312,152
Total Commercial Water and Sewer Service Revenue							\$146,276
Total Irrigation Service Revenue							\$99,192
Total Water and Sewer Service Revenues							\$557,620
Availability Billing - Haig Point (Water)					1,917	\$31.04	\$59,504
Availability Billing - Melrose (Water)					1,617	\$76.36	\$123,474
Availability Billing - Bloody Point (Water)					368	\$76.36	\$28,100
Availability Billing - Haig Point (Sewer)					1,917	\$55.19	\$105,799
Availability Billing - Melrose (Sewer)					1,617	\$85.08	\$137,574
Availability Billing - Bloody Point (Sewer)					368	\$85.08	\$31,309
Total Availability Billing							\$485,760
Misc. Other Revenue - Other Revenue							\$11,000
Misc. Other Revenue - Other Revenue (Return Check Fee)							\$25
Misc. Other Revenue - Late Fees (Metered Sales)							\$6,058
Misc. Other Revenue - Late Fees (Availability Charges)							\$13,114
Total Misc. Other Revenue							\$30,197
Total Operating Revenues							\$1,073,577

¹ Deposits and Interest on Deposits are not included in any of the above computations. Consumption and Units reflected as reported during test year.

DAUFUSKIE ISLAND UTILITY COMPANY, INC.
2014-346-WS
REVENUE IMPACT ANALYSIS

Settlement EXHIBIT WJM-2

Calculated DIUC Proposed Revenue Overview at 9.28%

	Customer Type	Customer Classification	Consumption in Gallons	Usage Charge per 1,000 gallons	Service Units	Base Facility Charge (BFC)	Test Year Calculated Revenues at Proposed Rates ¹	Increase Amount	% Increase
WATER	Haig Point RESIDENTIAL WATER	3/4" Residential			1,061	\$80.81	\$85,739	\$19,862	30.15%
		0 to 22,500 gallons	8,360,179	\$4.41			\$36,868	\$13,794	59.78%
		Over 22,500 gallons	3,192,728	\$4.41			\$14,080	\$5,268	59.78%
	Haig Point RESIDENTIAL & COMMERCIAL IRRIGATION				727		\$0		
		0 to 18,000 gallons	8,367,838	\$4.85			\$40,584	\$17,489	75.73%
		18,001 to 60,000 gallons	9,829,270	\$5.73			\$56,322	\$25,950	85.44%
	Melrose RESIDENTIAL WATER	Over 60,000 gallons	10,049,342	\$6.61			\$66,426	\$31,253	88.86%
		3/4" Residential			452	\$105.05	\$47,483	\$10,998	30.14%
		0 to 22,500 gallons	4,105,940	\$4.41			\$18,107	\$18,107	N/A
	Melrose RESIDENTIAL & COMMERCIAL IRRIGATION	Over 22,500 gallons	2,177,808	\$4.41			\$9,604	\$4,290	80.73%
					100		\$0		
		0 to 18,000 gallons	1,368,330	\$4.85			\$6,636	\$4,365	192.21%
SEWER	Haig Point RESIDENTIAL SEWER	18,001 to 60,000 gallons	2,002,230	\$5.73			\$11,473	\$8,149	245.16%
		Over 60,000 gallons	2,986,298	\$6.61			\$19,739	\$14,782	298.20%
		Commercial			106	\$113.17	\$11,996	\$2,781	30.18%
	Haig Point COMMERCIAL WATER	0 to 22,500 gallons	2,413,190	\$4.41			\$10,642	\$3,982	59.79%
		Over 22,500 gallons	2,132,690	\$4.41			\$9,405	\$3,519	59.79%
		Commercial			329	\$177.77	\$58,486	\$13,545	30.14%
	Melrose COMMERCIAL WATER	0 to 22,500 gallons	1,752,659	\$4.41			\$7,729	\$7,729	N/A
		Over 22,500 gallons	2,544,703	\$4.41			\$11,222	\$5,013	80.74%
		Water Service Total	61,283,205		2,775		\$522,541	\$210,876	67.66%
	SEWER	Haig Point RESIDENTIAL SEWER	Residential			1,061	\$143.65	\$152,413	\$35,300
0 to 22,500 gallons			8,360,179	\$2.38			\$19,897	\$8,862	80.31%
Over 22,500 gallons			3,192,728	\$2.38			\$7,599	\$3,385	80.33%
Melrose RESIDENTIAL SEWER		Residential			448	\$105.05	\$47,062	\$10,899	30.14%
		0 to 22,500 gallons	3,926,008	\$2.38			\$9,344	\$9,344	N/A
		Over 22,500 gallons	2,296,390	\$2.38			\$5,465	\$1,400	34.44%
Haig Point COMMERCIAL SEWER		Commercial			102	\$231.93	\$23,657	\$5,480	30.15%
		0 to 22,500 gallons	2,362,530	\$2.38			\$5,623	\$2,504	80.28%
		Over 22,500 gallons	2,132,690	\$2.38			\$5,076	\$2,261	80.32%
Melrose COMMERCIAL SEWER		Commercial			329	\$177.77	\$58,486	\$13,545	30.14%
		0 to 22,500 gallons	1,559,487	\$2.38			\$3,712	\$3,712	N/A
		Over 22,500 gallons	2,436,565	\$2.38			\$5,799	\$1,486	34.45%
	Sewer Service Total	26,266,577		1,940		\$344,133	\$98,178	39.92%	
Total Residential Water and Sewer Service Revenue							\$453,661	\$141,509	45.33%
Total Commercial Water and Sewer Service Revenue							\$211,833	\$65,557	44.82%
Total Irrigation Service Revenue							\$201,180	\$101,988	102.82%
Total Water and Sewer Service Revenues							\$866,674	\$309,054	55.42%
Availability Billing - Haig Point (Water)					1,917	\$40.40	\$77,447	\$17,943	30.15%
Availability Billing - Melrose (Water)					1,617	\$99.38	\$160,697	\$37,223	30.15%
Availability Billing - Bloody Point (Water)					368	\$99.38	\$36,572	\$8,472	30.15%
Availability Billing - Haig Point (Sewer)					1,917	\$71.83	\$137,698	\$31,899	30.15%
Availability Billing - Melrose (Sewer)					1,617	\$110.72	\$179,034	\$41,460	30.14%
Availability Billing - Bloody Point (Sewer)					368	\$110.72	\$40,745	\$9,436	30.14%
Total Availability Billing					7,804		\$632,193	\$146,433	30.15%
Misc. Other Revenue - Other Revenue							\$11,000	\$0	0.00%
Misc. Other Revenue - Other Revenue (Return Check Fee)							\$25	\$0	0.00%
Misc. Other Revenue - Late Fees (Metered Sales)							\$9,416	\$3,358	55.43%
Misc. Other Revenue - Late Fees (Availability Charges)							\$17,067	\$3,953	30.14%
Total Misc. Other Revenue							\$37,508	\$7,311	24.21%
Total Operating Revenues							\$1,536,375	\$462,798	43.11%

¹ Deposits and Interest on Deposits are not included in any of the above computations. Consumption and Units reflected as reported during test year.

Daufuskie Island Utility Company, Inc.
Docket No. 2014-346-WS
Operating Experience, Rate Base, and Rates of Return
For the Test Year Ended December 31, 2014
Combined Operations

Settlement Exhibit ICG-3
Page 1 of 1

Description	(1) Application Per Books \$	(2) Accounting & Pro Forma Adjustments \$	(3) After Accounting & Pro Forma Adjustments \$	(4) Proposed Increase \$	(5) After Proposed Increase \$
<u>OPERATING REVENUE</u>					
Residential revenue	307,239	4,913 1a	312,152	141,509 18a	453,661
Commercial Revenue	151,056	(4,780) 1b	146,276	65,557 18b	211,833
Irrigation Revenue	98,309	883 1c	99,192	101,988 18c	201,180
Availability Billing	489,665	(3,905) 2	485,760	146,433 19	632,193
Misc. Other Revenue	30,193	4 3	30,197	7,311 20	37,508
<u>TOTAL OPERATING REVENUE</u>	<u>1,076,462</u>	<u>(2,885)</u>	<u>1,073,577</u>	<u>462,798</u>	<u>1,536,375</u>
<u>OPERATION AND MAINTENANCE EXPENSES</u>					
Operation and Maintenance Expenses	848,818	(122,422) 4	726,396	6,194 21	732,590
<u>TOTAL OPERATION AND MAINTENANCE EXPENSES</u>	<u>848,818</u>	<u>(122,422)</u>	<u>726,396</u>	<u>6,194</u>	<u>732,590</u>
Depreciation and Amortization Expense	73,072	(2,002) 5	71,070	0	71,070
Amortization of Rate Case Expenses	92,420	(42,308) 6	50,112	0	50,112
Taxes Other than Income Tax Expense	23,440	139,849 7	163,289	3,964 22	167,253
Income Tax Expense	0	0 8	0	147,179 23	147,179
<u>TOTAL OPERATING EXPENSES</u>	<u>1,037,750</u>	<u>(26,883)</u>	<u>1,010,867</u>	<u>157,337</u>	<u>1,168,204</u>
<u>NET OPERATING INCOME</u>	<u>38,712</u>	<u>23,998</u>	<u>62,710</u>	<u>305,461</u>	<u>368,171</u>
Add: Customer Growth	0	286 9	286	939 24	1,225
<u>NET INCOME (LOSS) FOR RETURN</u>	<u>38,712</u>	<u>24,284</u>	<u>62,996</u>	<u>306,400</u>	<u>369,396</u>
<u>ORIGINAL COST RATE BASE:</u>					
Gross Plant in Service	7,964,379	(1,624,696) 10	6,339,683	0	6,339,683
Accumulated Depreciation	(790,024)	(141,198) 11	(931,222)	0	(931,222)
Construction Work In Progress (CWIP)	254,853	(254,853) 12	0	0	0
Contributions in Aid of Construction	(660,295)	0 13	(660,295)	0	(660,295)
Accumulated Amortization of CIAC	69,269	213 14	69,482	0	69,482
Net Plant	6,838,182	(2,020,534)	4,817,648	0	4,817,648
Working Capital	75,842	69,437 15	145,279	0	145,279
Unamortized Balances	0	0 16	0	0	0
<u>TOTAL RATE BASE</u>	<u>6,914,024</u>	<u>(1,951,097)</u>	<u>4,962,927</u>	<u>0</u>	<u>4,962,927</u>
<u>RETURN ON RATE BASE</u>	<u>0.56%</u>		<u>1.27%</u>		<u>7.44%</u>
<u>OPERATING MARGIN</u>	<u>-12.90%</u>		<u>-5.38%</u>		<u>16.18%</u>
<u>INTEREST EXPENSE</u>	<u>177,526</u>	<u>(56,759) 17</u>	<u>120,767</u>	<u>0</u>	<u>120,767</u>

Daufuskie Island Utility Company, Inc.
Docket No. 2014-346-WS
Operating Experience, Rate Base, and Rates of Return
For the Test Year Ended December 31, 2014
Water Operations

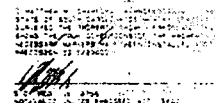
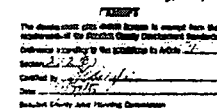
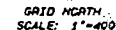
Settlement Exhibit ICG-4
Page 1 of 1

Description	(1) Application Per Books \$	(2) Accounting & Pro Forma Adjustments \$	(3) After Accounting & Pro Forma Adjustments \$	(4) Proposed Increase \$	(5) After Proposed Increase \$
<u>OPERATING REVENUE</u>					
Water Residential	139,071	491 1a	139,562	72,319 18a	211,881
Water Commercial	72,479	432 1b	72,911	36,569 18b	109,480
Water Irrigation	98,309	883 1c	99,192	101,988 18c	201,180
Availability Billing	213,004	(1,926) 2	211,078	63,638 19	274,716
Misc. Other Revenue	20,444	(715) 3	19,729	4,389 20	24,118
<u>TOTAL OPERATING REVENUE</u>	<u>543,307</u>	<u>(835)</u>	<u>542,472</u>	<u>278,903</u>	<u>821,375</u>
<u>WATER OPERATION AND MAINTENANCE EXPENSES</u>					
Operation and Maintenance Expense	469,605	(68,723) 4	400,882	3,733 21	404,615
<u>TOTAL OPERATING AND MAINTENANCE EXPENSES</u>	<u>469,605</u>	<u>(68,723)</u>	<u>400,882</u>	<u>3,733</u>	<u>404,615</u>
Depreciation and Amortization Expense	36,921	(6,383) 5	30,538	0	30,538
Amortization of Rate Case Expenses	46,210	(21,154) 6	25,056	0	25,056
Taxes Other than Income Tax Expense	11,748	69,946 7	81,694	2,389 22	84,083
Income Tax Expense	0	0 8	0	87,417 23	87,417
<u>TOTAL OPERATING EXPENSES</u>	<u>564,484</u>	<u>(26,314)</u>	<u>538,170</u>	<u>93,539</u>	<u>631,709</u>
<u>NET OPERATING INCOME</u>	<u>(21,177)</u>	<u>25,479</u>	<u>4,302</u>	<u>185,364</u>	<u>189,666</u>
Add: Customer Growth	0	0 9	0	351 24	351
<u>NET INCOME (LOSS) FOR RETURN</u>	<u>(21,177)</u>	<u>25,479</u>	<u>4,302</u>	<u>185,715</u>	<u>190,017</u>
<u>ORIGINAL COST RATE BASE:</u>					
Gross Plant in Service	3,899,032	(1,353,024) 10	2,546,008	0	2,546,008
Accumulated Depreciation	(382,950)	(80,727) 11	(463,677)	0	(463,677)
Construction Work In Progress (CWIP)	29,511	(29,511) 12	0	0	0
Contributions in Aid of Construction	(458,500)	0 13	(458,500)	0	(458,500)
Accumulated Amortization of CIAC	51,580	39 14	51,619	0	51,619
Net Plant	3,138,673	(1,463,223)	1,675,450	0	1,675,450
Working Capital	0	80,176 15	80,176	0	80,176
Unamortized Balances	0	0 16	0	0	0
<u>TOTAL RATE BASE</u>	<u>3,138,673</u>	<u>(1,383,047)</u>	<u>1,755,626</u>	<u>0</u>	<u>1,755,626</u>
<u>RETURN ON RATE BASE</u>	<u>-0.67%</u>		<u>0.25%</u>		<u>10.82%</u>
<u>OPERATING MARGIN</u>	<u>-20.24%</u>		<u>-7.08%</u>		<u>17.93%</u>
<u>INTEREST EXPENSE</u>	<u>88,763</u>	<u>(46,042) 17</u>	<u>42,721</u>	<u>0</u>	<u>42,721</u>

Daufuskie Island Utility Company, Inc.
Docket No. 2014-346-WS
Operating Experience, Rate Base, and Rates of Return
For the Test Year Ended December 31, 2014
Sewer Operations

Settlement Exhibit ICG-5
Page 1 of 1

Description	(1) Application Per Books \$	(2) Accounting & Pro Forma Adjustments \$	(3) After Accounting & Pro Forma Adjustments \$	(4) Proposed Increase \$	(5) After Proposed Increase \$
OPERATING REVENUE					
Sewer Residential	168,168	4,422 1a	172,590	69,190 18a	241,780
Sewer Commercial	78,577	(5,212) 1b	73,365	28,988 18b	102,353
Sewer Irrigation	0	0 1c	0	0 18c	0
Availability Billing	276,661	(1,979) 2	274,682	82,795 19	357,477
Misc. Other Revenue	9,749	719 3	10,468	2,922 20	13,390
TOTAL OPERATING REVENUE	533,155	(2,050)	531,105	183,895	715,000
SEWER OPERATION AND MAINTENANCE EXPENSES					
Operation and Maintenance Expense	379,213	(53,699) 4	325,514	2,461 21	327,975
TOTAL OPERATING AND MAINTENANCE EXPENSES	379,213	(53,699)	325,514	2,461	327,975
Depreciation and Amortization Expense	36,151	4,381 5	40,532	0	40,532
Amortization of Rate Case Expenses	46,210	(21,154) 6	25,056	0	25,056
Taxes Other than Income Tax Expense	11,692	69,903 7	81,595	1,575 22	83,170
Income Tax Expense	0	0 8	0	59,762 23	59,762
TOTAL OPERATING EXPENSES	473,266	(569)	472,697	63,798	536,495
NET OPERATING INCOME	59,889	(1,481)	58,408	120,097	178,505
Add: Customer Growth	0	286 9	286	588 24	874
NET INCOME (LOSS) FOR RETURN	59,889	(1,195)	58,694	120,685	179,379
ORIGINAL COST RATE BASE:					
Gross Plant in Service	4,065,347	(271,672) 10	3,793,675	0	3,793,675
Accumulated Depreciation	(407,074)	(60,471) 11	(467,545)	0	(467,545)
Construction Work In Progress (CWIP)	225,342	(225,342) 12	0	0	0
Contributions in Aid of Construction	(201,795)	0 13	(201,795)	0	(201,795)
Accumulated Amortization of CIAC	17,689	174 14	17,863	0	17,863
Net Plant	3,699,509	(557,311)	3,142,198	0	3,142,198
Working Capital	75,842	(10,739) 15	65,103	0	65,103
Unamortized Balances	0	0 16	0	0	0
TOTAL RATE BASE	3,775,351	(568,050)	3,207,301	0	3,207,301
RETURN ON RATE BASE	1.59%		1.83%		5.59%
OPERATING MARGIN	-5.42%		-3.64%		14.17%
INTEREST EXPENSE	88,763	(10,717) 17	78,046	0	78,046



TRACT A		1.39
TRACT B	EISELBERGER	169.79
TRACT C	BLOODY POOL	320.49
TRACT D	MORRISON	10.00
TOTAL		501.67

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EXHIBIT
 10/28/15
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 2014-346-WS

COUNTY OF BEAUFORT)
)
STATE OF SOUTH CAROLINA) SETTLEMENT AGREEMENT
)
)

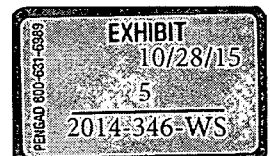


EXHIBIT A

applied to the oldest account due before the principal. If on July 1, 2023, Debtor still owes amounts under this Agreement, Debtor will pay those amounts in full on that date (the "Maturity Date").

- b. Amount of Monthly Payments. Debtor's monthly payment will be in the amount of six thousand seven hundred eighty four Dollars and four cents (\$6,784.04) or such reduced value as stipulated by Beaufort County Treasurer predicated on the pending appeals.

- 3. DEBTOR'S RIGHT TO PREPAY. Debtor has the right to make payments of principal and fees at any time before they are due. A payment of principal only is known as a "prepayment." When Debtor makes prepayment, Debtor will tell the Beaufort County Treasurer in writing that s/he is doing so.

Debtor may make a full prepayment or partial prepayments at any time to pay off the Debt. Beaufort County will use any prepayments to reduce the amount of the principal that the Debtor owes under this Settlement. If Debtor makes a partial prepayment, there will be no changes in the due date or in the amount of Debtor's monthly payment unless the Beaufort County Treasurer agrees in writing to those changes.

4. DEBTOR'S FAILURE TO PAY AS REQUIRED

- a. Default. If Debtor does not pay the full amount of each monthly payment on the date it is due, Debtor will be in default
- b. Notice of Default. If Debtor is in default, the Beaufort County may send Debtor a written notice stating that if Debtor does not pay the overdue amount by a certain date, the Beaufort County Treasurer may require Debtor to pay immediately the full amount of the principal which has not been paid and all the fees that the Debtor owes on that amount. That date must be at least thirty (30) days after the date on which the notice is delivered or mailed to the Debtor.
- c. No Waiver by Beaufort County Treasurer. Even if, at a time when Debtor is in default, the Beaufort County Treasurer does not require Debtor to pay immediately in full as described above, the Beaufort County Treasurer will still have the right to do so if Debtor is in default at a later time.
- d. Payment of Note Holder's Costs and Expenses. If the Beaufort County Treasurer has required Debtor to pay immediately in full as described above, the Beaufort County Treasurer will have the right to be paid back by Debtor for all its costs and expenses in enforcing this Agreement to the extent not prohibited by law. Those expenses include, but are not limited to reasonable attorneys' fees and/or court costs.

EXHIBIT A

5. **GIVING OF NOTICES.** Unless applicable law requires a different method, any notice that must be given to Debtor under this Settlement Agreement will be given by delivering it or by mailing it by first class mail to the business addresses below

Beaufort County Treasurer
Attention: Kimberly Chesney, Tax Collector
PO Box 487
Beaufort, SC 29901

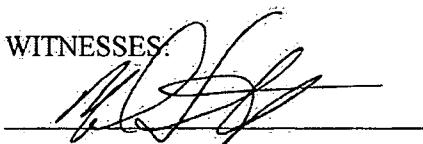
Beaufort County Attorney
P.O. Drawer 1228
Beaufort, SC 29901

Daufuskie Island Utility Company, Inc.
Attention: John F. Guastella
775 N. Highway A1A, Suite B103
Jupiter, Florida 33477

6. **Representation on Authority of Parties/ Signatories.** Each person signing this Settlement Agreement represents and warrants that s/he is duly authorized and has legal capacity to execute and deliver this Settlement Agreement. Each party represents and warrants to the other that the execution and delivery of the Settlement Agreement and the performance of such party's obligations hereunder have been duly authorized and that the Settlement Agreement is a valid and legal agreement binding on such party and enforceable in accordance with its terms.
7. **WAIVERS.** Debtor and any other person, who has obligations under this Note, waive the rights of presentment and notice of dishonor. "Presentment" means the right to require the Note Holder to demand payment of amounts due; "Notice of dishonor" means the right to require the Beaufort County Treasurer to give notice to other persons that amounts due have not been paid.

WITNESS, the hands and seals of the undersigned Debtor and Beaufort County Treasurer on this ____ day of ___, 2015.

WITNESSES:



Daufuskie Island Utility Company, Inc.

By John F. Guastella, President of
Guastella Associates, LLC its Manager

EXHIBIT A

WITNESSES:

Beaufort County Treasurer

EXHIBIT A

COUNTY OF BEAUFORT	)	
	)	SETTLEMENT AGREEMENT
STATE OF SOUTH CAROLINA	)	ADDENDUM
	)	

This Addendum entered into this 28 day of April, 2015 serves as "Addendum" to the "Daufuskie Island Utility Company Settlement Agreement" dated 2/18/2015 by and between Daufuskie Island Utility Company, Inc. (hereinafter "Debtor"), and Beaufort County Treasurer, (hereinafter "Treasurer"). For purpose of this document, Daufuskie Island Utility Company, Inc. and Beaufort County Treasurer may be referred to jointly as the "Parties."

WHEREAS, the Treasurer is directed to levy and collect the taxes of Beaufort County for such amounts as directed by the Beaufort County Assessor and the Department of Revenue ("DOR"); and

WHEREAS, the Debtor properly protested the Tax Assessments for the 2012, 2013 and 2014; and

WHEREAS, the Department of Revenue reduced the tax values for the years 2012, 2013 and 2014; and

WHEREAS, based on the reduced tax value the amount to be collected by the Beaufort County Treasurer reduced from six hundred fifty one thousand two hundred and sixty seven Dollars and twenty seven cents (\$651,267.27) to five hundred and twenty six thousand, eight hundred forty three Dollars and thirty nine cents (\$526,843.39); and

WHEREAS, pursuant to the Settlement Agreement Section (2)(b) the Beaufort County Treasurer retained the authority to reduce the monthly payment pending the resolution of any pending appeals.

NOW THEREFORE, in consideration of the mutual covenants and conditions set forth hereafter, the parties do hereby agree to add this "Addendum 1" to the existing Settlement Agreement as follows:

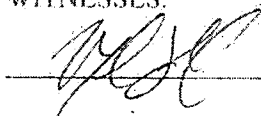
- I. Section 1 of the Settlement Agreement is hereby amended to read as follows:
 1. **DEBTOR'S PROMISE TO PAY.** For value received, in the form of allowing taxpayer to pay his taxes in installments over time, the Debtor promises to pay five hundred and twenty six thousand, eight hundred forty three Dollars and thirty nine cents 526,843.39 ("the Principal") as set forth herein to the order of the Beaufort County Treasurer's Office.
- II. Section 2(b) of the Settlement Agreement is hereby amended to read as follows:

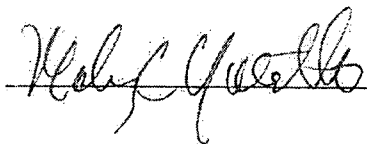
EXHIBIT A

2(b). Amount of Monthly Payments. Debtor's monthly payment will be in the amount of five thousand four hundred and eighty seven Dollars and ninety five cents (\$5,487.95) or such reduced value as stipulated by Beaufort County Treasurer predicated on the pending appeals.

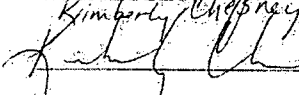
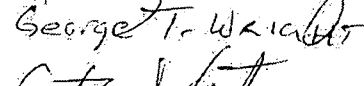
WITNESS, the hands and seals of the undersigned Debtor and Beaufort County Treasurer on this 28 day of April 2015.

WITNESSES:





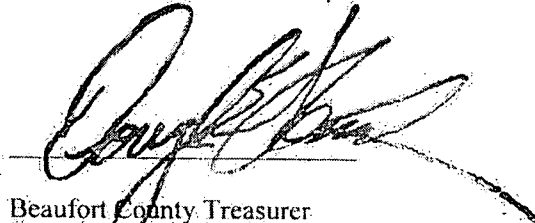
WITNESSES:


Kimberly Chappney

George T. Wright




Daufuskie Island Utility Company, Inc.

By John F. GUASTELLA, PRESIDENT
GUASTELLA ASSOCIATES, LLC ITS MANAGER



Beaufort County Treasurer

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.)
)
_____)

NOTICE OF FILING EXHIBIT

Attached please find correspondence submitted in response to the Commission's examination of witness Maria Walls during the October 28, 2015, hearing in this matter. Pursuant to discussion at the hearing, the following items were provided to the undersigned counsel and are hereby submitted as Hearing Exhibit 6:

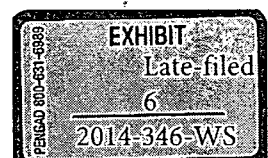
- Email from Gary N. James to Tom Gressette, 10-30-15, including Email from Hon. Maria Walls to Gary James, 10-28-15;
- Letter from Gary N. James to Tom Gressette, 10-30-15; and
- Letter from Guastella Utility Management to Beaufort County Treasurer, 10-2-09.

Respectfully submitted,

By: /s/ Thomas P. Gressette Jr.
Thomas P. Gressette, Jr.
PRATT-THOMAS WALKER, P.A.
16 Charlotte Street
Charleston, SC 29403
(843) 727-2200 main
(843) 727-2249 direct
tpg@p-tw.com

ATTORNEYS FOR DAUFUSKIE ISLAND
UTILITY COMPANY, INC.

November 19, 2015
Charleston, South Carolina



Tom Gressette

From: James, Gary <gjames@bcgov.net>
Sent: Friday, October 30, 2015 4:14 PM
To: Walls, Maria; Tom Gressette
Cc: Keaveny, Thomas
Subject: RE: Daufuskie Island Utility
Attachments: R800 25-45 DIUC Water Tank Ownership.pdf; DIUC - Water Tank Property letter to Gressette.docx

Mr. Tom Gressette

Please see the attached letter noting that we do not have any correspondence in our files requesting or any other communication that we have no authority to value this property.

Gary N. James

Assessor
Beaufort County
PO Box 1228
100 Ribaut Road
Beaufort, SC 29901-1228

From: Walls, Maria
Sent: Thursday, October 29, 2015 4:00 PM
To: James, Gary
Cc: Keaveny, Thomas; Tom Gressette
Subject: Daufuskie Island Utility

Good afternoon Gary,

In case we did not get a chance to speak this afternoon I wanted to provide you with a request and some background about Daufuskie Island Utility Company (DIUC). Yesterday I testified in front of the Public Service Commission related to a rate increase application that has been filed by DIUC. They are a small and the only utility company on Daufuskie Island.

I would be happy to share with you more of their history but the part that is relevant to your office is the following:

- The utility started out as two separate entities, Haig Point Utility and Melrose Utility, that served different parts of the island.
- Haig Point Utility was purchased and is now DIUC. Melrose went into bankruptcy and its infrastructure was transferred to DIUC to satisfy outstanding debts Melrose owed to Haig Point Utility (now DIUC)
- Before 2014 the Department of Revenue did not recognize or realize DIUC as a utility on Daufuskie Island.
- Since DOR had not recognized DIUC as a utility the Auditor's office never received a value from DOR for the utility. If they had, DIUC would have been taxed under a personal property account.
- In 2011, the county was not aware Haig Point Utility had been sold so the address for R800 025 000 0045 0000 was not updated in Aumentum. The taxes were not paid and it was sold at the 2011 tax sale to Mr. Mamdou Sabray Abdelrahman. Unknown to the County at this time was that this parcel contained valuable aspects of DIUC's water treatment system, such as an elevated water tower.

- DIUC is in the process of condemning R800 025 000 0045 0000.

The amount of taxes due and the complication that R800 025 000 0045 0000 is not deeded in the name of DIUC was a significant concern of the commission yesterday. It seems that a part of their consideration of the rate increase application is whether DIUC has ownership, and therefore tax liability, of R800 025 000 0045 0000. Based on my and DIUC's conversations with DOR it appears that DOR is valuing DIUC's assets in their entirety (to include the elevated tank site). What the Commission is requesting is a letter from the Assessor's office by tomorrow, October 30, 2015, answering the following:

- Did the Assessor's office receive notification from DOR communicating that the Assessor does not have the authority to value this property?
- If not, did the Assessor's office assign a value to this parcel?

Based on the 2015 tax roll I believe the answer is no and yes but they would like a letter from you communicating that. The letter can be scanned to Tom Gressette (copied on this email) who will provide it to the Commission. I will be out of the office tomorrow but please feel free to email or call me if you would like to discuss further (609-610-5544). I am sorry I did not get a chance to discuss this with you in person today, I wish you the best on your first week with Beaufort County and am looking forward to working with you.

Best Regards,

Maria Walls, CPA
Beaufort County Treasurer
Website: BeaufortCountyTreasurer.com
Telephone: 843-255-2586
Fax: 843-255-9444



COUNTY COUNCIL OF BEAUFORT COUNTY

Office of the Assessor

Multi Government Center • Post Office Box 1228

Beaufort, South Carolina 29901-1228

Phone: (843) 255-2400 Fax: (843) 255-9404

Web Site: www.bcgov.net

October 30, 2015

Tom Gressette
Public Service Commission

RE: Parcel R800-0025-0000-0045-0000
Daufuskie Island Utility
Ownership of

Dear Mr. Gressette:

I have reviewed the Beaufort County Assessor's Files for the above noted parcel.

We have no communication or correspondence from DOR requesting and/or indicating that we do not have the authority to value this property.

In fact, we have valued this property for several years, and the parcel is currently valued at \$24,200 as of our 2013 Revaluation.

The current ownership of the parcel is as you have noted: Mr. Mamdou Sabray Abdelrahman who acquired the property through a tax sale in 2011.

Attached to the email with this letter you will find the only correspondence relative to prior ownership of this parcel in our files (Dated 10/2/2009). At this time the parcel was listed as being part of the Haig Point Utility Company, and we noted it as the equestrian property, but did show it as having a water tank/tower.

Should you need additional information, please don't hesitate to contact me.

Gary N. James

Assessor

Beaufort County

PO Box 1228

100 Ribaut Road

Beaufort, SC 29901-1228

G₂ UTILITY MANAGEMENT, LLC

133 MYSTIC LANE
JUPITER, FL 33458
TEL: (561) 747-9867
FAX: (561) 745-9585

6 BEACON STREET, SUITE 410
BOSTON, MA 02108
TEL: (617) 423-7878
FAX: (617) 423-2929

VIA FACSIMILE

October 2, 2009

Beaufort County Office of the Assessor
Multi-Government Center
Post Office Box 458
Beaufort, SC 29901-0458

Re: Change of Billing Address for Haig Point Utility Company

To Whom It May Concern:

I am writing to inform you that G₂ Utility Management, LLC is the new management company for Haig Point Utility, Inc. replacing International Paper. This change affects the following five sites:

1. Well Site #1 (1.588 acres), Haig Point Tax ID Number: R800-022-00D-0026-0000
2. Well Site #2 (1.040 acres), Haig Point Tax ID Number: R800-022-00G-0079-0000
3. Elevated Tank Site (.337 acres) (Parcel 3 Equestrian Center), Haig Point Tax ID Number: R800-025-000-0045-0000
4. Ingress/Egress & Utility Easement, Haig Point, Daufuskie Island Tax ID Number: R800-022-00C-0070-0000
5. 803 Haig Point Road - Wastewater Treatment Plant, portion of Lot 47 Cooper River Place (5.853 acres) Tax ID# R800-025-000-0014-0000

Please mail all future correspondence at the following address:

Haig Point Utility Inc.
c/o G₂ Utility Management, LLC
6 Beacon Street, Suite #410
Boston, MA 02108
Phone: 617.423.7878
Fax: 617.423.2929

BEAUFORT COUNTY
ASSESSOR'S OFFICE

OCT 02 2009

RECEIVED

Please feel free to call with any questions. We look forward to working with you.

Very truly yours,
G₂ Utility Management, LLC

Christy Fabiano
Administrative Manager

WWW.GUASTELLA.COM



Guastella Associates, LLC

Qualifications & Experience



**Rate Setting
Valuation
Management
Consulting**

... SERVING REGULATED AND UNREGULATED WATER AND WASTEWATER UTILITIES SINCE 1978

725 N. Highway A1A, Suite B103,
Jupiter FL 33477
(561)-7479867
www.guastella.com

INTRODUCTION

GUASTELLA ASSOCIATES, LLC

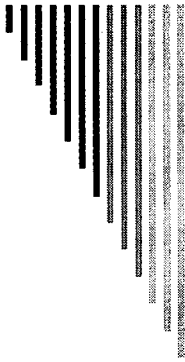
Guastella Associates, LLC (“formerly John F. Guastella Associates, Inc.”) is a consulting firm that specializes in providing utility rate setting, valuation and management services for public and privately-owned water and wastewater utilities.

John F. Guastella established Guastella Associates in 1978. Previously, Mr. Guastella was Director of the Water Division of the New York Public Service Commission. The Water Division provided the New York Commission with technical assistance in regulating the rates and service provided by approximately 450 privately-owned utilities. During the period from 1987 through 1991, Mr. Guastella also managed a 5,500 customer water utility in New York State. In 1989, Guastella Associates acquired the rates and valuation section of Coffin & Richardson, Inc., a general consulting firm that also provided a full range of services to water and wastewater utilities. Since 2009, Guastella Associates has served as the general manager of Daufuskie Island Utility Company, Inc. (“DIUC”), responsible for its day-to-day operations, billing, bookkeeping, financing, capital improvement projects and regulatory relations. DIUC provides water and wastewater service to some 550 connected customers and 600 availability customers located on Daufuskie Island South, Carolina.

As can be seen from the following qualifications and experience, key staff members have many years of combined experience in virtually every aspect of utility rate setting and valuation. The technical expertise of key staff, combined with their former employment by real estate and utility companies, a regulatory agency, and the management of water utilities, provides a total perspective towards addressing the rates and valuation needs of today’s water and wastewater utilities.

Guastella Associates has assisted the largest privately-owned utilities with respect to the most challenging issues, performing complex studies and providing expert testimony in administrative hearings as well as court proceedings. In addition, our client base has included hundreds of small water and wastewater utilities - - obtaining rate increases that turn operating losses into profits, posturing them for financing, correcting record keeping errors and, for some, negotiating their sale at multiples of their original cost net investment rate base. Some of our most successful assignments have been to help establish new developer-related water and wastewater utilities, applying the correct principles at the outset in order to develop fully compensatory initial rates, record keeping procedures and asset management, so they are structured to become self-sustaining utilities that will achieve the highest possible profit and ultimate market value.

Our wide-range of experience and expertise has enabled us to successfully address the special needs of large investor-owned utilities in rate cases and condemnation proceedings.



OUTLINE OF SERVICES

GUASTELLA ASSOCIATES, LLC

Guastella Associates, LLC ("formerly John F. Guastella Associates, Inc.") is a consulting firm specializing in utility management, valuation, appraisals and rate determinations. Guastella Associates has been providing professional services to regulated and unregulated utilities since 1978.

Specific areas of expertise includes:

I. RATE ANALYSIS

A. Revenue Requirements

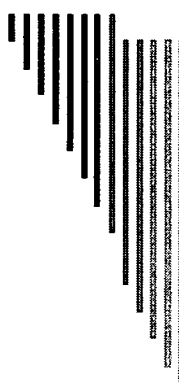
1. Examination of books and records -- revenues, expenses and capital investment.
2. Determination of the cost of providing service (revenue requirement) -- normalize historical data, establish known changes and perform projections.

B. Rate Design

1. Perform cost allocation studies to establish cost of service for residential, commercial, industrial, wholesale and fire protection customers, and for other special users.
2. Develop rate structures -- combine billing analyses and cost allocations to form usage rates, flat rates, minimum service and facilities charges, and such other special charges as connection fees, availability rates, etc.

C. Reports

1. Investor-owned utilities -- prepare complete rate filings for submission to regulatory agencies; prepare testimony, exhibits, and assist in all aspects of adjudication process.
2. Municipal utilities -- prepare detailed rate reports in support of rate increases for use by municipal officials and presentation at municipal hearings.



OUTLINE OF SERVICES

GUASTELLA ASSOCIATES, LLC

II. VALUATIONS

A. Appraisals

1. Eminent domain condemnation proceedings, negotiations for sale of utilities, damage claims for insurance and ad valorem tax and management purposes.
2. Determinations of original cost, replacement cost, reproduction cost and market value, including going concern value.
3. Calculation of the present value of cash flow under the income approach to market value determinations.
4. Analyses of market data under the sales comparison approach.

B. Depreciation

1. Actuarial studies using retirement rate or simulated plant balances methods to determine average service lives of physical property, theoretical depreciation reserve requirements and depreciation rates.
2. Establish affordable depreciation rates on the basis of comparative analyses of similar property of other utilities and practices of regulatory agencies and association

C. Feasibility Studies

1. Utility acquisitions by investors and municipalities.
2. Economic studies to establish extension of service costs and policy -- inside and outside service area.
3. Main extension agreements, guaranteed revenue contracts, refund provisions.

D. Financial Planning

1. Establish financing requirements for capital improvements.
2. Determine revenue and rate needs for various combinations of debt and equity financing.
3. Assist certain utilities in securing financing.
4. Establish financing needs, initial rates and regulatory approval of proposed new utilities.

III. MANAGEMENT

A. Operations

1. Provides general management of water and wastewater utilities.
2. Assist in day-to-day decisions as to utility accounting and related impact on rates.
3. Solve problems as to record keeping in accordance with regulatory requirements and prescribed systems of accounts.
4. Establish general policy and tariff provisions for customer service, billing, collecting, meter testing, complaint handling, and customer and regulatory relations.

B. Administrative

1. Coordinate activities with regulatory agencies to assure compliance with rules, regulations and orders.
2. Negotiations for purchase or sale of utility property and special contracts.

C. Training

1. On-the-job training for employees while working on various projects.
2. Special educational seminars on all aspects of utility rate settings, financing, valuation and rules.

PROFESSIONAL QUALIFICATIONS AND EXPERIENCE
of
JOHN F. GUASTELLA

B.S., Mechanical Engineering, Stevens Institute of Technology, 1962

Member:

American Water Works Association, Lifetime Member
National Association of Water Companies
New England Water Works Association, Lifetime Member

Committees:

AWWA, Water Rates Committee (Water Rates Manual M-1, 1983 Edition)
National Association of Regulatory Utility Commissioners (NARUC) and NAWC, Joint-Committee on Rate Design
NAWC, Rates and Revenues Committee
NAWC, Small Water Company Committee

Mr. Guastella is President of Guastella Associates, LLC ("formerly John F. Guastella Associates, Inc.") which provides management, valuation and rate consulting services for municipal and investor-owned utilities, as well as regulatory agencies. His clients include utilities in the states of Alaska, Arkansas, California, Connecticut, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Maine, Maryland, Massachusetts, Missouri, Michigan, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Dakota, Ohio, Pennsylvania, South Carolina, Texas, Rhode Island and Virginia. He has provided consulting services that include all aspects of utility regulation and rate setting, encompassing revenue requirements, revenues, operation and maintenance expenses, depreciation, taxes, return on investment, cost allocation and rate design. He has performed depreciation studies for the establishment of average service lives and depreciation rates of utility property. He has performed appraisals of utility companies for management purposes and in connection with condemnation proceedings. He has also negotiated the sale of utility companies. He directs the general management of a water and wastewater utility in South Carolina.

Mr. Guastella served for more than four years as President of Country Knolls Water Works, Inc., a water utility that served some 5,500 customers in Saratoga County, New York. He also served as a member of the Board of Directors of the National Association of Water Companies.

Mr. Guastella has qualified and testified as an expert witness before regulatory agencies and municipal jurisdictions in the states of Alaska, California, Connecticut, Delaware, Florida, Georgia, Illinois, Indiana, Maryland, Massachusetts, Missouri, Montana, Nevada, New Hampshire, New Mexico, New Jersey, New York, North Dakota, Ohio, Pennsylvania, Rhode Island, South Carolina, Texas and Virginia.

Prior to establishing his own firm, Mr. Guastella was employed by the New York State Public Service Commission for sixteen years. For two years he was involved in the regulation of electric and gas utilities, with the remaining years devoted to the regulation of water utilities. In 1970, he was promoted to Chief of Rates and Finance in the Commission's Water Division. In 1972, he was made Assistant Director of the Water Division. In 1974, he was appointed by Alfred E. Kahn, then Chairman of the Commission, to be Director of the Water Division, a position he held until he resigned from the Commission in August 1978.

At the Commission, his duties included the performance and supervision of engineering and economic studies concerning rates and service of many public utilities. As Director of the Water Division, he was responsible for the regulation of more than 450 water companies in New York State and headed a professional staff of 32 engineers and three technicians. A primary duty was to attend Commission sessions and advise the Commission during its decision making process. In the course of that process, an average of about fifty applications per year would be reviewed and analyzed. The applications included testimony, exhibits and briefs

Resume: JFG

involving all aspects of utility valuation and rate setting. He also made legislative proposals and participated in drafting Bills that were enacted into law: one expanded the N.Y. Public Service Commission's jurisdiction over small water companies and another dealt specifically with rate regulation and financing of developer-related water systems.

In addition to his employment and client experience, Mr. Guastella served as Vice-Chairman of the Staff-Committee on Water of the National Association of Regulatory Utility Commissioners (NARUC). This activity included the preparation of the "Model Record-Keeping Manual for Small Water Companies," which was published by the NARUC. This manual provides detailed instruction on the kinds of operation and accounting records that should be kept by small water utilities, and on how to use those records.

Each year since 1974 he has prepared study material, assisted in program coordination and served as an instructor at the Eastern Annual Seminar on Water Rate Regulation sponsored over the years by the NARUC in conjunction with the University of South Florida, Florida Atlantic University, the University of Utah, Florida State University, the University of Florida and currently Michigan State University. In 1980 he was instrumental in the establishment of the Western NARUC Rate Seminar and has annually served as an instructor since that time. This course is recognized as one of the best available for teaching rate-setting principles and methodology. More than 7,500 students have attended this course, including regulatory staff, utility personnel and members of accounting, engineering, legal and consulting firms throughout the country.

Mr. Guastella served as an instructor and panelist in a seminar on water and wastewater regulation conducted by the Independent Water and Sewer Companies of Texas. In 1998, he prepared and conducted a seminar on basic rate regulation on behalf of the New England Chapter of the National Association of Water Companies. In 2000 and 2001, Mr. Guastella developed and conducted a special seminar for developer related water and wastewater utilities in conjunction with Florida State University, and again in 2003 in conjunction with the University of Florida. It provided essential training for the financial structuring of small water and wastewater utilities, rate setting, financing and the establishment of their market value in the event of a negotiated sale or condemnation. In 2004, he prepared and conducted a special workshop seminar on behalf of the Office of Regulatory Staff of South Carolina, covering rate setting, valuation and general regulation of water and wastewater utilities. In 2006, he participated in an expert workshop on full cost pricing conducted by the U. S. Environmental Protection Agency in coordination with the Institute of Public Utilities, Michigan State University. In 2006 and again in 2013, he prepared and conducted a special seminar on rate setting and valuation on behalf of the New York Chapter of the NAWC. In 2007 and again in 2015, he prepared and conducted a special seminar on rate setting and valuation on behalf of the New England Chapter of NAWC.

Mr. Guastella has made presentations on a wide variety of rate, valuation and regulatory issues at meetings of the National Association of Regulatory Utility Commissioners, the American Water Works Association, the New England Water Works Association, the National Association of Water Companies, the New England Conference of Public Utilities Commissioners, the Florida, New England, New Jersey and New York Chapters of NAWC, the Mid-America Regulatory Conference, the Southeastern Association of Regulatory Utility Commissioners, the Pennsylvania Environmental Conference, the Public Utility Law Section of the New Jersey Bar Association, and the NAWC Water Utility Executive Council.

Resume: JFG

John F. Guastella
List of Proceedings in which
Expert Testimony
was Presented

Year	Client	State	Regulatory Docket/Case Number
1966	Sunhill Water Corporation	New York	23968
1967	Amagansett Water Company	New York	24210
1967	Worley Homes, Inc.	New York	24466
1968	Amagansett Water Company	New York	24718
1968	Amagansett Water Company	New York	24883
1968	Sunhill Water Corporation	New York	23968
1968	Worley Homes, Inc.	New York	Supreme Court
1969	Amagansett Water Supply	New York	24883
1969	Citizens Water Supply Co.	New York	25049
1969	Worley Homes, Inc.	New York	24466/24992
1970	Brooklyn Union Gas Company	New York	25448
1970	Consolidated Edison of New York	New York	25185
1971	Hudson Valley Water Companies	New York	26093
1971	Jamaica Water Supply Company	New York	26094
1971	Port Chester Water Works, Inc.	New York	25797
1971	U & I Corp. - Merrick District	New York	26143
1971	Wanakah Water Company	New York	25873
1972	Spring Valley Water Company	New York	26226
1972	U & I Corp. - Woodhaven District	New York	26232
1973	Citizens Water Supply Company	New York	26366
1978	Rhode Island DPU&C (Bristol County)	Rhode Island	1367A
1979	Candlewick Lake Utilities Co.	Illinois	76-0218
1979	Candlewick Lake Utilities Co.	Illinois	76-0347
1979	Candlewick Lake Utilities Co.	Illinois	78-0151
1979	Jacksonville Suburban Utilities	Florida	770316-WS
1979	New York Water Service Corporation	New York	27594
1979	Salem Hills Sewerage Disposal Corp. v. V. of Voorheesville	New York	Supreme Court

GUASTELLA DIRECT EXHIBIT A

John F. Guastella
List of Proceedings in which
Expert Testimony
was Presented

Year	Client	State	Regulatory Docket/Case Number
1979	Seabrook Water Corporation	New Jersey	7910-846
1979	Southern Utilities Corporation	Florida	770317-WS
1979	Township of South Brunswick	New Jersey	Municipal
1979	Westchester Joint Water Works	New York	Municipal
1979	Woodhaven Utilities Corporation	Illinois	77-0109
1980	Crestwood Village Sewer Company	New Jersey	BPU 802-78
1980	Crestwood Village Water Company	New Jersey	BPU 802-77
1980	Gateway Water Supply Corporation	Texas	Municipal
1980	GWW-Central Florida District	Florida	800004-WS
1980	Jamaica Water Supply Company	New York	27587
1980	Rhode Island DPU&C (Newport Water)	Rhode Island	1480
1981	Briarcliff Utilities, Inc.	Texas	3620
1981	Candlewick Lake Utilities Co.	Illinois	81-0011
1981	Caroline Water Company, Inc.	Virginia	810065
1981	GDU, Inc. - Northport	Florida	Municipal
1981	GDU, Inc. - Port Charlotte	Florida	Municipal
1981	GDU, Inc. - Port Malabar	Florida	80-2192
1981	Hobe Sound Water Company	Florida	8000776
1981	Lake Buckhorn Utilities, Inc.	Ohio	80-999
1981	Lake Kiowa Utilities, Inc.	Texas	3621
1981	Lakengren Utilities, Inc.	Ohio	80-1001
1981	Lorelei Utilities, Inc.	Ohio	80-1000
1981	New York Water Service Corporation	New York	28042
1981	Rhode Island DPU&C (Newport Water)	Rhode Island	1581
1981	Shawnee Hills Utility Company	Ohio	80-1002
1981	Smithville Water Company, Inc.	New Jersey	808-541
1981	Spring Valley Water Company, Inc.	New York	27936
1981	Spring Valley Water Company, Inc.	New York	27936
1981	Sunhill Water Corporation	New York	27903

John F. Guastella
List of Proceedings in which
Expert Testimony
was Presented

Year	Client	State	Regulatory Docket/Case Number
1981	Swan Lake Water Corporation	New York	27904
1982	Chesterfield Commons Sewer Company	New Jersey	822-84
1982	Chesterfield Commons Water Company	New Jersey	822-83
1982	Crescent Waste Treatment Corp.	New York	Municipal
1982	Crestwood Village Sewer Company	New Jersey	821-33
1982	Crestwood Village Water Company	New Jersey	821-38
1982	Salem Hills Sewerage Disposal Corp.	New York	Municipal
1982	Township of South Brunswick	New Jersey	Municipal
1982	Woodhaven Utilities Corporation	Illinois	82-0167
1983	Country Knolls Water Works, Inc.	New York	28194
1983	Heritage Hills Water Works Corp.	New York	28453
1984	Crestwood Village Sewer Company	New Jersey	8310-861
1984	Crestwood Village Water Company	New Jersey	8310-860
1984	Environmental Disposal Corp.	New Jersey	816-552
1984	GDU, Inc. - Port St. Lucie	Florida	830421
1984	Heritage Village Water (water/sewer)	Connecticut	84-08-03
1984	Hurley Water Company, Inc.	New York	28820
1984	New York Water Service Corporation	New York	28901
1985	Deltona Utilities (water/sewer)	Florida	830281
1985	J. Filiberto Sanitation, Inc.	New Jersey	8411-1213
1985	Sterling Forest Pollution Control	New York	Municipal
1985	Water Works Enterprise, Grand Forks	North Dakota	Municipal
1986	GDU, Inc. - Port Charlotte	Florida	Municipal
1986	GDU, Inc. - Sebastian Highlands	Florida	Municipal
1986	Kings Grant Water/Sewer Companies (settled)	New Jersey	WR8508-868
1986	Mt. Ebo Sewage Works, Inc.	New York	Municipal
1986	Sterling Forest Pollution Control	New York	Municipal
1987	Country Knolls Water Works, Inc.	New York	29443
1987	Crestwood Village Sewer Co. (settled)	New Jersey	WR8701-38

**John F. Guastella
List of Proceedings in which
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was Presented**

Year	Client	State	Regulatory Docket/Case Number
1987	Deltona Utilities – Marco Island	Florida	85151-WS
1987	Deltona Utilities, Inc. - Citrus Springs (settled)	Florida	870092-WS
1987	First Brewster Water Corp. v. Town of Southeast (settled)	New York	Supreme Court
1987	GDU, Inc. - Silver Springs Shores	Florida	870239-WS
1987	Ocean County Landfill Corporation	New Jersey	SR-8703117
1987	Palm Coast Utility Corporation	Florida	870166-WS
1987	Sanlando Utilities Corp. (settled)	Florida	860683-WS
1987	Township of South Brunswick	New Jersey	Municipal
1987	Woodhaven Utilities Corp. (settled)	Illinois	87-0047
1988	Crescent Estates Water Co., Inc.	New York	88-W-035
1988	Elizabethtown Water Co.	New Jersey	OAL PUC3464-88
1988	Heritage Village Water Company	Connecticut	87-10-02
1988	Instant Disposal Service, Inc.	New Jersey	SR-87080864
1988	J. Filiberto Sanitation v. Morris County Transfer Station	New Jersey	01487-88
1988	Ohio Water Service Co.	Ohio	86-1887-WW-CO1
1988	St. Augustine Shores Utilities	Florida	870980-WS
1989	Elizabethtown Water Co.	New Jersey	BPU WR89020132J
1989	GDU (FPSC generic proceeding as to rate setting procedures)	Florida	880883-WS
1989	Gordon's Corner Water Co.	New Jersey	OAL PUC479-89
1989	Heritage Hills Sewage Works	Connecticut	Municipal
1989	Heritage Village Water Company	Connecticut	87-10-02
1989	Palm Coast Utility Corporation	Florida	890277-WS
1989	Southbridge Water Supply Co.	Massachusetts	DPU 89-25
1989	Sterling Forest Water Co.	New York	PSC 88-W-263
1990	American Utilities, Inc. - United States Bankruptcy Court	New Jersey	85-00316
1990	City of Carson City	Nevada	Municipal
1990	Country Knolls Water Works, Inc.	New York	90-W-0458
1990	Elizabethtown Water Company	New Jersey	WR900050497J

John F. Guastella
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Year	Client	State	Regulatory Docket/Case Number
1990	Kent County Water Authority	Rhode Island	1952
1990	Palm Coast Utility Corporation	Florida	871395-WS
1990	Southern States Utilities, Inc.	Florida	Workshop
1990	Trenton Water Works	New Jersey	WR90020077J
1990	Waste Management of New Jersey	New Jersey	SE 87070552
1990	Waste Management of New Jersey	New Jersey	SE 87070566
1991	City of Grand Forks	North Dakota	Municipal
1991	Gordon's Corner Water Co.	New Jersey	OAL PUC8329-90
1991	Southern States Utilities, Inc.	Florida	900329-WS
1992	Elizabethtown Water Co.	New Jersey	WR 91081293J
1992	General Development Utilities, Inc. - Port Malabar Division	Florida	911030-WS
1992	General Development Utilities, Inc. - West Coast Division	Florida	911067-WS
1992	Heritage Hills Water Works, Inc.	New York	92-2-0576
1993	General Development Utilities, Inc. - Port LaBelle Division	Florida	911737-WS
1993	General Development Utilities, Inc. - Silver Springs Shores	Florida	911733-WS
1993	General Waterworks of Pennsylvania - Dauphin Cons. Water Supply	Pennsylvania	R-00932604
1993	Kent County Water Authority	Rhode Island	2098
1993	Southern States Utilities - FPSC Rulemaking	Florida	911082-WS
1993	Southern States Utilities - Marco Island	Florida	920655-WS
1994	Capital City Water Company	Missouri	WR-94-297
1994	Capital City Water Company	Missouri	WR-94-297
1994	Elizabethtown Water Company	New Jersey	WR94080346
1994	Elizabethtown Water Company	New Jersey	WR94080346
1994	Environmental Disposal Corp.	New Jersey	WR94070319
1994	General Development Utilities - Port Charlotte	Florida	940000-WS
1994	General Waterworks of Pennsylvania	Pennsylvania	R-00943152

GUASTELLA DIRECT EXHIBIT A

**John F. Guastella
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was Presented**

Year	Client	State	Regulatory Docket/Case Number
1994	Hoosier Water Company - Mooresville Division	Indiana	39839
1994	Hoosier Water Company - Warsaw Division	Indiana	39838
1994	Hoosier Water Company - Winchester Division	Indiana	39840
1994	West Lafayette Water Company	Indiana	39841
1994	Wilmington Suburban Water Corporation	Delaware	94-149 (stld)
1995	Butte Water Company	Montana	Cause 90-C-90
1995	Heritage Hills Sewage Works Corporation	New York	Municipal
1996	Consumers Illinois Water Company	Illinois	95-0342
1996	Elizabethtown Water Company	New Jersey	WR95110557
1996	Palm Coast Utility Corporation	Florida	951056-WS
1996	PenPac, Inc.	New Jersey	OAL-00788-93N
1996	Southern States Utilities, Marco Island	Florida	950495-WS
1997	Crestwood Village Water Company	New Jersey	BPU 96100739
1997	Indiana American Water Co., Inc.	Indiana	IURC 40703
1997	Missouri-American Water Company	Missouri	WR-97-237
1997	South County Water Corp	New York	97-W-0667
1997	United Water Florida	Florida	960451-WS
1998	Consumer Illinois Water Company	Illinois	98-0632
1998	Consumers Illinois Water Company	Illinois	97-0351
1998	Heritage Hills Water Company	New York	97-W-1561
1998	Missouri-American Wastewater Company	Missouri	SR-97-238
1999	Consumers Illinois Water Company	Illinois	99-0288
1999	Environmental Disposal Corp.	New Jersey	WR99040249
1999	Indiana American Water Co., Inc.	Indiana	IURC 41320
2000	South Haven Sewer Works, Inc.	Indiana	Cause: 41410
2000	Utilities Inc. of Maryland	Maryland	CAL 97-17811
2001	Artesian Water Company	Delaware	00-649
2001	Citizens Utilities Company	Illinois	01-0001
2001	Elizabethtown Water Company	New Jersey	WR-0104205

**John F. Guastella
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Year	Client	State	Regulatory Docket/Case Number
2001	Kiawah Island Utility, Inc.	South Carolina	2001-164-W/S
2001	Placid Lakes Water Company	Florida	011621-WU
2001	South Haven Sewer Works, Inc.	Indiana	41903
2001	Southlake Utilities, Inc.	Florida	981609-WS
2002	Artesian Water Company	Delaware	02-109
2002	Consumers Illinois Water- Grant Park	Illinois	02-0480
2002	Consumers Illinois Water- Village Woods	Illinois	02-0539
2002	Valencia Water Company	California	02-05-013
2003	Consumers Illinois Water - Indianola	Illinois	03-0069
2003	Elizabethtown Water Company	New Jersey	WR-030-70510
2003	Golden Heart Utilities, Inc.	Alaska	U-02-13, 14 & 15
2003	Utilities, Inc. – Georgia	Georgia	CV02-0495-AB
2004	Aquarion Water Company	Connecticut	04-02-14
2004	Artesian Water Company	Delaware	04-42
2004	El Dorado Utilities, Inc.	New Mexico	D-101-CU-2004-
2004	Environmental Disposal Corp.	New Jersey	DPU WR 03 070509
2004	Heritage Hills Water Company	New York	03-W-1182
2004	Sun Valley Water & Washoe County Dept. of Water Revenues	Nevada	TMWA Municipal
2004	Jersey City MUA	New Jersey	Municipal
2004	Rockland Electric Company	New Jersey	EF02110852
2005	Aquarion Water Company	New Hampshire	DW 05-119
2005	Intercoastal Utilities, Inc.	Florida	04-0007-0011-0001
2005	Haig Point Utility Company, Inc.	South Carolina	2005-34-W/S
2005	South Central Connecticut Regional Water Auth.	Connecticut	Municipal
2006	Pennichuck Water Works, Inc.	New Hampshire	DW-04048
2006	Village of Williston Park	New York	Municipal
2006	Jersey City MUA	New Jersey	Municipal
2006	Groton Utilities	Connecticut	Municipal

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Year	Client	State	Regulatory Docket/Case Number
2006	Connecticut Water Company	Connecticut	06-07-08
2006	Birmingham Utilities, Inc.	Connecticut	06-05-10
2006	Aqua Florida Utilities, Inc.	Florida	060368-WS
2007	Aquarion Water Company of CT	Connecticut	07-05-19
2007	Pennichuck Water Works, Inc.	New Hampshire	DW 04-048
2007	Aqua Indiana - Utility Center	Indiana	43331
2007	Environmental Disposal Corp.	New Jersey	WR 04 080760
2007	Aqua Florida Utilities, Inc.	Florida	07-0183
2007	Aqua Illinois, Inc. - Hawthorn Woods, Willowbrook & Vermilion	Illinois	07-0620/07-0621/08-0067
2008	Aqua Florida Utilities, Inc.	Florida	080121-WS
2008	Aquarion Water Company of MA	Massachusetts	D.P.U. 08-27
2008	Haig Point Utility Company, Inc.	South Carolina	2007-414-WS
2009	R.M.V. Land & C.M. Livestock, L.C.C.	New Jersey	EM02050313
2010	City of Griffin	Georgia	Civil Action No. 09V-2866
2010	Connecticut Water Company	Connecticut	09-12-11
2010	Montville WPCA	Connecticut	1400012464
2010	Milford Water Company	Massachusetts	DPU 10-78
2010	Arizona American Water Company	Arizona	W-01303A-10-0448
2011	Aqua Illinois	Illinois	ICC Docket (Consolidated)
2011	Artesian Water Company	Maryland	MPSC Case 9252
2011	Artesian Water Company	Delaware	PSC 11-207
2011	Kiawah Island Utility, Inc.	South Carolina	2011-317-WS
2012	Washington Gas Light	Maryland	Senate SB541
2012	Washington Gas Light	Maryland	House HB662
2012	Daufuskie Island Utility	South Carolina	2011-229-W/S
2012	Milford Water Company	Massachusetts	DPU 12-86
2013	Artesian Water Company	Pennsylvania	2:10-CV-07453-JP
2013	Aquarion Water Company - Oxford	Massachusetts	CA 09-00592E

John F. Guastella
List of Proceedings in which
Expert Testimony
was Presented

Year	Client	State	Regulatory Docket/Case Number
2013	Water Management Services	Florida	110200-WU
2013	City of Fernandina Beach	Florida	Civil Action No. 13CA000485AXYX
2013	City of Elizabeth	New Jersey	Docket Nos. UNN-L-0556-10 and UNN-L-2608-11
2014	Daufuskie Island Utility Company, Inc.	South Carolina	Case No. 2013-CP-7-02255
2014	Artesian Water Company	Delaware	Docket No. PSC 14-132
2014	Aquarion Water Company - Hingham	New Hampshire	SUCU 2013-03159-BLS2
2015	EPCOR	Arizona	ACC Docket # WS-01303A-14-0010
2015	Mountain Water Company	Montana	Case # DV-14-352

Papers and Presentations
By
John F. Guastella

Year	Title	Forum
1974 through 2015	1. Basics of Rate Setting 2. Cost Allocation and Rate Design 3. Revenue Requirements	Semi-annual seminars on utility rate regulation, National Association of Regulatory Utility Commissioners, sponsored by the University of South Florida, the University of Utah, Florida State University, The University of Florida and currently Michigan State University
1974	Rate Design Studies: A Regulatory Point-of- View	Annual convention of the National Association of Water Companies, New Haven, Connecticut
1976	Lifeline Rates	Annual convention of the National Association of Water Companies, Chattanooga, Tennessee
1977	Regulating Water Utilities: The Customers' Best Interest	Annual symposium of the New England Conference of Public Utilities Commissioners, Mystic Seaport, Connecticut
1978	Rate Design: Preaching v. Practice	Annual convention of the National Association of Water Companies, Baton Rouge, Louisiana
1979	Small Water Companies	Annual symposium of the New England Conference of Public Utilities Commissioners, Newport, Rhode Island
1979	Rate Making Problems Peculiar to Private Water and Sewer Companies	Special educational program sponsored by Independent Water and Sewer Companies of Texas, Austin, Texas
1980	Water Utility Regulation	Annual meeting of the National Association of Regulatory Utility Commissioners, Houston, Texas
1981	The Impact of Water Rates on Water Usage	Annual Pennsylvania Environmental Conference, Harrisburg, Pennsylvania
1981	A Realistic Approach to Regulating Water Utilities	Mid-America Regulatory Conference, Clarksville, Indiana
1982	Issues in Water Utility Regulation	Annual symposium of the New England Conference of Public Utilities Commissioners, Rockport, Maine
1982	New Approaches to the Regulation of Water Utilities	Southeastern Association of Regulatory Utility Commissioners, Asheville, North Carolina
1983	Allocating Costs and Revenues Fairly and Effectively	Maryland Water and Sewer Finance Conference, Westminster, Maryland
1983	Lifeline and Social Policy Pricing	Annual conference of the American Water Works Association, Las Vegas, Nevada (published)
1984	The Real Cost of Service: Some Special Considerations	Annual New Jersey Section AWWA Spring Meeting, Atlantic City, New Jersey
1987	Margin Reserve: It's Not the Issue	Florida Waterworks Association Newsletter, April/May/June 1987 issue

Papers and Presentations - JFG

Papers and Presentations

By

John F. Guastella

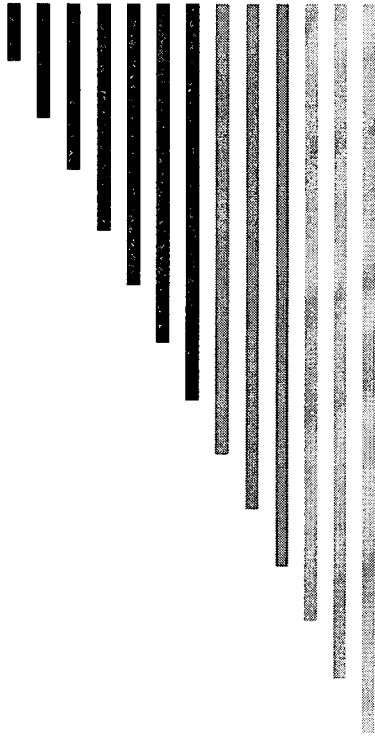
Year	Title	Forum
1987	A "Current" Issue: CIAC	NAWC - New England Chapter November 6, 1987 meeting
1988	Small Water Company rate Setting: Take It or Leave It	NAWC - New York Chapter June 14, 1988 meeting Leave It
1989	The Solution to all the Problems of Good Small Water Companies	NAWC Quarterly magazine, Winter issue
1989	Current Issues Workshop - Panel	New England Conference of Public Utilities Commissioners, Kennebunkport, Maine
1991	Alternative Rate Structures	New Jersey Section 1991 Annual Conference, AWWA, Atlantic City, New Jersey
1994	Conservation Impact on Water Rates	New England NAWC and New England AWWA, Sturbridge, Massachusetts
1996	Utility Regulation - 21st Century	NAWC Annual Meeting, Orlando, Florida
1997	Current Status Drinking Water State Revolving	NAWC Annual Meeting, San Diego, California
1998	Fund Small Water Companies - Problems and	NAWC Annual Meeting, Indianapolis, Indiana
1998	Solutions Basic Rate Regulation Seminar	New England Chapter - NAWC, Rockport, Maine
2000	Developer Related Water and Sewer Utilities	Florida State University, Orlando, Florida
2001	Seminar Developer Related Water and Sewer Utilities	Florida State University, Orlando, Florida
2002	Seminar Regulatory Cooperation - Small Company	New England Chapter - NAWC, Annual Meeting
2003	Education Developer Related Water and Sewer Utilities	University of Florida, Orlando, Florida
2004	Seminar Basic Regulation & Rate Setting Training	Office of Regulatory Staff, Columbia, South Carolina
2005	Seminar Municipal Water Rates	Nassau-Suffolk Water Commissioners Association, Franklin Square, New York
2005	Innovations in Rate Setting and Procedures	NAWC New York Chapter, West Point, New York

Papers and Presentations - JFG

**Papers and Presentations
By
John F. Guastella**

Year	Title	Forum
2006	Basics of Rate Setting	The Connecticut Water Company, Clinton, Connecticut
2006	Innovations in Rate Setting and Procedures	NAWC New York Chapter, Catskill, New York
2006	Best Practices as Regulatory Policy	NAWC New England Chapter, Ogunquit, Maine
2006	Rate and Valuation Seminar	NAWC New York Chapter
2006	Full Cost Pricing	U.S. Environmental Protection Agency Expert Workshop, Lansing, Michigan
2006	Innovations in Rate Setting	NAWC New England Chapter, Portsmouth, New Hampshire
2007	Weather Sensitive Customer Demands	NAWC Water Utility Executive Council, Half Moon Bay, California
2007	Basics of Rate Setting and Valuation Seminar	NAWC New England Chapter, Ogunquit, Maine
2007	Small Company Characteristics	National Drinking Water Symposium, La Jolla, California
2013	Rate and Valuation Seminar	NAWC New York Chapter
2015	Rate and Valuation Seminar	NAWC New England Chapter

Guastella Associates, LLC



**THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2011-229-WS
ORDER NO. 2012-515
DAUFUSKIE ISLAND UTILITY COMPANY, INC.**

Report on Capital Improvements

May 2015

May 18, 2015

The Honorable Jocelyn D. Boyd
Chief Clerk/Administrator
South Carolina Public Service Commission
101 Executive Center Drive
Columbia, South Carolina 29210

Re: Daufuskie Island Utility Company, Inc. ("DIUC" or "Company")
Docket No. 2011-229-WS, Order No. 2012-515
Report on Capital Improvements

Dear Ms. Boyd:

The above referenced decision dated July 10, 2012 in DIUC's last rate case anticipated that the Company would obtain a \$3.0 million loan, and required DIUC to establish a Capital Reserve in the amount of \$700,000 for capital repairs and improvements, and to submit a report on the use of the funds to the Public Service Commission ("PSC" or "Commission"), the Office of Regulatory Staff ("ORS") and the Property Owner's Associations ("POA") that intervened in the rate case. Accordingly, this is a detailed report on behalf of DIUC as to the use of the funds in the Capital Reserve account. It includes descriptions of the major improvements, their costs by account and photographs, some before and after construction. We also refer to DIUC's new web site that shows additional photographs and a video of a part of the major construction project.

Because this report is being distributed to the PSC, ORS, POA and, voluntarily, to the Department of Health and Environmental Control ("DHEC"), Beaufort County, SunTrust Bank and the individuals with whom we interact in the course of day-to-day business, it provides a unique opportunity to include information about the history of the Company, and the unusual challenges of operating a small water and wastewater utility with a goal of providing safe and adequate service to its customers. In the course of preparing this report, I realized that it will essentially serve as a case study of the problems faced by small water and wastewater utilities. In my professional career I have been responsible for the regulation of over 400 small water utilities, and I have provided consulting services for some 600 small water and wastewater utilities. The following is a list of only major challenges, some are typical and some unique to DIUC, but in my experience I have certainly never seen any utility with all of them:

- Inadequate records upon acquisition from International Paper and virtually no records when acquiring Melrose Utility Company ("MUC").
- MUC's failure to pay its 40% share of the operating costs of the jointly-owned Haig Point Wastewater Treatment Plant ("HPWWTP"), resulting in DIUC's loss of 25% of its annual revenue.
- MUC bankruptcy and abandonment of its water and wastewater systems, requiring its operation by DIUC voluntarily and without compensation.
- Inability to obtain any short or long term financing without a rate increase.
- Undertake a rate increase application without cash flow available to pay attorneys and consultants on a current basis.
- The need to make debt service payments on the loan by Coastal States Bank to CK Materials, which financed, in part, the acquisition of the utility from International Paper, for which DIUC's stock was pledged as collateral.
- Rejection of applications for financing by three banks, despite having obtained a rate increase in 2012.
- Failure of the lagoon liner at the HPWWTP, before financing was available to replace it.
- An unknown tax sale of the land at the site of the elevated storage tank because tax bills were sent to the wrong address and notice of sale posted at the wrong site.
- The need to condemn the storage tank site because the new owner would not accept a market value estimate.
- The receipt in August, 2012, (after the rate increase) of property tax bills for 2010, 2011, and 2012 with a combined total of about \$535,000 that had never previously been billed. The new annual property tax amount is nearly 20% of annual revenues -- DIUC's annual revenues are about \$1.1 million.

The detailed discussion of the above will be informative -- and I hope even interesting!

Original copies of this report are being distributed to each individual on the following service list for convenience and to assure the clarity of the photographs. Also enclosed is a bill insert that was sent to our customers with our recent billing, inviting them to visit our new website and to take advantage of the online bill pay feature.

I am available to answer any questions regarding this report and the Company's finances and operations.

Respectfully submitted,
Guastella Associates, LLC,
Manager of
Daufuskie Island Utility Company, Inc.

A handwritten signature in black ink, appearing to read "John F. Guastella". The signature is fluid and cursive, with the first name "John" and last name "Guastella" clearly distinguishable.

John F. Guastella, President

Service List

Public Service Commission:

101 Executive Center Drive
Columbia, South Carolina 29210

The Honorable Nikiya Hall, Chairman
The Honorable Swain E. Whitfield, Vice Chairman
The Honorable John E. Howard, Commissioner
The Honorable Elliott F. Elam, Commissioner
The Honorable Comer H. Randall, Commissioner
The Honorable Elizabeth B. Fleming, Commissioner
The Honorable G. O'Neal Hamilton, Commissioner

Office of Regulatory Staff:

1401 Main Street, Suite 900 Columbia, South Carolina 29201

C. Dukes Scott, Executive Director
Nanette S. Edwards, Deputy Executive Director
Dawn M. Hipp, Director, Water/Wastewater
Jay Jashinsky, Director, Auditing Office
Sharon G. Scott, Deputy Director, Auditing
Willie Morgan, Manager, Water/Wastewater
Shannon B. Hudson, Deputy Director, Legal Services Office
Hannah Majewski, Program Specialist, Water/Wastewater
Chad Cambell, Investigator

Property Owner's Associations:

John J. Beach, Esq. (4 copies, 3 for distribution to POAs)
Ellis, Lawhorne & Sims, P.A.
1501 Main Street, 5th Floor
P.O. Box 2285
Columbia, South Carolina 29202

Attorney for:

Haig Point Club and Community Association, Inc.
Melrose Property Owner's Association, Inc.
Bloody Point Property Owner's Association

Department of Health and Environmental Control:

2600 Bull Street
Columbia, South Carolina 29201

Douglas B. Kinard, Director, Drinking Water Protection Division
Jeffrey P. DeBessonnet, Director, Water Facilities Permitting Division
M. Scott Hagins, Water Pollution Compliance & Enforcement Section
Karen L. Ramos, Manager, Drinking Water Enforcement Section
H. Michael Longshore, Enforcement Officer, Bureau of Water
Penny A. Cornett, Program Manager for the Region 8 EQC Bureau of
Environmental Services Office

Beaufort County:

Maria Walls, Deputy Treasurer and Treasurer Elect
P.O. BOX 487
Beaufort, SC 29901

Outside Counsel:

G. Trenholm Walker, Esq.
Thomas P. Gressette, Jr., Esq.
Pratt-Thomas Walker, P.A.
16 Charles Street
P.O. Drawer 22247
Charleston, South Carolina 29413

SunTrust Bank:

Carol Coppola, First Vice President - Commercial Banking
33 Bull Street
Savannah, Georgia 31410

Select Customers:

Mr. Brian McCarthy
Mr. Peter Lang

Daufuskie Island Utility Company, Inc.

Owners:

Terry R. Lee, President
David Hutt, Esq.
Ronald Shimanowitz, Esq.

Operators:

Eric Johanson, Chief Operator
William Donaldson, Deputy Chief Operator
Tim Salem, Operator
Kevin Fitzpatrick, Operator
Tim Luther, Operator

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Appendix
Photographs

CAPITAL IMPROVEMENTS

In addition to the following brief descriptions of the capital repairs and improvements, an appendix is provided containing photographs (some before and after) of the major and readily visible improvements. We have also created a DIUC website that includes a “Capital Improvement Photo Log” and a short video showing the installation of a portion of the lagoon liner replacement.

- The lagoon liner at the Haig Point Wastewater Treatment Plant has been replaced, involving the safe and humane removal of alligators; replacement of sludge with clean earth fill; repair and replacement of aerator motors; renewal and replacement of the effluent pump station; relocation of the flow meter with new effluent pump; a new headwork’s wash down system; and related electrical equipment.
- The excavated earth and sludge under the failed the lagoon liner will be disposed of by constructing a new helipad at the Fire Station in order to save DIUC the cost of removal off-island. The helipad will be constructed in three stages over several months, with each layer of earth/sludge fill to be treated using a method that complies with DHEC’s requirements¹. The use of this fill for the helipad will also result in a savings to the Fire Department in the construction of a helicopter landing pad for emergency medical and other airlift services to Island residents.
- A new power transfer switch has been installed at the Bloody Point Wastewater Treatment Plant.
- Various improvements have been made to 15 lift stations, including the installation of new backup pumps and major restoration of two lift stations.
- A high resolution camera was purchased to be able to the efficiently diagnose the need for repairs and maintenance of the collection system.

¹ The site of the helipad is leased to the Fire Department by its owner (and customer of DIUC), Mr. Peter Lang, who provided written permission for the construction, as required by the DHEC.

- A “trash” pump has been obtained to bypass lift stations during maintenance.
- New chlorine gas detectors have been installed at well sites.
- New flow meters have been installed at well sites.
- Tanks at all well sites have been painted.
- A metal detector and roller skid was purchased for the purpose of locating and transporting pipe for main replacements and installations.
- New meters and meter boxes have been purchased and installed.
- New server software and programming for customer database has been purchased.
- A new website www.daufuskieislandutility.com has been programmed, coded and launched.
- A new prefabricated structure for office space and storage has been purchased and installed.
- New signage has been purchased and installed at treatment plants and well sites.
- Land acquisition through condemnation is proceeding.
- Two used utility trucks have been purchased; one replaced an unusable 1994 model and the other replaced an unreliable 10 year old truck which will be kept as a backup.

There is much more of a story than simply listing the above improvements. Both HPUC and MUC were created in the mid-1980s because they were essential for their new real estate projects. As is typical of developers of new real estate projects, little or no consideration was given to the replacement of brand new utility facilities with relatively long service lives, and which were adequately serving the customers during the growth years. When DIUC was acquired from International Paper (“IP”) in 2008, after 23 years since its creation, improvements were needed and that need has increased each year. The failure of the lagoon liner at the HPWWTP created a serious crisis. The transition from IP required development of adequate records in order to identify specific needs and overcome a serious cash flow shortfall, all of which were exacerbated by MUC’s bankruptcy and DIUC’s inability to obtain financing, even long after the rate increase in 2012. When

the lagoon liner failed in March of 2012, there was no cash available for its repair and replacement – no cash to pay our rate attorneys or rate consultant, or make Coastal States loan payments – everyone had to wait for the rate increase and then the financing. We didn't know at the time that financing would not happen until late 2013. Terry R. Lee, DIUC's president and one of its owners, literally came to the rescue. His construction company installed a temporary modification of the plant, as designed by Thomas & Hutton Engineering Co., until a permanent replacement of the lagoon liner could be made, undertaking the work without payment.

The need for improvements did not go unnoticed by the DHEC. On May 15, 2013 DHEC Staff issued a notice of violations related to test results at the HPWWTP and failure to submit discharge monitoring reports, to which we responded by providing the missing reports. On June 28, 2013, DHEC Staff conducted a Compliance Evaluation Inspection of the HPWWTP, identifying a number of deficiencies regarding the maintenance of records, reports, operator's logbook and operations manual; the need for a flow meter to record flows to the golf course, spare parts and the a number of operation and maintenance repairs and improvements at the wastewater treatment plants and lift stations. In response to DHEC, we acknowledged the deficiencies and submitted corrective action plans, also providing DHEC information about the lagoon liner failure and plans to obtain financing. In the summer of 2014, about 8 months after obtaining financing, Mike Guastella, Vice President of Operations of Guastella Associates, LLC ("GA"), met with DHEC to review the improvements that were completed and to assure DHEC of our commitment to address all remaining issues. On March 4, 2015, we entered into a Consent Order with DHEC to submit a Corrective Action Plan to comply with all of its directives, and avoid penalties. On May 1, 2015 we emailed our proposed Corrective Action Plan to DHEC, which it approved on the same day. We must note our appreciation of the expertise of the DHEC Staff in identifying improvements to both DIUC's facilities and day-to-day operations, which not only established regulatory compliance but has been

instrumental in helping us to provide the best possible service to our customers.

The following table provides the cost of capital expenditures by plant account.

Capital Expenditures by Account		
Account Number	Account Description	TOTAL
<u>WASTEWATER SYSTEM PLANT PROJECTS</u>		
354.4	Structures & Improvements-T&D	\$ 490,115.19
355.4	Power Generation Equipment	\$ 7,940.46
367.6	Reuse Meters	\$ 1,955.63
371.2	Pumping Equipment	\$ 3,855.49
371.6	Reclaimed Water Pumping Equipment	\$ 92,548.75
380.4	T & D Equipment	\$ 4,410.68
380.4A	T & D Equipment	\$ 31,208.36
380.5	Reclaimed Water T & D Equipment	\$ 6,138.94
390.7	Office Equipment - software	\$ 5,971.74
393.7	Tools, Shop & Garage Equipment	\$ 5,021.32
398.7	Other Intangible Plant	\$ 607.32
391.7	Transportation Equipment	\$ 3,000.00
	Total	\$ 649,773.88
<u>WATER SYSTEM PLANT PROJECTS</u>		
303.2	Land & Land Rights-source	\$ 14,243.80
311.2	Pumping Equipment	\$ 14,106.63
330.4A	Extraordinary Expense	\$ 37,945.74
334.4	Meters	\$ 18,109.70
339.2	Misc. Equipment-source	\$ 9,103.70
340.5	Office Equipment - software	\$ 5,971.74
343.5	Tools, Shop & Garage Equipment	\$ 1,205.24
181	Unamortized Debt Expense	\$ 5,197.90
341.5	Transportation Equipment	\$ 3,000.00
	Total	\$ 105,884.45
	TOTAL - CAPITAL EXPENDITURES	\$ 755,658.33

HISTORICAL BACKGROUND

In 1985, International Paper Realty Corporation of South Carolina ("IP") and The Melrose Group Limited Partnership ("Melrose"), owned or had control over approximately 1,800 acres of land on Daufuskie Island, Beaufort County, South Carolina. While each developer was establishing separate water and wastewater utility systems in contemplation of developing their respective properties, they recognized the benefit of constructing a consolidated wastewater treatment plant and the desire of the DHEC to centralize treatment facilities where feasible. Accordingly, in addition to IP establishing the Haig Point Utility Company, Inc. ("HPUC") and Melrose establishing the Melrose Utility Company ("MUC"), they also entered into a joint venture establishing the Haig Point/Melrose Wastewater Treatment Company, Inc. ("HPMWWTC"). The HPMWWTC constructed a wastewater treatment facility on a 5.85 acre site with a capacity of 640,000 gallon per day, for which it was agreed that the construction and operating costs would be shared 60% by HPUC and 40% by MUC.

In 1994, the Bloody Point Group Limited Partnership ("BP"), the developer of certain property in an area known as Bloody Point on Daufuskie Island provided certain easements and rights to MUC for its agreement to provide water and sewer service to Bloody Point.

In 2005, Haig Point, Inc. ("Haig Point"), formerly International Paper Realty Corporation of South Carolina, assigned all easement rights to construct, operate, maintain and replace the water and wastewater utility systems throughout the Haig Point development area, as contained in the Haig Point General Covenants and the Haig Point Community Association, Inc. Declaration of Covenants and Restrictions, to HPUC, its heirs and successors. Accordingly, as successor to HPUC, DIUC now has all easement rights to construct, operate, maintain and replace water and wastewater utility facilities on any common area and privately owned land that does not have an existing structure.

In 2008, the Commission approved the sale of HPUC's stock, assets and operating authority from Haig Point to CK Materials, LLC ("CKM"). HPUC and CKM entered into an agreement with GA to manage HPUC upon its acquisition. At the POA's request, one of the conditions of the acquisition was to change the name of the utility from the Haig Point Utility Company, Inc. to Daufuskie Island Utility Company, Inc. Soon after the acquisition by CKM, GA found that MUC was delinquent in paying its 40% share of the cost of the HPWWTP, and it remained delinquent despite many attempts to obtain payment. The resultant loss of about 25% of DIUC's annual revenue, in addition to the need for a general rate increase, created a severe cash flow problem that hampered operations. In 2009, in response to DIUC's request, the PSC opened an investigation of the MUC delinquency matter. Before the proceeding was adjudicated, however, MUC filed for bankruptcy -- and also essentially abandoned operation of its water and wastewater systems. In order to avoid a failure of MUC's systems and long-term interruption of water and wastewater service to its customers, DIUC undertook the operation and maintenance of MUC's systems, without compensation.

In 2010, CKM acquired MUC -- its merger with DIUC was approved by the Commission on March 1, 2010. Because MUC had no financial records, it would have to be operated for about a year in order to develop the level of its cost of operations in sufficient detail to be used to support a rate analysis. During this transition period, a number of unsuccessful efforts were made to obtain short term financing to help with the cash flow problem and to finance the legal and consulting costs that would be incurred for a rate case. In 2011, Trenholm Walker, Esq. of Pratt-Thomas Walker, P.C. and GA prepared a rate increase petition, agreeing to delay being paid for their services until after DIUC could attract capital. DIUC petitioned the PSC for a rate increase and, after approval of a settlement, an increase became effective on August 15, 2012. It was not until November of 2013, however, that

DIUC was able to close on a loan from SunTrust Bank.

DIUC is now the only water and wastewater utility on Daufuskie Island, which owns or controls all of the water and wastewater utility assets and operations.

FINANCING

DIUC's need for financing was an immediate concern soon after its acquisition in July of 2008 from IP, when we discovered that MUC had failed to pay its 40% share of the costs of operating the HPWWTP. Many unsuccessful attempts were made to obtain either a short or long term loan from banks or individual investors. In addition to being in a period of transition after taking over the operations from IP, we needed to file a complaint with the PSC regarding MUC's failure to abide by its agreement to pay its 40% share of operating the HPWWTP. Before the Commission could proceed with its investigation, MUC's owners not only filed for a Chapter 11 bankruptcy but vacated offices - - no one was available for any purpose. Our operators were familiar with MUC's facilities and we began operating the system, without compensation, so that water and wastewater service to MUC's customers would not be interrupted. One of DIUC's owners even personally funded some essential repairs to the MUC system. In early 2010, the Trustee in bankruptcy sold MUC's assets to CKM, and on March 1, 2010 the Commission approved the merger of MUC into DIUC.

We were then faced with another transition, but this time with virtually no records as to the cost of operating the MUC system, resulting in a delay in our preparation of an accurate and comprehensive rate analysis and petition for a rate increase. In anticipation of obtaining a rate increase, we contacted CoBank representatives who expressed interest in entering into a loan with DIUC after a rate increase would become effective, and provided a letter with preliminary terms of a loan. Those terms were reasonable and were incorporated into our rate increase petition that was filed with the Commission in December of 2011. After a full investigation and hearing, the Commission approved a settlement that was entered into by all parties, and a rate increase became effective on August 15, 2012. Despite demonstrating that DIUC complied with the financial conditions required for the loan, CoBank rejected our application - for fear that a

hurricane might render the island completely uninhabitable. We then found interest for financing with Wells Fargo Bank, but although apparently satisfied with DIUC's financial outlook, it raised concerns about CKM's non-utility construction business that apparently had been adversely impacted by the economic downturn. Although there was a separate class of stock within CKM that was effectively held by the individuals who had 99% of the ownership of DIUC, Wells Fargo insisted that DIUC divest itself of any connection to CKM. Because it was our priority to finance improvements that were essential to assure adequate service to DIUC's customers, an extremely complex and costly legal undertaking was initiated to eliminate all ties to CKM. Accordingly, a separate corporation was formed, Daufuskie Island Utility Holding Company, LLC, which is owned by three of the original owners of DIUC who have no affiliation with CKM. Despite being well along with completing the requested reorganization, and having obtained expedited approval by the Commission for the Wells Fargo loan, Wells Fargo's representative verbally informed our financing attorney, Robert H. (Bobby) Mozingo, Esq. of Nexsen-Pruett, that Wells Fargo was no longer interested in providing financing to DIUC, without giving a reason.

It seemed at that point that we were out of options, but once again Terry Lee came to the rescue by contacting Ms. Carol Coppola, First Vice President - Commercial Banking, SunTrust Bank, with whom he had a banking relationship, and asked her to explore the possibility of providing a loan to DIUC. Ms. Coppola undertook a comprehensive examination of the detailed financial information that we provided to her, finding that DIUC's cash flow, her primary concern, would support a \$3,250,000 loan. She also undertook a due diligence review of all aspects of DIUC's operations and asset ownership, including making a site inspection on the Island.

The separation of any ties to CKM continued as a condition of the SunTrust Bank financing, requiring each owner of DIUC and CKM to execute such numerous legal documents as

operating, environmental indemnification and redemption agreements, distribution/assignment agreements, personal guarantees, consents, as well as other corporate documents. We also had to produce for each parcel of property title and/or easements and new surveys in order to establish that each was owned or controlled by DIUC. In performing that rather massive effort, we found that certain parcels of land were owned by individuals or entities that had no affiliation with the utility or the original developers and owners – all of which had to be researched and addressed in order to satisfy loan conditions.² Keeping in mind that IP had poor records and MUC had none, this was an extremely time consuming and costly effort, exceeding \$250,000 in legal, consultant and contractor fees. Fortunately, we had requested financing in the amount of \$3,250,000 instead the \$3,000,000 anticipated in the rate case.

It was not until November, 2013 that we closed on the SunTrust loan, 15 months after the August 15, 2012 effective date of the rate increase. During this unexpectedly long period, we had to initiate a condemnation action to acquire the parcel of land at our storage tank site that had been sold in a tax sale, without our knowledge. The level of professional support by Ms. Coppola and her team at SunTrust who worked with us to understand and solve each issue is worthy of special acknowledgement, and is in stark contrast to the performance of the other potential lenders.

We also received considerable and continuing advice and assistance from the ORS who kept apprised of the need for specific improvements, the ongoing cash flow problem and issues that had to be addressed. The ORS supported our requests for expedited approval of the loan and for rejection of the attempt by the tax sale purchaser of the storage tank land to intervene in the finance proceeding before the Commission. The Commission acted decisively and in the best interests of our customers by expediting its approval of DIUC's finance petition, both originally

² For Example, one of the well sites was owned by a customer, Mr. Brian McCarthy of Bloody Point Properties, LLC, who graciously entered into an easement with DIUC, without charge, recognizing the need for financing capital improvements that would benefit the provision of service to himself and all other customers.

with Wells Fargo and again with SunTrust, clearly recognizing that capital improvements were essential for DIUC to provide adequate water and wastewater service. The DHEC also took a balanced approach to assure that DIUC complied with all of its regulations but worked with us during the period when no funds were available for the improvements. A DHEC representative even wrote us a letter to confirm that it was the utility's responsibility to own or control all utility facilities, a confirmation that was need as a condition for the loan.

It should be recognized that more than half of the proceeds of this loan were used for capital additions and payments for services provided to DIUC, but those capital improvements were not included in rate base because they were not yet constructed and in service. Thus, the financing was only possible because the owners were willing to convert a large portion of their equity investment into debt. From an earnings perspective, the equity investment supporting the rate base would not earn a full return because the allowed net operating income would not be available for equity return but instead used to pay interest on the new debt for future plant additions that were not included in rate base. This accommodation by the owners also resulted in a lower rate increase for the customers in the last rate case because the interest rate on debt was lower than an equity rate, and the income tax allowance was lower.

TAX SALE AND CONDEMNATION

Without our knowledge, on October 4, 2010, the 3.37 acre parcel of land which is the site of DIUC's elevated storage tank was sold for \$526.70 at a delinquent tax sale for unpaid ad valorem property taxes, and the Tax Deed recorded on December 1, 2011. The individual who purchased the land is Mamdouh Sabry Abdelrahman ("Mr. Sabry"), who we later learned had also purchased four other parcels. The tax bills for this property were apparently sent to the wrong address because neither DIUC nor GA had ever received them or notices of delinquent property taxes. We also later learned that the required posting of a notice of the intended tax sale at the subject property, which our operators visit daily, had been posted at the wrong property. We first learned of the tax sale in early 2012, thanks to the astute observations of Mr. Willie Morgan, Manager Water/Wastewater of the ORS during its investigation of DIUC's rate application. We immediately contacted Mr. Sabry by phone, and explained to him that this parcel of land is the site of our storage tank and not usable for any other purpose, and offered to pay him \$1,000 to cover his purchase price plus some costs he might incur to sell the land back to DIUC, with DIUC covering all the legal costs of the sale. Mr. Sabry seemed agreeable during that phone call, advising that he thought the parcel he purchased was not the site of the storage tank but another parcel adjacent to it, something he said he would have to look into. On March 19, 2012, we sent a letter to Mr. Sabry again explaining the circumstances and offered to pay him \$1,334.24 which included \$334.70 of past due availability fees he owed for his other four parcels. Because Mr. Sabry did not respond to the letter or any further telephone calls, we asked our attorney, Pratt-Thomas Walker, P.A., for assistance. After writing to Mr. Sabry and months of unsuccessful communications with his first attorney to try to settle this matter, we filed a law suit against Beaufort County and Mr. Sabry to reverse the tax sale.

Subsequently, however, as we became more deeply involved in satisfying financing

requirements, it became apparent that the time it would take to fully adjudicate that law suit would delay the financing, and that pursuing a condemnation would better satisfy SunTrust's conditions for approving the loan. Accordingly, we withdrew the lawsuit against Beaufort County and Mr. Sabry, and again tried to settle with Mr. Sabry by making a higher offer of \$8,000 in order to avoid the costs of further litigation. Mr. Sabry's attorney indicated that this offer was acceptable, and our attorney prepared the settlement agreement and legal document to transfer title of the land to DIUC. Those documents, however, were never executed, and we learned that Mr. Sabry had replaced his first attorney. When Mr. Sabry requested \$25,000 and forgiveness of past due availability fees related to his other four properties, it became apparent that any further settlement discussions would not be productive. We then initiated a condemnation proceeding, which included filing with the Court a market value estimate of \$3,700 of the subject land, which was prepared by an independent appraiser. On the last day it was due, Mr. Sabry filed a law suit objecting to DIUC's right to condemn, which suspended the condemnation proceeding until the "right to take" action would be decided. It should be noted that Mr. Sabry reacted to the condemnation by requesting \$1,000,000 as a settlement proposal.

Mr. Sabry's motion to the Court included seven arguments as to why DIUC did not have the right to condemn his land, and he also asked the Court to order DIUC to remove its storage tank and other facilities from the property. After discovery, my affidavit and deposition, briefs and oral argument, and after Mr. Sabry withdrew all but one of his seven arguments, the Court ruled in favor of DIUC's right to take the property. Mr. Sabry's one remaining argument that, by law, DIUC cannot act twice to take the property, once in the appeal of the tax sale and then in the condemnation action, was rejected by the Court, essentially ruling that the appeal of the tax sale was not a taking of the property and the condemnation is a separate and only action to take the property. After Mr. Sabry missed the deadline to appeal the Court's decision, the Court

nevertheless allowed him to file his appeal more than a month late. In his appeal, Mr. Sabry asks the Court of Appeals to reverse the trial court's decision that DIUC has the statutory authority to condemn the property sought. We are awaiting the Court's decision on the appeal, after which the condemnation proceeding would be scheduled for trial.

During my deposition in early 2014, Mr. Sabry's attorney asked and I agreed to have his engineer inspect the property the following week, but he never called to arrange an inspection. Weeks later, oral argument was delayed to give Mr. Sabry's engineer time to inspect the property, and again he never arranged an inspection. With respect to the proceeding on our application for financing, Mr. Sabry applied to the PSC for intervener status and requested a delay in the scheduled hearing, which was denied because the Commission correctly found that the condemnation and land issue was irrelevant to the financing application. As of this date, Mr. Sabry has not responded to our interrogatories, production of document requests or provided an appraisal in connection with the condemnation proceeding, but instead has continued with his appeal of the right to take decision. He has never paid any of the availability charges for his other four properties, which now amount to more than \$5,000.

By the end of May, the South Carolina Court of Appeals will have all briefs and filings necessary to begin consideration of Mr. Sabry's appeal. While most cases are considered by the Court of Appeals within four to six months of completed filings, we will request the Court proceed with haste to conclude the matter.

PROPERTY TAXES

Within days after our rate increase became effective on August 15, 2012, we received property tax bills for 2010, 2011 and 2012 for the first time, adding up to more than \$363,000, with 2012 at \$132,398. We thought property tax bills of that magnitude must be a mistake because historically the total annual property taxes for a number of individual properties had only been about \$10,000. DIUC certainly did not have the cash flow to pay those property tax bills even with the new rates that would begin to generate about \$1.1 million annually, with only \$10,000 allowed for property taxes. We had begun the task of securing financing and simply continued to pay the usual individual property taxes. After we received the 2013 property tax bill in the amount of \$171,338 and a past due balance of over \$535,214, we began making inquiries of Beaufort County and the Department of Revenue (DOR). Note that as one of the conditions for obtaining a loan, the DOR had certified that we were current on all taxes due to the state, after we paid a past due amount of about \$15,000 – with cash provided by Terry Lee of course.

On the basis of discussions with Mr. Taylor Ingram, Utility Assessment Coordinator of the DOR, it appears that documents filed with DOR in connection with the acquisition of MUC in 2010 or the early financing efforts, prompted DOR to obtain DIUC's annual reports to the PSC as far back as 2010. As it does for other utilities, the DOR calculates an assessment by applying 10.1% to the book value (original cost less depreciation) as reflected in the annual reports to the PSC. It provides those assessments to Beaufort County and, in turn, Beaufort County applies its tax rate and sends the property tax bills. When Beaufort County received DOR's assessments for 2010, 2011 and 2012 in August of 2012, it simply sent property tax bills to DIUC for each of those years.

Our attempts to address and solve the property tax problem with Beaufort County and the DOR, including assistance by our attorney, Thomas P. Gressette, Jr., Esq. of Pratt-Thomas

Walker, did not progress until Ms. Dawn M. Hipp, Director of Water/Wastewater of the ORS, who recognized the importance of the impact these taxes would have on the customers, made a strong and successful effort to open lines of communication with Beaufort County and, in particular, Ms. Maria Walls, who is the Deputy Treasurer and Treasurer Elect. Ms. Walls quickly arranged a meeting at which Tom Gressette and I explain the rate setting process, DIUC's cash flow situation and most importantly the rate impact on our customers, and we discussed the legal constraints that Ms. Walls had to address. Ms. Walls made a commitment to review the circumstances of past property tax billings, determine whether any adjustments could legally be made, and suggested that we explore the possibility of having the DOR revise its assessments. After interchanges of communications, Ms. Walls soon responded with a solution that would be in the best interests of our customers. She prepared an agreement under which DIUC would enter into a monthly payment plan beginning in mid-2015 to pay the 2012, 2013, 2014 and 2015 property taxes over an 8 year period (the 2010 and 2011 taxes were rescinded). In addition, if the DOR revised its assessment, the monthly payment would be revised accordingly. We then worked with Mr. Ingram to submit documentation enabling the DOR to revise the book value basis for its assessments to instead reflect the last allowed net investment rate base, to be applicable until the next rate base determination.

As a result of this cooperative effort by the above representatives of ORS, DOR, Beaufort County and our attorneys, we saved DIUC's customers \$356,726 in property taxes, and minimized the rate impact of the remaining taxes by spreading the cost over an eight year period.

RATE INCREASE

DIUC's history and circumstances demonstrate that its need for enough revenue to cover the operating and capital costs of a utility is not only a legal requirement recognized in a Supreme Court guidepost decision, but a reality. We are not aware of the payment of any dividends to the owners of DIUC's predecessor, HPUC, and certainly none have ever been paid to its current owners, not even after the last rate increase. All revenues have been used to provide service to DIUC's customers, and when cash was insufficient for that purpose, the owners subsidized the operation by directly paying for costs or by providing construction work without immediate compensation. We have had to work out delayed payment schedules for electric bills and vendors. Trenholm Walker agreed to handle the last rate case and wait to be paid until after DIUC obtained financing, which turned out to be over two years – and in the interim also waited to be fully compensated for legal support work in obtaining financing and dealing with Mr. Sabry. Similarly, GA waited to be paid for rate, financing and management work. Our economic and environmental regulators were, of course, also essential in assuring that DIUC continued to provide adequate service to its customers. For example, the ORS assisted with establishing a payment schedule for delinquent electric bills and avoid discontinuance of service, and helped facilitate approval of financing petitions, and has readily provided advice on many other issues. The DHEC assisted with the modified operation of the HPWWTP on a temporary basis until financing was obtained to enable the replacement of the lagoon liner, and allowed reasonable time to comply with its other recommended improvements.

On the basis of a recent rate analysis, DIUC's rate base is about 50% higher than allowed in the last rate case, and its total operating expenses, including operation and maintenance, depreciation, amortization, property taxes and income taxes, have more than doubled, in large part due to the new property taxes. There are additional improvements that will need financing

and we have to refinance the \$500,000, interest only, line of credit portion of the \$3,250,000 total financing. We have also reached the point where DIUC must earn a reasonable rate of return on its equity investment after covering all operating expenses. Accordingly, we must report that we will petition the PSC for approval of a very substantial rate increase by the end of this month.

At the public hearing in the last rate case, customers expressed concern about a lack of information regarding the utility and the basis for the rates. We recognize that while the struggle to survive and provide safe and adequate water and wastewater service to our customers has been our priority, we must also establish better customer relations. By providing a copy of this report to the three property owners' associations through their attorney, John Beach, Esq., I am offering to meet informally with the customers to make a PowerPoint slide presentation of the basics of utility rate setting and the regulatory process. My presentation would be similar to one that I have made for many years at the Water Rate Seminar conducted by the National Association of Regulatory Utility Commissioners, which has been attended by some 7,500 students, most of whom were new to utility rate setting. We will also review the improvements that have been made as well as explain the specific cost basis for the rate increase, which will have been filed by the time this meeting could be arranged. I am also inviting representatives of the ORS and DHEC to attend and, if they wish, to make a presentation with respect to their responsibilities in general or specifically with respect to DIUC. Representatives of the POAs may contact me at any time to schedule the meeting.

ACKNOWLEDGEMENTS

I hope it is clear from this report that the goal of providing adequate service to our customers has been the priority of DIUC's owners and management. It should also be apparent that we would likely have failed to meet that goal were it not for the cooperation and help of everyone receiving in this report. The PSC's responsibility to act in the best interests of our customers is reflected in its reasonable decisions with respect to rate setting and financing, expediting decisions when necessary for DIUC to obtain a loan for system improvements. The ORS has routinely provided invaluable guidance as to keeping costs reasonable, attracting capital and dealing with major obstacles. The DHEC has overseen our physical operations to improve the way we use and monitor DIUC's facilities, but at the same time understanding its financial limits. SunTrust's expertise and professionalism has made possible an otherwise impossible challenge in obtaining financing for essential improvements. Beaufort County acted to limit as much as possible the impact on our customers of very unusual circumstances regarding property taxes. Our attorney's performance has been outstanding and successful – and generous. Some of our customers have voluntarily provided important accommodations essential to DIUC's operations, to the benefit of all customers.

On behalf of the owners and myself, I extend our most sincere appreciation and gratitude to each of you.

I also must thank DIUC's operators for their renewed dedication and hard work; and GA staff: Gary C. White, Vice President, who supervises all accounting and record keeping; Carolyn Carleton, Administrator, responsible for billing, accounting, collecting and customer service; and Mike Guastella, who oversees all physical and financial operations, capital improvements and regulatory compliance.

We are available to answer any questions, and look forward to a continued cooperative effort

toward the common goal of serving the best interests of our customers.

Respectfully submitted,
Guastella Associates, LLC,
Manager of
Daufuskie Island Utility Company, Inc.

A handwritten signature in black ink, appearing to read "John F. Guastella". The signature is written in a cursive, flowing style with a large initial "J" and "G".

John F. Guastella, President

APPENDIX

EXHIBIT 1

RECORDED

2001 Jun -04 03:24 PM

Sharon Q. Bunn

BEAUFORT COUNTY AUDITOR

Prepared by:

BETHEA, JORDAN & GRIFFIN, P.A.
Shelter Cove Executive Park, Suite 400
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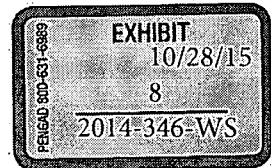
COUNTY Beaufort, County
BK 01402 PG 2190

FILE NUM 2001019868

RECORDING FEES 10.00

RECORDED BY Q WILSON

RECORDED 04/05/2001 10:37:40 AM



STATE OF SOUTH CAROLINA)
COUNTY OF BEAUFORT)
SPECIAL WARRANTY DEED
AND
BILL OF SALE

THIS SPECIAL WARRANTY DEED is made effective this 1st day of April, 2001, by and between HAIG POINT, INC., a Delaware corporation with an address of Post Office Box 7319, Hilton Head Island, South Carolina 29938 ("Grantor") and HAIG POINT UTILITY COMPANY, INC., a South Carolina corporation with an address of P.O. Box 7319, Hilton Head Island, South Carolina 29938 ("Grantee").

WHEREAS, Haig Point, Inc., is the owner and developer of the community known as Haig Point on Daufuskie Island, South Carolina; and

WHEREAS, the Grantee is a corporation organized and existing under the laws of the State of South Carolina as a utility company, for the purpose of constructing and maintaining water and sewer facilities for persons and businesses in Haig Point on Daufuskie Island, South Carolina; and

WHEREAS, Grantor desires to convey to Grantee certain real property which is more particularly described below.

NOW, THEREFORE, KNOW ALL PERSONS BY THESE PRESENTS, that Grantor, for and in consideration of the sum of Ten and No/100 Dollars (\$10.00) and no other valuable consideration to it paid by the Grantee, the receipt and legal sufficiency of which is hereby acknowledged, has granted, bargained, sold and released and by these presents does grant, bargain, sell and release unto the Grantee, its successors and assigns forever, the following real and personal property, subject to, however, the conditions, limitations, and reservations of easements and rights set forth herein:

REAL PROPERTY

ALL those certain pieces, parcels or tracts of land situated, lying and being in Haig Point, Daufuskie Island, Beaufort County, South Carolina, shown as "Elevated Tank Site" having and containing 0.337 acres, more or less, as depicted on that certain Plat entitled "9.691 Acre Tract known as Equestrian Center, being a portion of Haig Point, Daufuskie Island, South Carolina,"

{246122.2} 13732-00101

which plat was prepared by Thomas & Hutton Engineering Co., Boyce L. Young, S.C.P.L.S. #11079, dated May 14, 1999 and recorded in Plat Book 70 at Page 29 in the Office of the Register of Deeds for Beaufort County, South Carolina. For a more accurate description of the distances, courses, metes and bounds of the Property, reference to said plats of record is hereby made.

SUBJECT TO, however, the following conditions, limitations, and reservations of easements and rights:

1. Grantor expressly reserves a non-exclusive access, ingress and egress easement to, over, and through the Property along with the right to utilize and grant to others entry to, over, and through the Property for vehicular and pedestrian access to and from any and all of the remainder of Haig Point so long as Grantor, or its successors or assigns, continues to own any real property within the boundaries of the Haig Point planned unit development as defined in the master plan on record with the Beaufort County Zoning and Planning Department.
2. Grantee is restricted from passing any rule or regulation which would diminish the easement rights reserved herein unto Grantor or any previous easement rights vested with Grantor.
3. Grantor makes no warranties to title to that portion of the Property which is deemed marshland or wetlands, as defined by Federal or State law, or which lies below the mean high water mark of Calibogue Sound.
4. Grantor makes no warranties to interests created by or limitations on the Property use imposed by the Federal Coastal Zone Management Act or other Federal law or regulation, or by South Carolina Code Sections 48-39-10 et. seq., as amended, or any regulations promulgated pursuant to said State or Federal laws.
5. Grantor makes no warranties to zoning laws and regulations of Beaufort County, South Carolina and/or any regulatory agency of the State of South Carolina affecting the Property.

Beaufort County Tax Map Reference: 800-~~25~~-45

The Property conveyed herein is a portion of the property conveyed to Grantor herein by deed dated October 23, 1984 and recorded October 24, 1984 in the Office of the Register of Deeds for Beaufort County, South Carolina in Deed Book 406 at Page 64.

BILL OF SALE FOR PERSONAL PROPERTY AND FIXTURES

This conveyance shall constitute a bill of sale and conveys title to all personal property and improvements located on the Property conveyed herein to the Grantee, including, but not limited to all pipes, valves, fittings and appurtenances to the water supply system and utility infrastructure and other improvements and systems located on the real property conveyed herein (collectively the "Improvements"), if any. The Improvements are conveyed to the Grantee "WHERE IS, AS IS" and without recourse. The Grantor disclaims and makes no representations or warranties, express or implied, in fact or law, with respect to the Improvements including, without limitation, representations or warranties of merchantability, or fitness

for ordinary or any particular purpose.

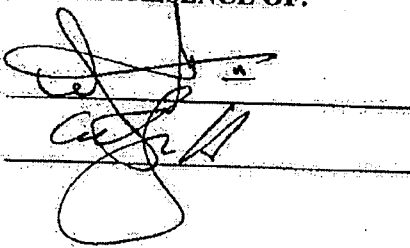
TOGETHER WITH all and singular the rights, members hereditaments and appurtenances to the said premises belonging or in anywise incident or appertaining.

TO HAVE AND TO HOLD, all and singular the said premises before mentioned unto the said Grantee, its successors and assigns, forever, subject to, however, the conditions, limitations, and reservations of easement and rights set forth above.

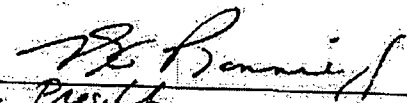
AND the Grantor does hereby bind itself and its successors to warrant and forever defend all and singular the said premises unto Grantee, its successors and assigns, against itself and its successors and any person lawfully claiming or to claim the same or any part thereof, by, through or under it, but against none other.

IN WITNESS WHEREOF, Haig Point, Inc., a Delaware corporation, has caused these presents to be executed by their duly authorized officers this 1st day of April, 2001.

**SIGNED, SEALED AND DELIVERED
IN THE PRESENCE OF:**



GRANTOR:
HAIG POINT, INC., a Delaware corporation

By: 
Its: Pres. Lt.

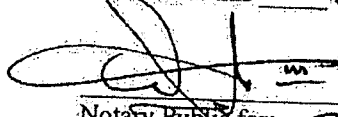
STATE OF SOUTH CAROLINA)

COUNTY OF BEAUFORT)

ACKNOWLEDGMENT

I, the undersigned Notary Public, do hereby certify that Haig Point, Inc., by Leonard H. Rennie, its Pres. Lt., appeared before me this day and acknowledged the due execution of the foregoing instrument.

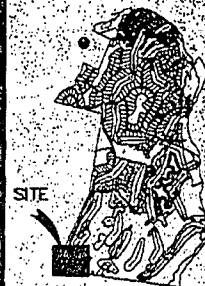
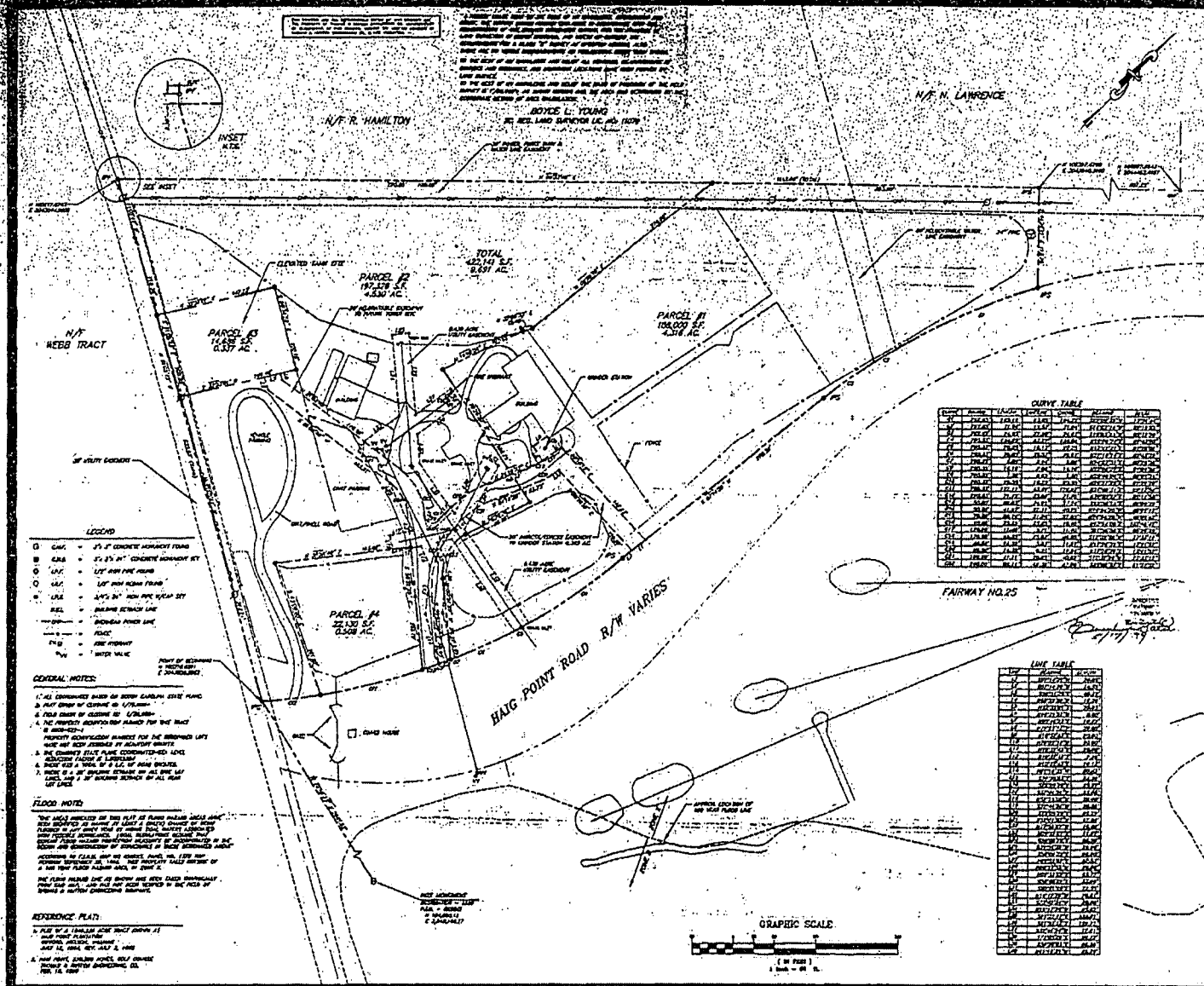
Witness my hand and official seal this 1st day of April, 2001.



Notary Public for: 

My Commission Expires: 4-25-10

(SEAL)



LOCATION MAP

NO.	DATE	DESCRIPTION
1	5/14/89	PRELIMINARY
2	5/14/89	REVISED
3	5/14/89	REVISED
4	5/14/89	REVISED
5	5/14/89	REVISED
6	5/14/89	REVISED
7	5/14/89	REVISED
8	5/14/89	REVISED
9	5/14/89	REVISED
10	5/14/89	REVISED

OWNER
HAIG POINT INC.

WILTON HEAD ISLAND, SOUTH CAROLINA

DESIGNER
THOMAS & HUTTON ENGINEERING CO.
50 PARK OF COMMERCE WAY
SAVANNAH, GA 31405 / (912) 234-5300



HAIG POINT

SCALE: 1" = 50' PLAT INCHES

SHEET TITLE:
9.691 AC. TRACT

SHOWN AS
EQUESTRIAN CENTER
BEING A PORTION OF HAIG POINT
DAWSON ISLAND, SOUTH CAROLINA

DRAWN BY: SER/CWO APPROVED BY: E.Y.

DATE: MAY 14, 1989

SHEET NO.

1 of 1

JOB NO. 11874

22X

ORIGINAL DOCUMENT

EXHIBIT 2

500
1000
Beaufort
7308
MLF/lwb

BEAUFORT COUNTY SC - ROD
BK 02288 PGS 2080-2084
FILE NUM 2008001317
01/05/2008 02:26:40 PM
REC'D BY M DOE RCPT# 367713
RECORDING FEES 10.00

Prepared by and when recorded return to:

MCNAIR LAW FIRM, P.A./WJN
Shelter Cove Executive Park, Suite 400
23-B Shelter Cove Lane
Post Office Drawer 3
Hilton Head Island, SC 29938
(843) 783-2171

STATE OF SOUTH CAROLINA)

COUNTY OF BEAUFORT)

ASSIGNMENT OF RIGHTS

December 2005, THIS ASSIGNMENT OF RIGHTS (the "Assignment") is made effective this 26th day of December, 2005, by HAIG POINT, INC., a Delaware corporation having an address c/o International Paper Company, 3 Paragon Drive, Montvale, NJ 07645 (hereinafter the "Assignor") to HAIG POINT UTILITY COMPANY, INC., a South Carolina corporation having an address c/o International Paper Company, 3 Paragon Drive, Montvale, NJ 07645 (hereinafter the "Assignee").

WHEREAS, Assignor, formerly known as International Paper Realty Corporation of South Carolina, is the developer of that certain planned community known as Haig Point on Daufuskie Island, South Carolina (hereinafter "Haig Point"); and

WHEREAS, Assignor is also the Declarant under certain documents entitled "Declaration of Rights, Restrictions, Affirmative Obligations and Conditions Applicable to all Property at Haig Point, Daufuskie Island, South Carolina" recorded in the Beaufort County Register of Deeds in Book 431 at Page 325 (the "Haig Point Covenants");

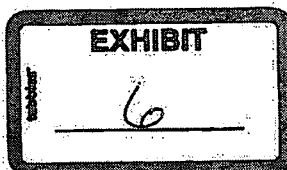
WHEREAS, the Haig Point Community Association, Inc., a South Carolina not for profit corporation was organized for the purposes set forth in the Declaration of Covenants and Restrictions of Haig Point Community Association, Inc. dated August 31, 1985 and recorded October 1, 1985 in the Office of the Beaufort County Register of Deeds in Book 431 at Page 355, as amended by that certain First Amendment thereto dated October 4, 1987 and recorded October 8, 1987 in Book 487 at Page 731, that certain Second Amendment thereto dated April 26, 1995 and recorded April 28, 1995 in Book 774 at Page 1217, and that certain Third Amendment thereto dated November 17, 2000, and recorded December 20, 2000, in Deed Book 1365 at Page 1366, as further amended from time to time (collectively the "HPCCA Covenants"); and

WHEREAS, Assignor desires to convey to Assignee certain rights reserved in the Haig Point Covenants and the HPCCA Covenants, more particularly described below.

NOW, THEREFORE, KNOW ALL PERSONS BY THESE PRESENTS, that Assignor, for and in consideration of the sum of Ten and No/100 Dollars (\$10.00) and no other valuable consideration to it paid by the Assignee, the receipt and legal sufficiency of which are hereby acknowledged, assigns the following rights and Assignee accepts said rights set forth as follows:

- 1 of 4 -

Book2298/Page2080



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EXHIBIT 2

1. Assignment. Assignor hereby assigns, transfers, sets over and by these presents has assigned, transferred and set over, unto Assignee, and Assignee agrees to accept such assignment as set forth in Exhibit "A" attached hereto and made part hereof.
2. Recording. This Assignment of Rights shall be recorded in the Register of Deeds in Beaufort County, South Carolina.
3. Acceptance. By execution of this Assignment, Assignee acknowledges said Assignment and agrees to accept all of the obligations of Assignor set forth in Exhibit "A". By acceptance of this Assignment, Assignee agrees to release Assignor from any further obligations under Haig Point Covenants and the HPCAA Covenants and to hold Assignee harmless and indemnify Assignee for any claims relating to obligations under Haig Point Covenants and the HPCAA Covenants.

[Execution and acknowledgment on following page.]

EXHIBIT 2

IN WITNESS WHEREOF, Haig Point, Inc., a Delaware corporation, has caused these presents to be executed by its duly authorized officer this 30th day of December, 2005.

SIGNED, SEALED AND DELIVERED
IN THE PRESENCE OF:

ASSIGNOR:
HAIG POINT, INC.,
A Delaware corporation

Kenneth M. Williams
L. H. Ronnie, Jr.

By: [Signature]
Its: Chairman of the Board and President

STATE OF NEW JERSEY

COUNTY OF BERGEN

)
)
)
ACKNOWLEDGMENT

I, the undersigned Notary Public, do hereby certify that L. H. Ronnie, Jr., as Chairman of the Board and President of Haig Point, Inc., appeared before me this day and acknowledged the due execution of the foregoing instrument, by and on behalf of the Assignor.

Witness my hand and official seal this 30th day of December, 2005.

[Signature] (SEAL)
Notary Public for New Jersey
My Commission Expires:

[Execution and Acknowledgment of Assignee on Following Page.]

COLETTE J BORELL

Notary Public, State of New Jersey

My Commission Expires November 14, 2008

EXHIBIT 2

SIGNED, SEALED AND DELIVERED
IN THE PRESENCE OF:

Kathleen M. Willemas
Lisa S. Sussell

ASSIGNEE:
HAIG POINT UTILITY COMPANY, INC.,
A South Carolina Corporation

By: Thomas F. Connor
Its: Vice President

STATE OF NEW JERSEY)

COUNTY OF BERGEN)

ACKNOWLEDGMENT

I, the undersigned Notary Public, do hereby certify that Thomas Connor, as Vice President of Haig Point Utility Company, Inc., appeared before me this day and acknowledged the due execution of the foregoing instrument, by and on behalf of the Assignee.

Witness my hand and official seal this 30th day of December, 2005.

Colette J. Borell (SEAL)
Notary Public for New Jersey
My Commission Expires:

COLETTE J. BORELL
Notary Public, State of New Jersey
My Commission Expires November 14, 2008

EXHIBIT 2

EXHIBIT "A"

1. An absolute assignment of Assignor's perpetual, alienable and releasable easement right as set forth in Article III, Section 18 of the Haig Point General Covenants recorded in Deed Book 431 at Page 325 in the Office of the Register of Deeds for Beaufort County, South Carolina, on October 1, 1985, relating specifically to water and sewer utility service; and

2. An absolute assignment of the Assignor's perpetual, alienable, and releasable easement right as set forth in Article IV, Section 8 of the Haig Point General Covenants recorded in Deed Book 431 at Page 325 in the Office of the Register of Deeds for Beaufort County, South Carolina, relating specifically to water and sewer utility service; and

3. An assignment of the Company's right of ingress, egress and access via roadways and waterways as set forth in Article III, Section 24, of the Haig Point General Covenants recorded in Deed Book 431 at Page 325 in the Office of the Register of Deeds for Beaufort County, South Carolina.

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EXHIBIT 2

REC
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HAIG POINT GENERAL COVENANTS

FILED IN DEED - C BOOK 431 PAGE 325
FILED AT 165888 ON 10/31/85

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EXHIBIT 2

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AFFIRMATIVE OBLIGATIONS AND CONDITIONS
APPLICABLE TO ALL PROPERTY AT HAIG POINT,
DAUFUSKIE ISLAND, SOUTH CAROLINA

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EXHIBIT 2

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FILED AT 165800 ON 10/01/03

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EXHIBIT 2

STATE OF SOUTH CAROLINA }
COUNTY OF BEAUFORT }

DECLARATION OF RIGHTS,
RESTRICTIONS, AFFIRMATIVE
OBLIGATIONS AND CONDITIONS
APPLICABLE TO ALL PROPERTY
AT HAIG POINT, DAUFUSKIE
ISLAND, SOUTH CAROLINA

THIS DECLARATION, made this 31st day of August, 1985,
by INTERNATIONAL PAPER REALTY CORPORATION OF SOUTH CAROLINA,
A South Carolina Corporation, hereinafter referred to as the
"Company".

W I T N E S S E T H:

WHEREAS, the Company holds title in fee simple to the
certain lands (hereinafter referred to as the "Property")
described in Article II, Section 1 of this Declaration and
intends to plan and develop a community comprised of the
Property and known as "Haig Point" with certain facilities
and services for the use and benefit of all property owners
within such community; and

WHEREAS, the Company holds options for the purchase of
certain additional lands located on Daufuskie Island as
described in Article II, Section 2 of this Declaration; and

WHEREAS, the Company desires to provide for the
preservation of the values and for the maintenance of common
facilities, services and properties; and, to this end, the
Company has consented to subject the Property together with
such additions as may hereafter be made, as provided in
Article II, to the covenants, restrictions, assessments,
affirmative obligations, charges and liens, hereinafter set
forth (hereinafter referred to as the "General Covenants" or
"these Covenants"), each and all of which is and hereby
declared to be for the benefit of the Property and every
owner of any and all parts thereof.

NOW, THEREFORE, the Company hereby declares that the
Property and such additions thereto as may hereafter be made
pursuant to Article II hereof are and shall be held,
transferred, sold, conveyed, given, purchased, leased,
occupied, and used subject to the General Covenants. These
General Covenants, the benefits of these General Covenants,
and the affirmative and negative burden of these General
Covenants shall touch and concern and run with the land
herein referred to as the Property.

ARTICLE I

DEFINITIONS
FILED IN DEED - C BOOK 431 PAGE 329
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All defined terms set forth in this Declaration or any
Supplemental Declaration, unless otherwise defined herein,
will have the meaning ascribed to them in the Declaration of
Covenants and Restrictions of Haig Point Community

EXHIBIT 2

Association, Inc. (the "Association Covenants") executed by International Paper Realty Corporation of South Carolina and the Haig Point Community Association, Inc. on the 31st day of August, 1985 and recorded simultaneously herewith.

1. "Association" shall mean and refer to the Haig Point Community Association, Inc., a South Carolina non-profit corporation, its successors and assigns.

2. "Company" shall mean and refer to International Paper Realty Corporation of South Carolina, a Delaware corporation authorized to do business in the State of South Carolina, its successors and assigns.

3. "Haig Point" shall mean and refer to the property described in Exhibit A attached hereto and by reference incorporated herein and any additional real property made subject to these General Covenants by the filing of a Supplementary Declaration by the Company in the future, including the property described in Exhibit B attached hereto and incorporated by reference herein.

4. "General Covenants" or "these Covenants" shall mean and refer to the covenants set forth in this Declaration, as amended from time to time.

5. "Property" or "Properties" shall mean and refer to the real property now owned by the Company on Daufuskie Island, Beaufort County, South Carolina, as described in Exhibit A attached hereto and incorporated by reference herein, and to all additional real property made subject to these General Covenants by the filing of a Supplementary Declaration by the Company in the future.

6. "Master Plan" shall mean and refer to the drawing which represents the conceptual plan for the future development of Haig Point. Since the concept of the future development of Haig Point is subject to continuing revision and change by the Company, present and future references to the "Master Plan" shall be references to the latest revision thereof.

ARTICLE XI PROPERTY DESCRIPTION

Section 1. Existing Property. The real property which is, and shall be held, transferred, sold, conveyed, given, donated, leased and occupied subject to these General Covenants is located on Daufuskie Island, Beaufort County, South Carolina and is more particularly described in Exhibit "A" attached hereto and by reference incorporated herein.

The Company intends to develop the Property in accordance with the Master Plan, as subsequently modified

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EXHIBIT 2

from time to time, as a residential community featuring recreation facilities and various amenities and all other activities permitted by law which the Company deems appropriate as uses for the Property. The Company reserves the right to review and modify the Master Plan at its sole option, from time to time, based upon its continuing research and design program or economic conditions. The Master Plan or any future Master Plan, shall not bind the Company, its successors and assigns, to adhere to the Master Plan in the development of the land shown thereon; however, the Company covenants, on behalf of itself, its successors and assigns, that the Master Plan will at no time be modified or amended to provide for a gross density greater than 1.24 units per acre based upon the acreage set forth in the property description attached hereto as Exhibit A. Real property conveyed by the Company shall be classified and restricted in accordance with their designation in the deed of conveyance from the Company. The Company shall not be required to follow any predetermined sequence or order of improvements and development, and it may bring within the plan of these General Covenants additional lands, and develop the same before completing the development of the Property. The Company shall have full power to add to, subtract from, or make changes in the Master Plan, including the addition of other nearby lands owned by the Company or acquired in the future by the Company.

Section 2: Additions to Existing Property. Additional lands may become subject to this Declaration. The Company, its successors and assigns, shall have the right, without consent of any person, including the Association, to bring within the plan and operation of this Declaration, additional properties in future stages of development. The additions authorized under this and the succeeding subsections shall be made by either deeding such additional property subject to this Declaration by specific reference in individual deeds or by filing a Supplementary Declaration of Covenants and Restrictions (hereinafter referred to as "The Supplementary Declaration") with respect to the additional property which shall extend the operation and effect of these General Covenants to such additional property. The Supplementary Declaration may contain such complementary additions and/or modifications of these General Covenants as may be necessary or convenient, in the judgment of the Company, to reflect the different character, if any, of the added properties. The Company holds an option for the purchase of the property described in Exhibit "B" attached hereto and incorporated by reference herein, and the Company may elect to subject this additional property to these General Covenants.

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EXHIBIT 2

ARTICLE III

GENERAL COVENANTS

Section 1. Purpose. The primary purpose of these covenants and restrictions and the foremost consideration in the origin of same has been the creation of a community which is aesthetically pleasing and functionally convenient. The establishment of objective standards relating to design, size and locations of dwellings and other structures makes it impossible to take full advantage of the individual characteristics of each parcel of property and of technological advances and environmental values. For this reason such standards are not established by these covenants. In order to implement the purposes of these covenants, the Company shall establish and amend from time to time objective standards and guidelines which shall be in addition to these covenants.

Section 2. Residential Lots. All Residential Lots in Haig Point shall be used for residential purposes exclusively. The use of a portion of a dwelling on a Residential Lot as an office by the owner or tenant thereof shall be considered a residential use if such use does not create, in the sole discretion of the Company, customer or client traffic to and from the lot. No structure, except as hereinafter provided, shall be erected, altered, placed or permitted to remain on any Residential Lot other than one (1) single family dwelling, one (1) small accessory building which may include a detached private garage, provided the use of such accessory building does not overcrowd the site and provided further, that such building is not used for any activity normally conducted as a business. A guest suite or like facility may be included as part of the main dwelling or accessory building, but such suite may not be rented or leased except as part of the entire premises including the main dwelling, and provided, however, that such suite would not result in over-crowding the site. The provisions of this Section shall not prohibit the Company, its successors or assigns, from using a house or other family dwelling units as models for a sales program. Use as a model shall be limited to display purposes except as hereinafter provided.

Section 3. Architectural and Design Review.

- (a) **Purpose.** In order to preserve the natural beauty of Haig Point and its setting, to maintain Haig Point as a pleasant and desirable environment, to establish and preserve a harmonious design for the community, and to protect and promote the value of property, no building, fence, swimming pool, tennis court, garage, paving materials of any kind, or any other structure or improvement of any nature or addition shall be erected, placed or altered until the proposed plans,

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EXHIBIT 2

specifications, exterior color or finish, plot plan (showing the proposed location of such building or structure, drives and parking areas), building height, landscape plan, and construction schedule shall have been approved in writing by the Company.

(b) Objectives. Architectural and design review shall be directed toward attaining the following objectives for Haig Point:

- (1) Preventing excessive or unsightly grading, indiscriminate earth moving or clearing of property, removal of trees and vegetation which could cause disruption of natural water courses or scar natural landforms.
- (2) Ensuring that the location and configuration of structures are visually harmonious with the terrain and vegetation of the Residential Lot and with surrounding Residential Lots and structures, and do not unnecessarily block scenic views from existing structures or tend to dominate any general development or natural landscape.
- (3) Ensuring that the architectural design of structures and their materials and colors are visually harmonious with Haig Point's overall appearance, history and cultural heritage, with surrounding development, with natural landforms and native vegetation, and with development plans, officially approved by the Company, or any governmental or public authority, if any, for the areas in which the structures are proposed to be located.
- (4) Ensuring the plans for landscaping provide visually pleasing settings for structures on the same lot and on adjoining or nearby lots, and blend harmoniously with the natural landscape.
- (5) Ensuring that any development, structure, building or landscaping complies with the provisions of these Covenants.
- (6) Promoting building design and construction techniques that respond to energy consumption and environmental quality consideration such as heat loss, air emissions, and run-off water quality.

(c) Submission, Approval and Refusal of Architecture, Siting, Landscaping and Other Building Plans. Two copies of all plans and related data shall be submitted to the Company. The Company shall establish a fee sufficient to cover the expense of reviewing plans and

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FILED IN 165883 ON 12/21/85

EXHIBIT 2

related data at the time they are submitted for review and to compensate any consulting architects, landscape architects, urban designers or attorney's retainer. The fee initially established by these General Covenants shall be \$150 for each submission. The Company shall have the right to increase this amount not more than once in any subsequent twelve (12) month period. Approvals shall be dated and shall not be effective for construction commenced more than six months after such approval. Disapproved plans and related data shall be accompanied by a reasonable statement of items found unacceptable. In the event approval of such plans is neither granted nor denied within thirty (30) days following receipt by the Company of the written request for approval, the provisions of this section shall be thereby waived. Refusal or approval of plans, site location, building height, or specifications may be based by the Company upon any ground which is consistent with the objectives of these covenants, including purely aesthetic considerations, so long as such ground is not arbitrary or capricious.

- (d) Architectural and Design Review Guidelines. The Company will publish Architectural and Design Review Guidelines from time to time which will set forth minimum criteria and controls for construction of improvements on the Property. In order to further carry out the objectives set forth in this Section, the Architectural and Design Review Guidelines will provide for lot line setbacks, lot coverage and clearing limitations, and specify types of materials approved for incorporation in the exterior construction of structures. All plans submitted to the Company must incorporate the provisions of these Guidelines prior to the Company becoming obligated to review the plans, and the failure by the Company to review non-conforming plans shall not be deemed a waiver of the provisions of this section.

- (e) Approval Not a Guarantee or Representation of Proper Design or Good Workmanship. No approval of plans, location or specifications, and no publication or Architectural and Design Review Guidelines shall ever be construed as representing or implying that such plans, specifications or standards will, if followed, result in a properly designed residence. Such approvals and standards shall in no event be construed as representing or guaranteeing that any residence or improvement thereto will be built in a good workmanlike manner. The Company shall not be responsible or liable for any defects in any plans or specifications submitted, revised or approved under these covenants nor for any defects in construction pursuant to such plans and specifications. The Property Owner shall have sole responsibility for compliance with approved plans

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EXHIBIT 2

and does hereby hold the Company harmless for any failure thereof caused by the Property Owner's architect or builder. The Company reserves the right to prohibit the Property Owner's builder and/or general contractor from the site in the event it is determined that failure to comply with approved plans is determined to be intentional or due to gross negligence.

Section 4. Siting. To assure that buildings and other structures will be located so that the maximum view, privacy and breeze will be available to each building or structure, and that structures will be located with regard to the topography of each property taking into consideration the location of large trees and other aesthetic and environmental considerations, the Company reserves unto itself, its successors and assigns, the right to control and to decide solely (so long as (a) its decisions are not arbitrary or capricious and (b) subject to the provisions of the pertinent land use regulations of public authorities having jurisdiction) the precise site and location of any building or structures on any property in Haig Point. The location shall be determined only after reasonable opportunity is afforded the Property Owner to recommend a specific site. Provided, however, that in the event an agreed location is stipulated in writing in the contract of purchase from the Company, and such location complies with the local county subdivision regulations, the Company shall approve automatically such location for a residence or group of residential units.

Section 5. Building Height. No single Family Dwelling Unit structure shall be constructed on a Residential Lot which has a height exceeding three (3) and one-half (1 1/2) stories above the natural existing grade of said Residential Lot. For purposes of this Section, one-half (1/2) story is defined as habitable space within the roof structure of the Dwelling Unit. A raised level below the first habitable floor of a Dwelling Unit to comply with the minimum height established by applicable flood zone regulations of the United States shall be considered a story for purposes of this Section. No other attached or detached residences shall be constructed on the existing property described on Exhibit A which has a height exceeding three (3) stories, provided that the first parking level or deck underneath such buildings shall not be considered a story. No attached or detached Dwelling Unit structure shall be constructed on any additions to the existing property which has a height exceeding five (5) stories above the minimum height established by applicable flood zone regulations of the United States. The height of any structure, including Single Family Residential or attached or detached Dwelling Units within the Property shall be subject to the prior review and approval in writing by the Company.

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FILED AT LOS ANGELES ON 10/01/85

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EXHIBIT 2

Section 6. Parking. Each Property Owner subject to these Covenants shall provide sufficient space for the parking of approved vehicles for his and his family's use and the use of their guests off community roads prior to the occupancy of any building or structure constructed on said property in accordance with reasonable standards established by the Company. Enclosed parking shall be provided for all vehicles used by occupants of each residence.

Section 7. Completion of Construction. The exterior of all houses and other structures must be completed within twelve (12) months after the construction of same shall have commenced, except where such completion is impossible or would result in great hardship to the Property Owner or builder due to strikes, fires, national emergency or natural calamities. Houses and other dwelling structures may not be temporarily or permanently occupied until the exterior thereof have been completed. During the continuance of construction the Property Owner shall require the contractor to maintain the Residential Lot in a reasonably clean and uncluttered condition. Upon completion of construction the Property Owner shall cause the contractor to immediately remove all equipment, tools and construction material from the Lot. Any damage to roads, paths, Common Properties or any other property owned by any person or entity caused by the Property Owners' contractor or other parties providing labor or services to the Property Owner shall be repaired by the Property Owner or by the Company at Property Owner's expense. The landscaping plan for all Family Dwelling Units and other structures must be completed within ninety (90) days of occupancy or substantial completion, whichever date shall first occur.

Section 8. Service Yards. Each Property Owner shall provide a visually screened area to serve as a service yard and an area in which garbage receptacles, fuel tanks or similar storage receptacles, electric gas meters, air conditioning equipment, clothes lines, and other unsightly objects must be placed or stored in order to conceal them from view from the road and adjacent properties. No window air conditioning units may be installed or used on any Residential Lot.

Section 9. Signs and Mailboxes. No signs or ornaments shall be erected or maintained on the Property by anyone including, but not limited to, the Property Owner, a realtor, a contractor or subcontractor, or except with the written permission of the Company or except as may be required by legal proceedings. If such permission is granted the Company reserves the right to restrict size, color and content of such signs. No mailboxes may be erected or maintained on the Property except mailboxes approved and provided by the Company to a Property Owner. The actual cost of providing, erecting and maintaining a mailbox, including

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Company approved numbering or lettering, shall be paid by the Property Owner.

Section 10. Other Buildings, Vehicles and Boats. No mobile home, recreational vehicle, trailer, tent, or other similar vehicle or out-building or structure shall be placed on any Residential Lot, Development Unit Parcel, Multiple Family Tract or any other Portion of the Property at any time, either temporarily or permanently without prior approval from the Company. No boat may be stored, temporarily or permanently, on any Residential Lot unless concealed from view in a garage approved by the Company.

Section 11. Unsightly Conditions. It shall be the responsibility of each Property Owner and tenant thereof to prevent the accumulation of litter, trash, packing crates or rubbish or the development of any unclean, unsightly or unkempt condition of buildings or grounds on his property either before, during or after construction, nor to permit accumulations which shall tend to substantially decrease the beauty of the community as a whole or the specific area.

Section 12. Lights. The design and location of all exterior lighting fixtures shall be subject to the approval of the Company. Neither these nor any other illumination devices, including but not limited to Christmas ornaments, located anywhere on the structures or grounds of any Residential Lot or Family Dwelling Unit shall be located, directed, or of such intensity to affect adversely the night-time environment of any adjacent property.

Section 13. Animals. No animals, livestock, or poultry of any kind shall be raised, bred, kept or pastured on the Property, except that: (i) a reasonable number of common household pets such as dogs and cats may be kept in any one Family Dwelling Unit, provided said pets must be secured by a leash or lead, or under the control of a responsible person and obedient to that person's command at any time they are permitted outside a house or other dwelling or other enclosed area approved by the Company for the maintenance and confinement of pets; and (ii) horses may be allowed in such areas and for such purposes as may be designated by the Company from time to time in the Company's sole discretion. No horse may be kept on any Residential Lot without the express written permission of the Company, and in the event such permission is granted the Property Owner will be subject to such rules and regulations regarding horses as may be published from time to time by the Company.

Section 14. Sewage. Prior to the occupancy of a Dwelling Unit, proper and suitable provisions shall be made for the disposal of sewage by connection with the sewer mains of the Company, its licensee, successor or assigns. No sewage or other waste material shall be emptied or

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discharged in to the ocean, any creek, marsh, river, sound, waterway or beach or shoreline thereof.

Section 15. Water. No private water wells may be drilled or maintained on any Residential Lot or any other portion of the Property so long as the Company or a public service district or other governmental unit, its successors and assigns has installed a water distribution line within 100 feet of such property with average daily water pressure in such line adequate for the normal household use in dwellings served by such distribution line.

Section 16. Repairs and Hazards. Any building or other improvement on the Property that is destroyed partially or totally by fire, storm or any other means shall be repaired or demolished within a reasonable period of time, and the land restored to an orderly and attractive condition.

Section 17. Offensive Activity. No noxious or offensive activity shall be carried on upon any Residential Lot, Family Dwelling Unit, Development Unit Parcel, Common Properties, Open Space Area, or any portion of the Property, nor shall anything be done thereon tending to cause embarrassment, discomfort, annoyance, or nuisance to the community. The Company shall have the express right, in its sole discretion, to publish rules from time to time to prohibit, regulate or otherwise deal with activities which violate this Paragraph. No fireworks of any type may be discharged within the property without express advance written permission of the Company.

Section 18. 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 electric, cable television, and telephone poles, wires, cables, conduits, drainage ways, sewers, wells, pumping stations, tanks, water mains and other suitable equipment for the conveyance and use of electricity, telephone equipment, gas, sewer, water, drainage or other public conveniences or utilities on, in or over those portions of the Property as may be reasonably required for utility line purposes; provided, however, that no such utility easement shall be applicable to any portion of the Property as may (a) have been used prior to the installation of such utilities for construction of a building whose plans were approved pursuant to these General Covenants by the Company, or (b) such portion of the Property as may be designated as the site for a building on a plot plan or for erection of a building which has been filed with the Company and which has been approved in writing by the Company. These easements and rights expressly include the right to cut any trees, bushes or shrubbery, make any gradings of the soil, or to take any other similar action reasonably necessary to provide

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economical and safe utility installation and to maintain reasonable standards of health, safety and appearance. Any material disturbance to the grounds of any Property Owner caused by such utility installation shall be repaired and said grounds returned to their prior condition by the Company or prompt and reasonable remuneration for such repair shall be made to such Property Owner by the Company.

Section 19. Antennas. Except with the written permission of the Company, no television antenna, receiving "dish", radio receiver or sender or other similar device shall be attached to or installed on the exterior portion of property within Haig Point. Nor shall radio, television signals, nor any other form of electromagnetic radiation be permitted to originate from any Family Dwelling Unit, Residential Lot, Multiple Family Tract, Public or Commercial Unit, Development Unit Parcel, or any other portion of the Property which may unreasonably interfere with the reception of television or radio signals upon any other of such properties. However, the provisions of this section shall not prohibit the Company from installing equipment necessary for a master antenna system, security system, cable television and mobile radio systems or other similar systems within Haig Point.

Section 20. Trespass. Whenever the Company is permitted by these Covenants to correct, repair, clean, preserve, clear out or do any action on any property or on the easement areas adjacent thereto, entering such property and taking such action shall not be deemed a trespass.

Section 21. Parcels. No Residential Lot shall be subdivided, or its boundary lines changed, except with the written consent of the Company. However, the Company hereby expressly reserves to itself, its successors or assigns, the right by to replat any lot and to take such other steps as are reasonably necessary to make such replatted lot suitable and fit as a building site including, but not limited to, the relocation of the lot or easements, walkways, rights-of-way, private roads, bridges, parks and recreational facilities. The provision of this Section shall not prohibit the combining of two (2) or more contiguous lots into one (1) larger lot. Following the combining of two (2) or more lots into one (1) larger lot, only the exterior boundary lines of the resulting larger lot shall be considered in the interpretation of these General Covenants. Consolidation of lots, as described above, must be approved by the Company, said approval to be granted in the Company's sole discretion upon such terms and conditions as may be established by the Company from time to time, including specific provisions for the payment of assessments.

Section 22. Bridges. The Company expressly reserves to itself, its successors and assigns, any other provisions in

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this Declaration notwithstanding, the right to build bridges, walkways, or fixed spans across any or all natural or man-made canals, creeks, paths, or lagoons in Haly Point. Nothing in this Section shall be construed as placing an affirmative obligation on the Company to provide or construct any such improvement.

Section 23. Repurchases. When any Residential Lot, Family Dwelling Unit, or Development Unit Parcel or any other portion of the Property is offered for sale by a Property Owner or successors in title to the Property Owner, the Company shall have the option to purchase such property at the price and on the terms of any duly executed bona fide contract for such property duly submitted to the Company for verification. The Company shall have thirty (30) days after presentation of such contract to exercise this purchase option. If the Company declines to exercise this option, it shall execute a Waiver of Repurchase Option, said Waiver to be an instrument prepared by the Company, its successors or assigns, which shall also be executed by the Property Owner and prospective purchaser and be in recordable form. Should, however, such sale to a third party not be consummated within six (6) months of the date of the contract transmitted to the Company, the terms and limitations of this Section shall again be imposed upon any sale by the Property Owner. If the Company shall elect to purchase such property, the transaction shall be consummated within sixty (60) days following delivery of notice by the Company to the Property Owner of its decision to purchase. The provisions of this paragraph shall not apply to sales under powers contained in Mortgages and similar security instruments.

Section 24. Ingress and Egress; Roadways and Waterways. The Property Owner, in accepting title to property conveyed subject to the covenants and restrictions of this Declaration, waives all rights of uncontrolled and unlimited egress and ingress to such property (and waives such rights for any person claiming entry rights by virtue of any relationship or permission of such Property Owner and successors in title) and agrees that such ingress and egress to its property may be limited to docks and roads built by the Company. The Company reserves the right for itself, its successors and assigns, but not the obligation, to (a) maintain guarded gates controlling access to such roads; (b) require payment of toll charges for use of such roads by members of the general public including business invitees, except that (1) no such toll shall be applicable to any Property Owners, lessees, or tenants of Property Owners, nor shall the toll be applicable to any person who gives reasonable evidence satisfactory to entry guards that their entry into the premises of the Property Owner is with the specific permission of the Property Owner, or his duly authorized agent; provided, however, that this exception

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shall not apply to commercial or construction vehicles of any kind; (2) no such toll charge shall be applicable to guests of the Company; (c) determine in its sole discretion the types of vehicles that will be permitted access to the Property and use of such roads; (d) provided, however, that the Company reserves the right to limit access to the Property to the Company, Property Owners, lessees or tenants, and their guests and invitees; and (e) further provided, that transportation fees may be charged for ferry boat and water taxi services and for jitney and transportation services within the Property. If and when the roadways and streets are conveyed to the Association the aforesaid rights may be assigned to the Association by the Company.

Section 25. Firearms. Without the written permission of the Company, no hunting by any means or discharge of firearms of any type shall be allowed on the Property; provided, however, the Company may develop or permit the development of skeet, trap and shooting ranges.

Section 26. Timesharing. No Dwelling Unit or other portion of the Property within Haig Point shall be used for or subject to any type of vacation Time Sharing Plan, as defined by Section 27-32-10, et. seq. of the 1976 Code of Laws of South Carolina, as amended.

ARTICLE III

ADDITIONAL RESTRICTIONS TO IMPLEMENT EFFECTIVE ENVIRONMENTAL CONTROLS

In order to protect the natural beauty of the vegetation, topography, and other natural features of all properties within Haig Point and in furtherance of the safety and esthetic enjoyment of Haig Point, the following environmental controls and restrictions are hereby established.

Section 1. Topography and Vegetation. In order to protect the natural beauty of the vegetation and topography of the shoreline, woodlands, marsh, lake and lagoon edges located throughout Haig Point, written approval of the Company is hereby required for the removal, reduction, cutting down, excavation or alteration of topographic and vegetation characteristics. Written approval will be granted for the minimum amount of earth movement required in plans and specifications approved pursuant to the provisions of Section 3 of Article II.

Section 2. Tree Removal. Prior to approval of a Property Owner's landscaping plan by the Company, no trees

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or underbrush may be removed without the written consent of the Company. Upon completion of a residence pursuant to approved plans, no trees measuring three (3) inches or more in diameter at a point four (4) feet above ground level measured outside bark to outside bark, may be removed without the written approval of the Company.

Section 3. Certain Controls. In order to implement effective insect, reptile and woods fire control, the Company and its agents have the right to enter upon any property on which a building or structure had not been constructed and upon which no landscaping plan had been implemented, for the purpose of mowing, removing, clearing, cutting, or pruning underbrush, weeds or other unsightly growth which in the opinion of the Company detracts from the overall beauty, setting and safety for Haig Point. The cost of this vegetation control shall be kept as low as reasonably possible and shall be paid by the owner of the property. The Company and its agents may likewise enter upon such property to remove any trash which has collected. The provisions in this paragraph shall not be construed as an obligation on the part of the Company to mow, clear, cut or prune any property, to provide garbage or trash removal services, or to provide water pollution control on any privately owned property. Entrance upon property pursuant to the provisions of this paragraph shall not be deemed a trespass.

Section 4. Pesticides; Fire Control. In addition, the Company reserves unto itself, its successors and assigns a perpetual, alienable and releasable easement and right on, over and under any portion of the Property to disperse pesticides and take other action which in the opinion of the Company is necessary or desirable to control insects, vermin, reptiles or any other animal not permitted by Article II, Section 12 of these Covenants, to put fire breaks and other activities which in the opinion of the Company are necessary or desirable to control fires on any property, or any improvements thereon. No burning of underbrush, trees, trash, leaves, debris or setting of fires for any purpose other than normal outdoor cooking shall be allowed without the written permission of the Company. Entrance upon property pursuant to the provisions of this paragraph shall not be deemed a trespass.

Section 5. Vehicle Control. In the interest of the health, safety and esthetic enjoyment of the Owners and visitors within Haig Point, the Company reserves unto itself, its successors and assigns, the exclusive and absolute right to prescribe or otherwise limit the type, size, axle length, tires, weight and engine or motor characteristics of all vehicles, boats, jitneys, carriages or other mode of transportation to be used within Haig Point, and further, to establish and enforce speed limits

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and other traffic and vehicle rules and regulations within Haig Point as the Company in its sole discretion deems appropriate.

Section 6. Parking. Parking on the traveled portion of any roadway within Haig Point shall be prohibited at all times. Parking areas will be established by the Company or the Association at various places for access to selected common areas and commercial areas. Any vehicle violating this restriction may be removed by the Company or its designated agent and towing charges assessed with the impounding of the vehicle.

Section 7. Beaches. In order that Property Owners, their guests and the guests of the Company may enjoy free and uninterrupted usage of the beaches of Haig Point, the use of any vehicle or mode of transportation of any nature, including bicycles, on the beaches of Haig Point shall be restricted and governed by such rules and regulations as may be adopted from time to time by the Company in its sole discretion.

ARTICLE IV

ADDITIONAL RESTRICTIONS AFFECTING OPEN SPACE AREAS

Section 1. Intention of Company. It is the intent of the Company to maintain and enhance (or to convey subject to open space restrictions to the Association) certain areas which the Company designates as "Open Space Areas" or "Private Open Space Areas" on plats subsequently filed for record in the office of the Register of Marine Conveyances of Beaufort County, South Carolina, by the Company and accompanied by a written instrument setting forth such restrictions. It is the further intent and purpose of these restrictions and covenants to protect, to maintain and enhance the conservation of natural and scenic resources, to promote the conservation of soils, wet lands, wildlife, game and migratory birds, enhance the value of abutting and neighboring properties adjacent to such forests, wildlife preserves, natural reservations or sanctuaries or other open areas and open spaces, and to afford and enhance recreation opportunities, preserve historical sites and implement generally the Haig Point Master Plan for development.

Section 2. Easement to Property Owners in Open Space Areas. An easement in Open Space Areas is hereby granted to the Owners of property in Haig Point, their tenants and to the guests of the Company and Property Owners which easement shall entitle such owners, tenants, and their guests to enjoy the Open Space Areas subject to the rules and regulations of the Company.

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Section 3. Open Space Uses. Land designated as "Open Space Areas" may be employed in the construction, maintenance, and enjoyment of the following types of facilities:

- (a) Social, recreational and community buildings.
- (b) Public and private profit making clubs, golf courses, equestrian centers and other recreational facilities.
- (c) Daycare centers, nursery schools and kindergartens.
- (d) Art schools and/or art galleries and/or museums.
- (e) Emergency squad(s) and fire stations.
- (f) Such other facilities and uses determined by the Company to be in the best interest of the community, including but not limited to, drainage, fire breaks, sewage effluent spray areas and soil borrow pits.

Section 4. Easement to Property Owners in Private Open Space Areas. Land designated as "Private Open Space Areas" shall be subject to the easement granted in Section 3 of this Article IV in every respect except that the enjoyment thereof shall be and is hereby limited to guests of the Company and owners of the property, their tenants and guests immediately contiguous and adjacent to such land and owners of non-contiguous property designated on plats of property in Haig Point as being entitled to the enjoyment thereof. The easement in Private Open Space Areas hereby granted shall not extend to any area not clearly designated as "Private Open Space Areas". All expenses incurred in the protection, maintenance and enhancement of "Private Open Space Areas" shall be paid equally by the owners who are entitled to an easement of enjoyment over such areas.

5. Private Open Space Improvements. Upon receipt of the written request of seventy-five percent (75%) of Property Owners having an easement of enjoyment over a Private Open Space Area, the Company at its sole discretion may permit the construction, maintenance, and operation of indoor and/or outdoor recreation facilities upon such Private Open Space Area. The cost of such construction, maintenance and operation shall be at the sole cost of the owners entitled to such easement of enjoyment.

Section 5. Wildlife Study. Pursuant to its overall program of wildlife conservation and nature study, the right is expressly reserved to the Company to erect wildlife feed stations, to plant small patches of cover and food crops for wildlife, to make access trails or paths or boardwalks through said Open Space Areas and Private Open Space Areas for the purpose of permitting observation and study of

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wildlife, hiking, and riding, to erect small signs throughout the Open Space Areas and Private Open Space Areas designating points of particular interest and attraction, and to take such other steps as are reasonable, necessary and proper to further the aims and purposes of the open space and community use and enjoyment thereof.

Section 7. Erosion Control. The Company shall have the right to protect from erosion all Property at Haig Point including Open Space Area or Private Open Space Area by planting trees, plants, and shrubs where and to the extent necessary or by such mechanical means as construction and maintenance of siltation basins, or other means deemed expedient or necessary by the Company. The right is likewise reserved to the Company to take steps necessary to provide and ensure adequate drainage ways in open spaces, to cut fire breaks, remove diseased, dead or dangerous trees and carry out other similar activities.

8. Reservation of Easements. The Company reserves unto itself, its successors and assigns, a perpetual, alienable and releasable easement of right to go on, over and under the ground to erect, maintain and use electric, community antenna television, telephone poles, wires, cables, conduits, drainage ways, sewers, water mains, and other suitable equipment for the conveyance and use of electricity, telephone and television equipment, gas, sewer, water drainage or other public conveniences or utilities in said Open Space Areas and Private Open Space Areas. These reservations and rights expressly include the right to cut any trees, bushes or shrubbery reasonably necessary to provide economical and safe utility installation and to maintain reasonable standards of health, safety and appearance. The Company further reserves the right to locate wells, pumping stations and tanks, or other utility facilities within such Open Space Areas and Private Open Space Areas. Such rights may be exercised by any licensee or assignee of the Company, but this reservation shall not be considered an obligation of the Company to provide or maintain any such utility or service.

Section 9. Public Rights Limited. The granting of the easement in Open Space Areas and Private Open Space Areas in this part in no way grants to the public or to the owners of any land outside Haig Point the right to enter such open space without the express permission of the Company.

Section 10. Reservations. The Company expressly reserves to itself, its successors and assigns, every reasonable use and enjoyment of said open space, in a manner not inconsistent with the provisions of this Declaration.

Section 11. Conveyance of Open Space Areas. The Company further reserves the right to convey "Open Space

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Areas" to the Association or any non-profit organization. Such conveyance shall be made subject to the provisions of this Article IV and shall contain such additional restrictions and reservations as set forth in the deed of conveyance. As an appurtenance to such conveyances, the Association shall have all of the powers, immunities and privileges reserved unto the Company in this part as well as all of the Company's obligations with respect thereto, including the obligation to maintain and enhance set out in Section 1 of this Article. Property conveyed to the Association pursuant to the authority of this Section 11 shall become "Common Properties", "Restricted Common Properties", or "Purchased Common Properties" as prescribed by the "Declaration of Covenants and Restrictions of the Haig Point Community Association, Inc.", which are to be recorded in the Office of the Clerk of Court of Beaufort County, South Carolina, contemporaneously herewith.

Section 12. Company Actions. Where the Company is permitted by these covenants to correct, repair, clean, preserve, clear out or do any action on any restricted property, entering the property and taking such action shall not be deemed a trespass or breach of these Covenants.

Section 13. No Obligation on Company. It is expressly understood and agreed that the granting of the easements set out in this Article IV in no way places a burden of affirmative action on the Company, that the Company is not bound to dedicate any area as Open Spaces or to make any of the improvements noted herein, or extend to any Property Owner any service of any kind, except as such may be undertaken at the expense of the Association.

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SPECIAL RESTRICTIONS AFFECTING GOLF FAIRWAY RESIDENTIAL AREAS

Section 1. Definitions. "Golf Fairway Residential Areas" are hereby defined as all those Residential Lots or blocks of land intended for subdivision located adjacent to any golf course located in the Property.

Section 2. Landscaping. That portion of any Golf Fairway Residential Lot within thirty (30) feet of the lot line bordering the golf course shall be in general conformity with the overall landscaping pattern for the golf course fairway area established by the golf course architect. All individual lot landscaping plans must be approved by the Company before their implementation.

Section 3. Maintenance Easement. There is reserved to the Company a "Golf Course Maintenance Easement Area" on

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each Property adjacent to any golf course located in the Property. This reserved easement shall permit the Company to go onto any Golf Course Maintenance Easement Area. Such maintenance and landscaping may include regular removal of underbrush, trees less than three (3) inches in diameter, stumps, trash or debris, planting of grass, watering, application of fertilizer, and mowing the Easement Area. This Golf Course Maintenance Area shall be limited to the portion of such lots within thirty (30) feet of the lot line(s) bordering the golf course, provided, however, that the above described maintenance and landscaping rights shall apply to the entire lot until there has been filed with the Company a landscaping plan for such lot by the Owner thereof, or alternatively, a residence is constructed on the lot. Notwithstanding the provisions herein of this Article V the Company hereby reserves the right to allow an owner to construct a dwelling over a portion of the "Golf Course Maintenance Easement Area" in those cases where it, in its uncontrolled discretion, determines that such construction will not materially lessen the beauty or playing qualities of the adjacent golf course, or unreasonably interfere with the views of adjoining Property Owners.

Section 4. Golf Easement. Until such time as a residence is constructed on a lot, the Company reserves an easement to permit and authorize registered golf course players and their caddies to enter upon a lot to recover a ball or play a ball, subject to the official rules of the course, without such entering and playing being deemed a trespass. After a residence is constructed, such easement shall be limited to that portion of the lot included in the Golf Course Maintenance Easement Area, and recovery of balls only, not play, shall be permitted in such Easement Area. Golfers or their caddies shall not be entitled to enter on any such lot with a golf cart or other vehicle, shall not spend unreasonable time on such lot, or in any way commit a nuisance while on such lot. After construction of a residence on a Golf Fairway Residential Lot, "Out of Bounds" markers may be placed on said lot at the expense of the Company.

Section 5. Restrictions. Owners of Golf Fairway property shall be obligated to refrain from any actions which would detract from the playing qualities of the golf course or the development of an attractive overall landscaping plan for the entire golf course area. Such prohibited actions shall include, but are not limited to, such activities as the maintenance of unfenced dogs or other pets on the lot under conditions interfering with play due to their loud barking, running on the fairways, picking up balls or other like interference with play.

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ARTICLE VI

SPECIAL RESTRICTIONS AFFECTING ALL WATERFRONT AND WOODLAND AREAS

Section 1. Habitat Preservation. In order to preserve the natural appearance and scenic beauty of the property and to provide a "cover" for animals which habitually move along the woodland or marshland, Company designated wildlife areas and the area located within thirty (30) feet of the South Carolina Coastal Council Critical Line and with fifteen (15) feet of the top of the bank of any lake, lagoon or waterway shall be preserved substantially in its present natural state except for Company approved clearing for view and breezes. Notwithstanding the foregoing, the Company hereby reserves the right to exempt lots or portions of lots from said construction and clearing restrictions in those cases where it, in its uncontrolled discretion, determines that such exemption will not materially lessen the wildlife habitat, natural appearance and scenic beauty of the property.

Section 2. Watercraft Restrictions. In order to protect the natural beauty and water quality of the natural ponds, man-made lakes and lagoons, water craft will be allowed to operate only on the inland ponds, man-made lakes and lagoons as designated by the Company where the operation will not affect golf and other outdoor recreational facilities or residential facilities or residential units. Permission to operate water craft on the designated waterways shall be at the discretion of the Company which will establish operating rules for each designated waterway. To this end, water craft propelled by an internal combustion engine shall not be allowed except to perform maintenance or other community related functions with prior Company approval.

ARTICLE VII

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ADDITIONS, LIMITATIONS, MODIFICATIONS
AND VIOLATION OF COVENANTS

Section 1. Duration. All covenants, restrictions, and affirmative obligations set forth in this Declaration shall run with the land and shall be binding on all parties and persons claiming under them specifically including, but not limited to, the successors and assigns, if any, of the Company for a period of twenty-five (25) years from the execution date of the Declaration after which time all said covenants shall be automatically extended for successive periods of ten (10) years, unless changed in whole or in part by an instrument signed by the then Owners of two thirds (2/3) of Residential lots and Family Dwelling Units in the Property.

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Section 2. Enforcement. In the event of a violation or breach of any of the restrictions contained herein by any Owner of property within the Property or by any agent of such Owner, any other Owner of property shall have the right to proceed at law or in equity to compel a compliance with the terms hereof or to prevent a violation or a breach. In addition to the foregoing, the Company and/or Association shall have the right to proceed at law or in equity to compel a compliance with the terms hereof or to prevent a violation or a breach. In addition to the foregoing the Company and/or Association shall have the right, whenever there shall have been built on any lot any structure which is in violation of these restrictions, to enter upon such property where such violation exists and summarily abate or remove the same at the expense of the Owner, if after thirty (30) days' written notice of such violation it shall not have been corrected by the Owner. Any such entry and abatement or removal shall not be deemed a trespass. Any person entitled to file a legal action for the violation of these covenants shall be entitled to recover reasonable attorney's fees as a part of such action. The failure to enforce any rights, reservations, restrictions, or condition contained in the Declaration, however long continued, shall not be deemed a waiver of this right to do so hereafter as to the same breach, or as to a breach occurring prior or subsequent thereto and shall not bar or affect its enforcement.

Section 3. Amendment by Company. The Company reserves the right at its sole discretion to amend, modify, add to, subtract from, cancel or in any way change these General Covenants or to limit the property subject to these General Covenants for a period of six (6) years from the date hereof. Thereafter, these General Covenants may be amended by the Company with the written approval of Property Owners owning at least sixty-six and two-thirds percent (66-2/3%) of all Family Dwelling Units and Residential Lots in the Property.

Section 4. Additional Restrictions. The Company hereby reserves the right to add additional restrictive covenants in the future which may apply to any portion of the Property or to any addition to the Property which has not been conveyed by the Company to any grantee.

Section 5. Successors to Company. The Company reserves the right to assign to the Association or to any other entity any of its rights or functions reserved in these covenants including, but not limited to, its rights to approve (or disapprove) plans and specifications of proposed improvements.

Section 6. Severability. Should any covenant or restriction herein contained, or any article, section,

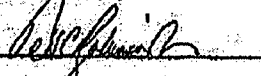
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subsection, sentence, clause, phrase or term of this Declaration be declared to be void, invalid, illegal, or unenforceable, for any reason, by the adjudication of any court or other tribunal having jurisdiction over the parties hereto and the subject matter hereof, such judgment shall in no wise affect the other provisions hereof which are hereby declared to be severable and which shall remain in full force and effect.

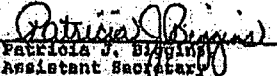
IN WITNESS WHEREOF, International Paper Realty Corporation of South Carolina has caused these presents to be executed by its duly authorized officers this 31 day of August, 1985.

SIGNED, SEALED AND
DELIVERED IN THE
PRESENCE OF:


R. Kyle Jerney

INTERNATIONAL PAPER
REALTY CORPORATION
OF SOUTH CAROLINA

By: 
R. Michael Ross, President

By: 
Patricia J. Blaginsky
Assistant Secretary

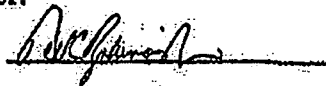
FILED IN DEED - C BOOK 431 PAGE 358
FILED AT 165888 ON 10/01/85

EXHIBIT 2

STATE OF SOUTH CAROLINA }
COUNTY OF BEAUFORT }

PROBATE

PERSONALLY appeared before me Neil C. Robinson, Jr., who, being duly sworn, deposes and says that (s)he saw International Paper Realty Corporation of South Carolina, by R. Michael Ross, its President, and Patricia J. Biggins, its Assistant Secretary, sign the within Declaration, and the said Corporation by said officers seal said Declaration, and as the act and deed of said Corporation, deliver the same, and that (s)he with A. Neville Jarvey witnessed the execution thereof.



SWORN to before me this

31 day of August, 1985.

A. Neville Jarvey (seal)
Notary Public for South Carolina

My Commission Expires: July 1, 1992

FILED IN DEED - C BOOK 431 PAGE 351
FILED AT 165800 ON 10/01/85

EXHIBIT 2

EXHIBIT A

ALL THAT certain piece, parcel or tract of land, situate, lying and being on Daufuskie Island, Beaufort County, State of South Carolina, known as Haig Point Plantation, consisting of one thousand and forty (1,040) acres of said Haig Point Plantation located on Daufuskie Island, being more particularly bounded and described as follows: on the North by Cooper River, on the East by Calibogue Sound, on the South by Melrose Plantation and the Webb Tract and on the West by what is known as the Cooper River Settlement Subdivision. The lines between the Melrose lands and the Webb Tract and the Cooper River Settlement Subdivision are marked by the original ditches. Said property being more accurately described on that certain plat by Gifford, Nielson & Williams titled "Plat of A 1040.236 Acre Tract Known As Haig Point Plantation" dated July 12, 1984 and finally revised October 17, 1984 and recorded in Plat Book 32, Page 151.

ALSO

ALL THOSE two certain lots, tracts or parcels of land, situate, lying and being on a part of the plantation known as Haig Point Plantation on Daufuskie Island, South Carolina, the first northerly piece is bounded on a line commencing at a monument of stone standing at the high mark of the Cooper River and running South seven (7) degrees and thirty (30) minutes east five hundred and eighty-five (585) feet to a monument of stone, thence north eighty-two (82) degrees and thirty (30) minutes east four hundred and twenty-four (424) feet to a mark; thence northerly along the high water mark to the place of beginning, containing three (3) acres, more or less. The second and southerly piece or parcel of land lies to the south of the first piece of land above described, not adjoining it, and is bounded by a line commencing at a monument of stone, standing at high water mark at the edge of the marsh lying on Calibogue Sound, thence running south eighty-two (82) degrees and thirty (30) minutes west to a monument of stone three hundred (300) feet, thence south seven (7) degrees and thirty (30) minutes east five hundred and seventy-five (575) feet to the high water mark at the edge of the marsh, thence along the high water mark inland of the marsh to the place of beginning, containing two (2) acres of land, more or less, said southerly parcel being more fully shown and described on the amended plat of July 12, 1984 by Gifford, Nielson & Williams as "Front Range Lighthouse Tract" to which reference is craved. Said plat is recorded in the Office of the Clerk of Court for Beaufort County in Plat Book 32, Page 151.

FILED IN DEED - C BOOK 431 PAGE 352
FILED AT 165080 ON 10/01/85

EXHIBIT 2

EXHIBIT B

All that certain piece, parcel or tract of land, situate, lying and being on Beaufort Island, Beaufort County, South Carolina, sometimes referred to as the Wild Tract, containing seven hundred and thirty-three (733) acres, according to the survey and plat of Harold R. Johnson, Surveyor, dated July 9, 1930, recorded in the Office of the Clerk of Court for Beaufort County in Plat Book 12, Page 52, and showing the following metes and bounds, to wit: commencing at a concrete marker on the high water mark of the Cooper River on the property line between the Wild Tract and the property of the heirs of Robert Jenkins and running South 60 degrees 40 minutes East, 69.71 chains along a ditch to an iron pipe on the West side of a road, thence South 60 degrees, South minutes East, 0.74 chains to an iron pipe on the opposite side of the road, thence continuing South 60 degrees, forty-five minutes East, 25.16 chains to a marker, thence South thirty-one degrees forty-five minutes East 10.34 chains to an iron pipe which is the Southeast corner of the tract of land and the boundary line between the Wild Tract and the lands of Harpers thence South 55 degrees, forty-five minutes West 6.86 chains to an iron stake, thence South 55 degrees, fifteen minutes West 30.31 chains to a cross iron pipe, thence South 55 degrees, fifteen minutes West 13.66 chains to a six inch iron pipe, which is the Southeast corner of the Wild Tract, thence South 74 degrees, 40 minutes West, 74 chains to an iron pipe 2 feet in diameter, thence North 60 degrees, 30 minutes West, 4.18 chains to an iron stake at the high water mark of the marshes of the Cooper River which is the Southeast corner of the Wild Tract, thence along the high water mark of the Cooper River in a generally northern direction to the point of beginning, and bounded on the North now or formerly by lands of the heirs of Robert Jenkins, William Rogers and others, on the East by Melrose Plantation, now or formerly of Bradford, on the South by lands now or formerly of H. White, Frank White Jenkins and Melrose Johnson, and on the West by the waters and marshes of the Cooper River. Said property being more accurately described as the Wild Tract on that certain plat of Coastal Surveying Co., Inc. dated May 2, 1930 and recorded in the Office of the Clerk of Court for Beaufort County in Plat Book 28, Page 171.

FILED IN DEED - C BOOK 431 PAGE 333
FILED AT 15268 ON 10/01/85

All that certain piece, parcel or tract of land, situate, lying and being on Beaufort Island, Beaufort County, South Carolina, designated as Oak Ridge Plantation and sometimes known as Walker Road Plantation, containing five hundred thirty-eight and nine hundred (538,9) acres, according to plat of said tract of land prepared August, 1931, by Palmer & Roberts, Inc., Civil Engineers, said tract of land is bounded on the Northeast by Melrose Plantation, now or formerly belonging to Robert H. Stoddard, on the Southeast and South by the high water mark of the

EXHIBIT 2

Atlantic Ocean, on the Southwest and West by Bloody Point Plantation, now or formerly owned by Morton Deutsch, a small tract owned by Mr. Burn; Lot No. One of Benjes Point tract, owner unknown; and by another piece of land owned by Morton Deutsch, on the Southwest and Northwest by what was formerly known as Maryfield Plantation and bounded by portion thereof owned by various parties, namely Robinson, Frances Jones, John Mitchell, Malcolm Johnson, et al. Said parcel being more accurately described as Oak Ridge Plantation on that certain plat of Coastal Surveying Co., Inc. dated May 2, 1950 and recorded in the Office of the Clerk of Court for Beaufort County in Plat Book 28, Page 171.

Robinson, Frances Jones & Mitchell
 FILED IN DEED - 6 BOOK 431 PAGE 354
 FILED AT 165000 ON 10/01/03 64017
 BOOK NUMBER 431 PAGES 325-334
 FILING FEE \$1.00
 STATE STAMPS .00
 COUNTY STAMPS .00
 TOTAL FEES \$1.00
 HENRY JACKSON
 CLERK OF COURT 1ST CITY, SC

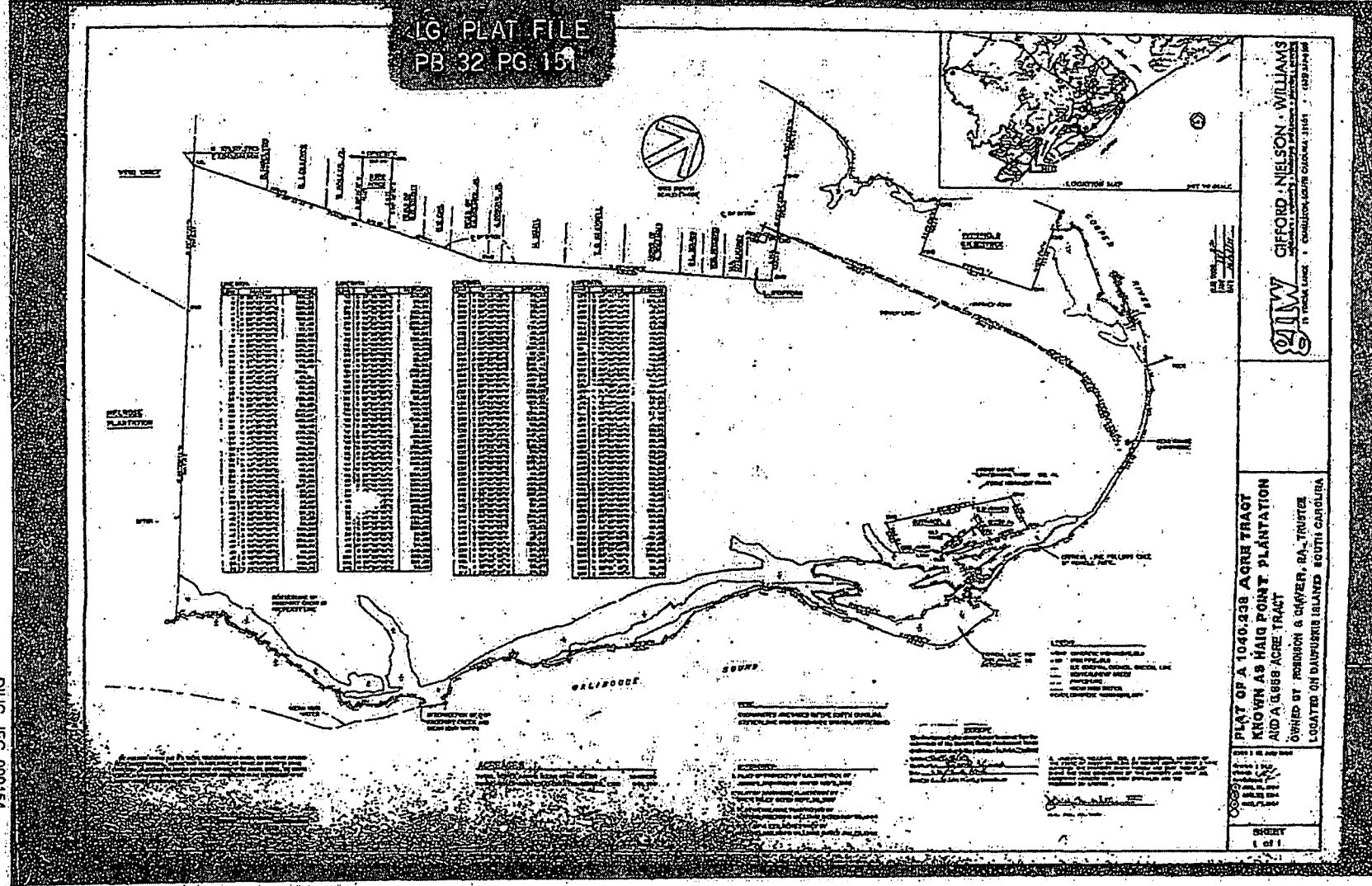


EXHIBIT 3

8/1/93

3469

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STATE OF SOUTH CAROLINA)
COUNTY OF BEAUFORT)

INDENTURE GRANT OF EASEMENT
AND BILL OF SALE
FOR PERSONAL PROPERTY

THIS INDENTURE EASEMENT AND BILL OF SALE FOR PERSONAL PROPERTY made effective the 3rd day of January, 1994, by and between BLOODY POINT GROUP LIMITED PARTNERSHIP, Post Office Box 21607, Hilton Head Island, South Carolina 29925 (hereinafter referred to as "Owner") and THE MELROSE UTILITY COMPANY, INC., a private utility company duly chartered and existing under the laws of the State of South Carolina, Post Office Box 21607, Hilton Head Island, South Carolina 29925 (hereinafter referred to as "Utility").

WITNESSETH:

WHEREAS, Utility owns and operates a water supply and sewage collection, disposal and treatment system on Daufuskie Island, Beaufort County, South Carolina; and

WHEREAS, Owner is the owner of certain real property within that area known as Bloody Point on Daufuskie Island, more particularly described in Exhibit "A" attached hereto and by this reference incorporated herein, upon which residential and recreational structures and facilities may be or have been constructed together with certain water mains and sanitary sewer lines; and

WHEREAS, Utility has agreed to provide water and sewer service to Bloody Point and to acquire the said water mains, sanitary sewer lines and related infrastructure, along with easements to such utility infrastructure, for nominal consideration and in further consideration of the operation and maintenance of said lines after the acquisition thereof.

NOW THEREFORE, KNOW ALL MEN BY THESE PRESENTS, that BLOODY POINT GROUP LIMITED PARTNERSHIP for and in consideration of the sum of Ten and No/100 Dollars (\$10.00) to it in hand paid and before the sealing of these presents, by THE MELROSE UTILITY COMPANY, INC., in the State aforesaid, the receipt and sufficiency of which is hereby acknowledged, has granted, bargained, sold and released and by these presents does grant, bargain, sell and release unto the Utility, its successors and assigns forever, the following easements and personal property upon the terms and conditions stated herein:

EASEMENTS

1. A PERPETUAL NON-EXCLUSIVE UTILITY EASEMENT, said easement lying in and under and through those private right-of-ways known as River Road, Bloody Point Drive and Puskie Lane in Bloody Point, Daufuskie Island, South Carolina, and up to the front ten (10') feet of all residential lots abutting said

BETHEA, JORDAN
& GRIFFIN, P.A.
ATTORNEYS AND
COUNSELORS AT LAW

EXHIBIT 3

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private rights-of-way, to the extent necessary, if the utility infrastructure is placed outside the private rights-of-way upon residential property abutting said rights-of-way, all easement property being a portion of Bloody Point, Daufuskie Island, South Carolina, more particularly described in Exhibit "A" attached hereto and by this reference incorporated herein. Said easement being for the purposes of accessing and maintaining the water and sewer utility infrastructure, sewage force mains, water mains and effluent lines shown and described on those certain plats and plans prepared by Thomas & Hutton Engineering Company, Inc. listed on Exhibit "B" attached hereto and by this reference incorporated herein.

2. **A PERPETUAL NON-EXCLUSIVE UTILITY EASEMENT**, said easement lying in and under and through that parcel known as the Bloody Point Golf Course containing 182.38 acres, more or less, and depicted on that certain plat entitled "A Plat of Bloody Point Golf Course & Facilities" dated May 16, 1990 by Boyce L. Young, S.C.R.L.S. 11079, of Thomas & Hutton Engineering and recorded July 24, 1990 in the Beaufort County R.M.C. Office in Plat Book 39 on Page 40. Said easement being for the purposes of accessing and maintaining the water and sewer utility infrastructure, sewage force mains, water mains and effluent lines shown and described on those certain plats and plans prepared by Thomas & Hutton Engineering Company, Inc. listed on Exhibit "B" attached hereto and by this reference incorporated herein, and said easement including up to ten (10') feet of all residential lots abutting said Bloody Point Golf Course, to the extent necessary, if the utility infrastructure is placed outside the Bloody Point Golf Course.

The easements intended to be conveyed herein pertain to the property conveyed to the within Owner by deed dated October 26, 1989, and recorded in the R.M.C. Office for Beaufort County, South Carolina, in Deed Book 539 at Page 1333.

INFRASTRUCTURE

1. All pipes, valves, hydrants, fittings, wells, pumps and appurtenances to the water supply and sanitary sewage collection system as more fully shown and described on the "as built" plans for the system prepared by Thomas & Hutton Engineering Company, Inc. and listed on Exhibit "B" attached hereto and by this reference incorporated herein. Said conveyance shall include two potable water wells, an 80,000 gallons per day wastewater treatment facility, water distribution lines up to and including all residential and commercial water meters, all sewage collection mains, lift stations and manholes. Said conveyance shall not include those portions of the water distribution systems from existing or future individual residences or buildings to the water meters, or those portions of the sewage collection system from each building or residence to either the manhole or stub-in in the sewage collection line.
2. All inventory and equipment listed on Exhibit "C" attached hereto and by this reference incorporated herein.

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TERMS AND CONDITIONS

(a) This Easement Agreement may be terminated or modified by the Owner and Utility at any time by mutual consent by an instrument in writing which refers to this Easement and Bill of Sale and which is recorded in the RMC Office for Beaufort County, South Carolina.

(b) This Agreement is binding upon and shall benefit the parties hereto, their successors and assigns.

(c) The Utility may use the property herein conveyed only for purposes of the operation of the water and sewer service. The Utility's permitted use of the property shall also include the right to reasonable access to the property for purposes of maintenance, repair and replacement of the water supply and sewage treatment and disposal systems located thereon. Utility shall also have the right to reasonable access to the easement property for the purpose of testing and inspecting which shall include surface and subsurface tests and inspections.

(d) This conveyance is subject to all applicable restrictions, covenants, easements, etc. applicable to the subject Property and of record in the RMC Office for Beaufort County, South Carolina.

(e) This conveyance is made pursuant to the terms and conditions of the Agreement referenced above, which is hereby incorporated by reference herein and which shall not merge with the passing of title but which shall survive.

TOGETHER with all and singular, the rights, members, hereditaments and appurtenances to the above property belonging to or in anyway incident or appertaining to the above-described property. Owner expressly reserves the right to use the lands covered by the easements above for any purpose which will not interfere with the use of the easements by the Utility in the operation of the water and sewer systems.

TO HAVE AND TO HOLD, all and singular, the rights, privileges and easements aforesaid unto **THE MELROSE UTILITY COMPANY, INC.**, its successors and assigns forever.

BETHEA, JORDAN
B. GRIFFIN, P.A.
ATTORNEYS AND
COUNSELLORS AT LAW

EXHIBIT 3

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IN WITNESS WHEREOF, Owner has caused these presents to be executed in its name and its corporate seal affixed hereto in Hilton Head Island, South Carolina on the 3 day of January, in the year of our Lord one thousand nine hundred and ninety-four and in the two hundred and Eighteenth year of the Sovereignty and Independence of the United States of America.

WITNESSES:

OWNER:
BLOODY POINT GROUP LIMITED
PARTNERSHIP

By: THE MELROSE COMPANY, INC.
General Partner

By:

Donna M. Buckle

James C. Gault

Attest:

STATE OF SOUTH CAROLINA)
COUNTY OF BEAUFORT)

PROBATE

PERSONALLY appeared before me the undersigned witness who, on oath, says that s/he saw the within-named BLOODY POINT GROUP LIMITED PARTNERSHIP by its appropriate officers sign the within Indenture Deed Grant of Easement and Bill of Sale, and the said Corporation, by said officers, seal said Instrument, and, as its act and deed, deliver the same, and that s/he with the other witness subscribing above witnessed the execution thereof.

SWORN to before me this 3
day of January, 1994.

Donna M. Buckle
Witness

James C. Gault (L.S.)

Notary Public for South Carolina
My Commission Expires: 2/23/99
(md,tow:12:22:00:01)

BETHEA JORDAN
& GRIFFIN, P.A.
ATTORNEYS AND
COUNSELORS AT LAW

EXHIBIT 3

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IN WITNESS WHEREOF, THE MELROSE UTILITY COMPANY, INC., acknowledges its acceptance of the personal property and easements described herein in accordance with the terms and conditions set forth above, this 3rd day of January, 1994.

WITNESSES:

UTILITY:
THE MELROSE UTILITY COMPANY,
INC.

Donna M. Beechko
Jerese C. Baret

By: James R. Bist

By: [Signature]

STATE OF SOUTH CAROLINA)
COUNTY OF BEAUFORT)

PROBATE

PERSONALLY appeared before me undersigned witness who, on oath, says that s/he saw the within-named THE MELROSE UTILITY COMPANY, INC. by its appropriate officers sign, seal, and as its act and deed, deliver the within written Indenture Deed Grant of Easement and Bill of Sale; and that s/he with other witness subscribing above witnessed the execution thereof.

SWORN to before me this 3
day of January, 1994.

Donna M. Beechko
Witness

Jerese C. Baret (L.S.)
Notary Public for South Carolina
My Commission Expires: 3/23/99
notidw-52-melrose1

BETHEA, JORDAN
& GRIFFIN, P.A.
ATTORNEYS AND
COUNSELORS AT LAW

EXHIBIT 3

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Exhibit "A"

ALL those certain pieces, parcels or tracts of land lying and being on Daufuskie Island, Beaufort County, South Carolina, having and containing 330.48 acres, more or less, and being shown as Tract C, Bloody Point on that plat entitled "Plat of the Lands of the Estate of Morton Deutsch and Surfside Development Company Totaling 541.74 Acres," said plat dated July 28, 1988, prepared by Matthew M Crawford, S.C.R.L.S. #9756 of Southeastern Surveying, Inc., said plat having been recorded in the RMC Office for Beaufort County, South Carolina, in Plat Book 35 at Page 223.

BETHEA, JORDAN
& GRIFFIN, P.A.
ATTORNEYS AND
COUNSELLORS AT LAW

EXHIBIT 3

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Exhibit "B"

1. Two potable water wells and related infrastructure as depicted in the plans by Thomas & Hutton Engineering Company entitled "Potable Water Wells No. 1 and No. 2 for the Daufuskie Island Club" dated April, 1989, sheets 1 through 14 inclusive.
2. 80,000 gallons per day wastewater treatment facility and related infrastructure as depicted on the plans by Thomas & Hutton Engineering Company entitled "Construction of an 80,000 GPD Wastewater Treatment Facility to Serve the Daufuskie Island Club" dated May 3, 1989, sheets 1 through 15 inclusive.
3. All water and sanitary sewer utility infrastructure as depicted on the plans prepared by Thomas & Hutton Engineering Company entitled "Site Development for the Bloody Point Village of the Daufuskie Island Club" dated May 15, 1990, sheets 1 through 6 inclusive.
4. All water and sanitary sewer utility infrastructure, including pump stations, as depicted on the plans prepared by Thomas & Hutton Engineering Company entitled "Site Development for the Phase I Lots of the Daufuskie Island Club" dated May 3, 1989, sheets 1 through 20 inclusive.
5. Water and sanitary sewer utility infrastructure as depicted on the plans prepared by Thomas & Hutton Engineering Company entitled "Site Development for the Daufuskie Island Club Phase III Lots at Bloody Point, Daufuskie Island, Beaufort County, South Carolina" dated June, 1991, sheets 1 through 7 inclusive.
6. All water and sanitary sewer utility infrastructure located in, on or through those private right-of-ways known as Bloody Point Road and Fuskie Lane depicted on plat prepared by Thomas & Hutton Engineering Company entitled "A Plat of Bloody Point Golf Course & Facilities" dated May 16, 1990 and last revised December 19, 1990 by Boyce L. Young, S.C.R.L.S. 11079 of Thomas & Hutton Engineering Company.
7. Water and sanitary sewer utility infrastructure located in, on or through the 50 foot right-of-way extending from Fuskie Lane depicted on the plat prepared by Thomas & Hutton Engineering Company entitled "A Plat of Phase III (formerly Parcel C) A Portion of Daufuskie Island Club" dated May 22, 1991, revised January 21, 1992 and recorded November 30, 1992 in Plat Book 45 at Page 39.

BETHEA, JORDAN
& GRIFFIN, P.A.
ATTORNEYS AND
COUNSELORS AT LAW

EXHIBIT 3

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Exhibit "C"

All inventory and equipment.

NONE

BETHEA, JORDAN
& GRIFFIN, P.A.
ATTORNEYS AND
COUNSELORS AT LAW

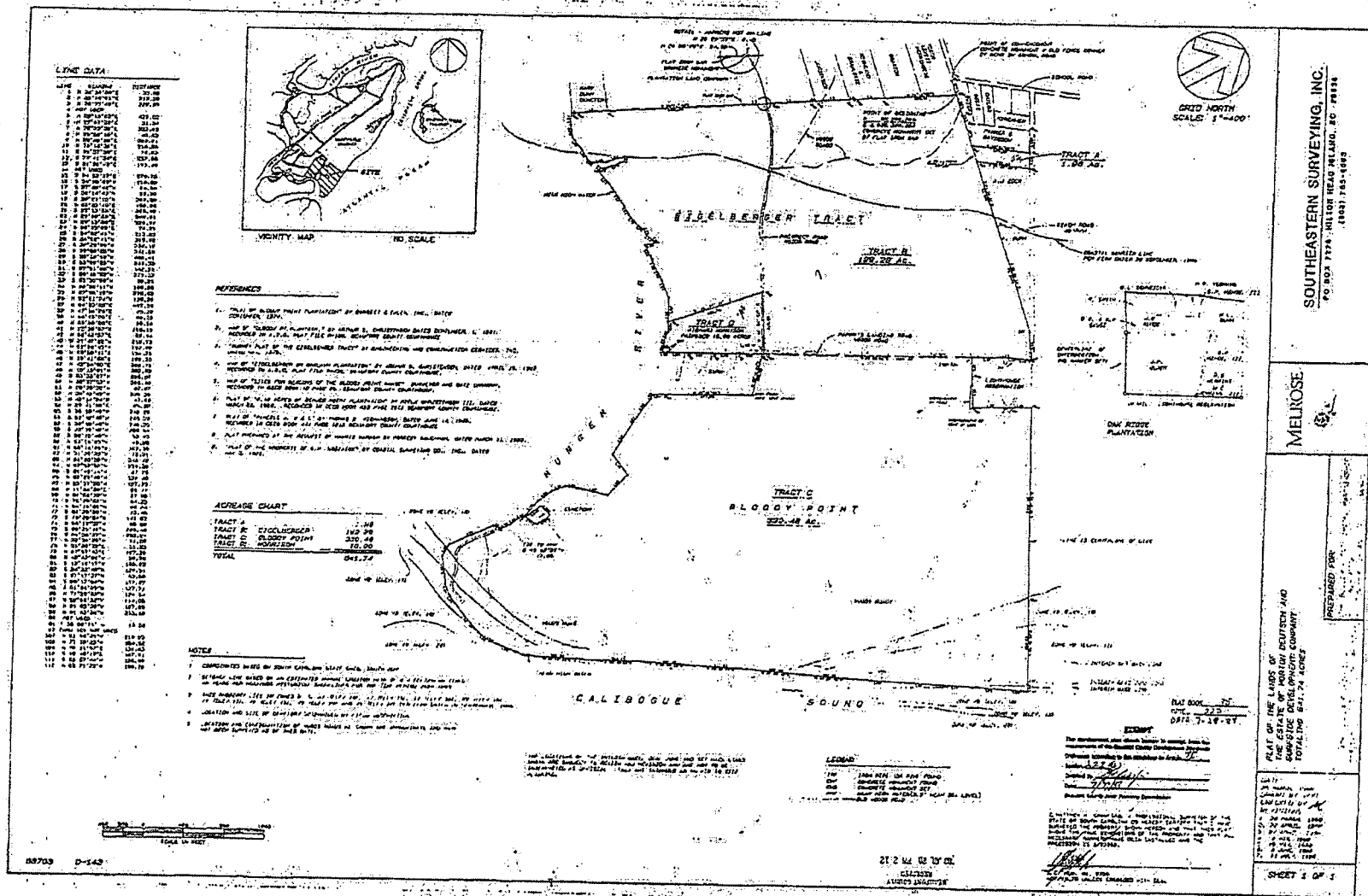


EXHIBIT 4

Average Monthly Water and Sewer Costs - Based on Monthly Usage of 11,000 Gallons

Utility		Monthly Base	Quarterly Base	Monthly Water Usage	Monthly Billed Usage	Usage Rate	Monthly Cost	Total Water	Monthly Base	Quarterly Cost	Monthly Billed Usage	Usage Rate	Monthly Cost	Total Sewer	Monthly TOTAL
St. John's County Utility Dept.	2014	\$ 12.08		11,000 tg	11,000 tg	\$ 3.07	\$ 33.77	\$ 45.85	\$ 13.27		11,000 tg	\$ 4.19	\$ 46.09	\$ 59.36	\$ 105.21
Charleston Water System	2016	\$ 19.35		14,704 ccf	12,704 ccf	\$ 3.24	\$ 41.16	\$ 60.51	\$ 41.00		12,704 ccf	\$ 9.83	\$ 124.88	\$ 165.88	\$ 226.39
Charleston Water System	2015	\$ 18.75		14,704 ccf	12,704 ccf	\$ 3.15	\$ 40.02	\$ 58.77	\$ 39.00		12,704 ccf	\$ 9.71	\$ 123.36	\$ 162.36	\$ 221.12
Mt. Pleasant		\$ 8.00		11,000 tg	11,000 tg	\$ 4.07	\$ 44.77	\$ 52.77	\$ 14.00		11,000 tg	\$ 4.90	\$ 53.90	\$ 67.90	\$ 120.67
Folly Beach	2015	\$ 21.58		11,000 tg	11,000 tg	\$ 3.90	\$ 42.90	\$ 64.48	\$ 27.18		11,000 tg	\$ 5.05	\$ 55.55	\$ 82.73	\$ 147.21
Isle of Palms	2015	\$ 15.00		11,000 tg	11,000 tg	\$ 3.59	\$ 39.49	\$ 54.49	\$ 22.78		11,000 tg	\$ 5.46	\$ 60.06	\$ 82.84	\$ 137.33
Sullivan Island	2014	\$ 28.83		11,000 tg	11,000 tg	\$ 3.33	\$ 13.32	\$ 92.83	\$ 23.82		11,000 tg	\$ 6.16	\$ 24.63	\$ 173.81	\$ 266.64
Seabrook Island		\$ 18.30		11,000 tg	11,000 tg	\$ 3.76	\$ 41.36	\$ 59.66	\$ 34.10		- tg	\$ -	\$ -	\$ 34.10	\$ 93.76
Daufuskie Island Utilities Co.	2016	\$ 49.77	\$ 149.30	11,000 tg	11,000 tg	\$ 4.41	\$ 48.51	\$ 98.28	\$ 72.73	\$ 218.18	11,000 tg	\$ 2.38	\$ 26.18	\$ 98.91	\$ 197.18
Excluding Income Taxes		\$ 44.40	\$ 133.21	11,000 tg	11,000 tg	\$ 3.93	\$ 43.23	\$ 87.63	\$ 63.57	\$ 190.70	11,000 tg	\$ 2.08	\$ 22.88	\$ 86.45	\$ 174.08
Excluding Income & Property Taxes		\$ 38.78	\$ 116.35	11,000 tg	11,000 tg	\$ 3.44	\$ 37.84	\$ 76.62	\$ 54.69	\$ 164.08	11,000 tg	\$ 1.79	\$ 19.69	\$ 74.38	\$ 151.01
Excl. Income Tax, Prop. Tax & Equity Return		\$ 35.19	\$ 105.57	11,000 tg	11,000 tg	\$ 3.12	\$ 34.32	\$ 69.51	\$ 48.55	\$ 145.66	11,000 tg	\$ 1.59	\$ 17.49	\$ 66.04	\$ 135.55

JFG Rebuttal Exhibit 5

John Guastella

From: Longshore, Mike
Sent: Wednesday, July 15, 2015 2:32 PM
To: John Guastella
Subject: Re: Attendees at August 12, 2014 Enforcement Conference

Thank you for the kind words, John. Y'all have been a pleasure to work with; I've been kept in the loop on everything that has been going on, and we don't always get that level of communication...

H. Michael Longshore, MPH
Compliance and Enforcement Section
Water Pollution Control Division
Bureau of Water
Phone: (803) 898-1261
FAX: (803) 898-4190

From: John Guastella <jfg@guastella.com>
Sent: Wednesday, July 15, 2015 2:06 PM
To: Longshore, Mike
Subject: RE: Attendees at August 12, 2014 Enforcement Conference

Hi Mike,

Thank you for such a quick response, and your well wishes. You are right on the mark regarding adequate rates so we can keep our operations up to standards. If you had a chance to read the capital improvement report we sent to you, you know the challenges we have faced, and your cooperation, understanding and patience has been a key factor in our progress. I acknowledged your guidance in that report and I repeat our appreciation to you and your staff, who to a person have been professional and at the same time with a friendly approach. My Mike was very impressed with you as well, and motivated to keep in compliance with all requirements and provide the best possible service to our customers.

Best wishes,
John

From: Longshore, Mike [mailto:LONGSHHM@dhec.sc.gov]
Sent: Wednesday, July 15, 2015 1:46 PM
To: jfg@guastella.com
Subject: Attendees at August 12, 2014 Enforcement Conference

John,

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.

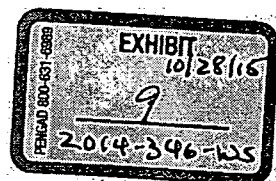
We would like to thank Guastella Associates for your attention, cooperation and assistance in addressing long-standing issues and violations at these facilities. The upgrades you have made, and continue to make, will serve both the utility and its customers well. We wish you success in your proposed 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.

With kindest regards,

Mike

H. Michael Longshore, MPH
Compliance and Enforcement Section
Water Pollution Control Division
Bureau of Water
Phone: (803) 898-1261
FAX: (803) 898-4190

DIUC-ORS 1.9 Attachment A – GA Management Agreement



MANAGEMENT AGREEMENT

THIS MANAGEMENT AGREEMENT ("Agreement") is made this 18th day of June, 2015, between Guastella Associates, LLC, a Florida limited liability company ("GA"), and Daufuskie Island Utility Company, Inc. ("Company" or "DIUC"), a Florida corporation, the Company's parent corporation, Daufuskie Island Utility Holding Company, LLC a South Carolina limited liability company ("Parent") and the Parent's individual stockholders, together with the Company's, Parent's and Stockholders' heirs, assigns and successors (collectively, the Company, Parent and Stockholders are referred to hereafter as "Clients"). Clients and GA are collectively the "Parties".

BACKGROUND

- A. GA provides rate, valuation and management services to water and wastewater utilities.
- B. The Clients will retain GA to provide general rate and valuation services independent, separate and apart from this Agreement.
- C. In early 2010, GA (formerly G2 Utility Management LLC) began managing the Melrose Utility Company, Inc. ("MUC") by providing the same services as set forth in the agreement between the Clients and GA for the management of DIUC, and at similar fees. On March 1, 2010 MUC was merged with DIUC at the approval of the South Carolina Public Service Commission.
- D. The Clients wish to enter into this Agreement with GA, to provide management services to the Company that assist in the long-term success of the Company. The Parent and Stockholders are joining into this Agreement and are agreeing to be jointly and severally responsible with the Company to pay the Compensation specified in Article III of this Agreement in order to induce GA to enter into this Agreement and to agree to provide the services specified below to the Company, which will provide a material benefit to Parent and the Stockholders. GA would not otherwise enter into this Agreement without the inclusion of Parent and Stockholders.

NOW THEREFORE, in consideration of the promises and covenants herein the Parties agree as follows:

ARTICLE I. COMPANY'S GOALS

GA's management of the Company shall be guided by the following Company goals:

- 1. Provide safe and adequate water and wastewater service to customers on a continuous basis, and respond to customer inquiries quickly, accurately and courteously.
- 2. Comply with all environmental and economic regulatory requirements, and maintain operational records as required by the South Carolina Department of Health and Environmental Control ("DHEC") that are necessary to monitor the physical operation of

the Company on an ongoing basis as well as to plan for future additions and replacements.

3. Establish and maintain excellent relations with customers, community associations and regulators, including the DHEC, the South Carolina Public Service Commission ("PSC") and the Office of Regulatory Staff ("ORS").
4. Maintain financial books and records in accordance with the National Association of Regulatory Utility Commissioners Uniform System of Accounts prescribed by the PSC in order to accurately record the cost of providing service and reflect the financial condition of the Company, and to justify the need, as appropriate, for general rate changes as well as support for special fees and charges.
5. Operate the Company efficiently and manage its assets in order to minimize the rates charged to the customers but also to achieve a reasonable profit for the stockholders so that the Company will be able to maintain financial viability and attract capital.
6. If appropriate and in the best interests of the customers and Company, plan for the expansion of the Company to new real estate developments or areas beyond the existing committed service area. Determine the fees and charges payable to the Company for infrastructure costs related to the expansion and for the "carrying costs" incurred by the Company for reserved capacity that is not in use. Any expansion will not jeopardize the ability to serve present and future customers in the existing service area with respect to water supply, service and cost.
7. All management decisions as to record keeping, rate setting and expansion will seek to include steps to maintain the Company's market value so that it will ultimately be postured for the potential sale and conversion of the expanded system into a municipal regional system, if appropriate in the future.

ARTICLE II. SCOPE OF SERVICES

GA will advise and report to the Company's president, and the president will be responsible to delegate to GA the authority to act on behalf of the Company in certain matters as identified by the president in order to allow GA to provide the services mentioned below. Only the president has the authority on behalf of the Company to direct GA and GA shall have the right to rely upon direction from the president as having full authority to act on behalf of the Company without the need to confirm such authority with the Company's board of directors, the Stockholders, the Parent or any other third parties. GA will provide the following services on behalf of and in the name of the Company:

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.

The above scope of services does not include, among other things, the preparation and filing of general rate increases, any economic and environmental regulatory investigations and proceedings for special or unusual issues, appraisals, valuations or other matters that are not routine in the day-to-day management or that would typically require the services of outside consultants. The Company will employ GA for such work under separate agreement and with the prior approval of the president of the Company. The Parent/Stockholder(s) shall also enter into a separate agreement with GA with respect to any contracts between the Parent/Stockholder(s) and third parties that seek extension of service outside of the Company's existing committed service area for the determination by GA of fees to be paid by the third parties that would allow for the recovery of the carrying costs that have been and will be absorbed by the Company's Parent/Stockholder(s) for the creation and growth of the utility.

ARTICLE III. COMPENSATION FOR MANAGEMENT SERVICES

The Clients shall be jointly and severally liable to pay GA the following forms of compensation ("Compensation") in the amounts specified below:

1. **Management Fee.** The Clients shall pay GA a Management Fee in the amount of \$13,596.85 per month, payable in advance on the 1st day of each month, plus all of GA's out-of-pocket traveling expenses (including without limitation, transportation, room and board) and mileage reimbursement at the then current rate. The Management Fee shall increase annually beginning on January 1 of each year this Agreement is in effect by (a) 3.5% plus (b) for customer growth based on a formula that takes 25% of the existing Management Fee per existing equivalent residential connection (ERC) and applies that amount to the ERC's added in the immediately preceding year. For example, on January 1, 2016, the Management Fee would become \$14,344.68 per month ($\$10,971 \times 1.035 + \$271.94 (.25 \times \$10,971/250$

existing ERC x 20 ERC's added in 2011)). The number of ERC's used in this example is hypothetical only for the purposes of the example.

2. **Finance Fee.** The Clients recognize that GA's labor in connection with any long term funding is not covered by GA's standard Management Fee and the Clients, accordingly, agree to compensate GA for GA's efforts and labor in connection with or in any way related to long term funding at the greater of (i) 2% of the principal amount of any loan(s) which GA handles or processes; or (ii) GA's usual hourly rates for the actual time spent handling any facet of long term funding including without limitation communications with prospective lenders and the Clients; reviewing or negotiating loan terms or documents; communications with third parties regarding loan terms or documents; coordination of the execution of any loan documents and the closing of any loan transaction(s); and any other work related to long term funding. The Finance Fee shall be paid at the closing of any such loan.
3. **Capital Fee.** The Clients shall pay GA a Capital Fee for the procurement, contract preparation, administration and inspection of all capital improvements and additions, which Capital Fee shall be (a) 10% of the construction cost for projects to extend service outside the existing committed service area, and (b) 10% for the first \$50,000 of construction costs and 8% for amounts in excess of \$50,000 of construction costs for all other projects. GA shall bill the Capital Fee from time to time as construction costs are incurred and paid, and the Clients shall pay the Capital Fee no less than monthly as construction costs are being incurred.
4. **Incentive Fee.** The Clients shall pay GA an Incentive Fee, which shall be billed annually on or before March 15th of each year for the preceding year, and shall be paid within fifteen days after the bill has been sent to the Clients. The Incentive Fee shall be (a) 20% of the Total Net Utility Operating Income of the utility; and (b) in the event of the sale of the Company, in an amount equal to a percentage of the amount that the sale price or condemnation award exceeds the current adjusted purchase price in the amount of \$2,065,387.00 ("Adjusted Purchase Price"), to be paid at the closing of a sale or the payment of a condemnation award. The Adjusted Purchase Price reflects the current purchase price and related costs incurred by the Parent to acquire the utility. The Incentive Fee upon the sale of the Company shall be (a) 8% of the first \$3,000,000 that the sale price or condemnation award exceeds the Adjusted Purchase Price, plus (b) 12% of the next \$5,000,000 that the future sale price or condemnation award exceeds the Adjusted Purchase Price, and (c) 15% of all amounts in excess of \$8,000,000 over the Adjusted Purchase Price.

For the purposes of the above paragraph, Total Net Utility Operating Income is calculated as shown on Schedule 300 of the Company's annual report to the PSC, Form PSC/ORS (Rev. 12/2005), and reflected on line 26 of that form, which is attached hereto as Appendix A; and the "sale of the Company" means any transaction or series of transactions the purposes of which results directly or indirectly in (a) the sale or condemnation of (i) all or substantially all of the assets of the Company, (ii) any business or division of the Company, (iii) the capital securities or equivalents of the Company, in excess of 50%, or (iv) ownership rights in the Company sufficient to directly or

indirectly have the power to direct or cause the direction of the management and policies of the Company; (b) otherwise causing the Company to become a subsidiary of a company; or (c) a merger or consolidation or any other combination of the Company with another company, or any other governmental, quasi-governmental or other entity.

The Compensation includes all of GA's profit and overhead, and GA shall not bill any charges for office rent, equipment, furniture, computers and supplies owned and used by GA. The Company, however, shall continue to pay, at its sole cost and expense, its own employees, other contractors, repairs, maintenance, supplies, power, chemicals, taxes, regulatory assessment fees and all other operating expenses. The Company shall also maintain insurance that is sufficient to cover GA with respect to general and professional liability in such amount and under such terms that are acceptable to GA. GA has calculated and designed its Compensation for the above services at a cost that is generally in the range of allowable fees for rate setting purposes. The Parties intend that the Management Fee will be covered by general rates for services without subsidization by the Stockholders. However, the Clients understand and agree that GA's Management Fee is not contingent on the fees being allowed in general rates for services because the rates are subject to, among other things, Stockholder policy, unanticipated PSC decisions, regulatory lag or unusual events that would impact costs and timely cost recovery; and the Clients, in any case, shall still owe and pay GA's Management Fee. The Compensation to be paid does not include the physical operation of the systems that is performed by the Company's own employees and contractors, for which the Company shall continue to be separately and solely responsible.

ARTICLE IV. TERM

This Agreement shall be effective as of June 18, 2015 and shall continue for the remainder of the current calendar year and for three full calendar years beyond the current calendar year, until December 31, 2018 ("Initial Term"). After the Initial Term, this Agreement shall be automatically renewed on December 31 of every subsequent three-year period for successive three-year terms as long as at least one of John F. Guastella, Michael J. Guastella, and Gary C. White remain employed with or directly or indirectly has an ownership interest in GA. If at least one of John F. Guastella, Michael J. Guastella, and Gary C. White does not remain employed with or directly or indirectly has an ownership interest in GA, this Agreement shall be renewed on December 31 of every subsequent three-year period for successive three-year terms unless the Clients deliver a written notice of nonrenewal to GA no later than ninety (90) days before the end of the then existing term.

ARTICLE V. TERMINATION

The Clients may terminate this Agreement for cause if GA, after being notified in writing by the Clients of any failure by GA to perform its duties under this Agreement, fails to correct any failure of performance within thirty (30) days of receiving the Clients' notice, or if such cure shall take longer than 30 days, fails to implement such cure within the 30 day period and to diligently pursue such cure until completed. GA may terminate this Agreement for cause if the Clients, after being notified in writing by GA of any failure by the Clients to perform their duties under this Agreement, fail to correct any failure of performance within thirty (30) days of receiving GA's

notice, or if such cure shall take longer than 30 days, fail to implement such cure within the 30 day period and to diligently pursue such cure until completed. Either GA or the Clients may terminate this Agreement without notice if the other party, through any of its officers, directors, employees or shareholders, undertakes any illegal actions such that any of the Parties' officers, directors, employees or shareholders are convicted of a felony or misdemeanor involving a crime of moral turpitude. GA may terminate this Agreement without cause by giving the Company sixty (60) days advance written notice of GA's election to terminate the Agreement. In the event of termination of the Agreement by the Clients for cause or because of any illegal actions by GA's officers, directors, employees or shareholders or by GA without cause, the Clients shall pay GA any unpaid Compensation on a prorated basis up to and including the date of termination. In the event of termination of the Agreement by GA for cause or because of the illegal actions by the Stockholders or any of the Client's officers, directors, employees or shareholders, the Clients shall pay GA any unpaid Compensation up to the end of the then existing term. Additionally, the Clients recognize that GA's management of the Company will posture the Company for a sale at the Company's highest market value and the Clients, accordingly, shall pay GA the Incentive Fee specified in Article III, Paragraph 4(b), if any event entitling GA to the Incentive Fee occurs within fifteen (15) years of the termination or other expiration of the Agreement.

ARTICLE VI. MISCELLANEOUS

A. Assignment. The Clients shall not assign this Agreement without GA's express written consent. GA may not assign this Agreement without the Company's express written consent, except that GA shall be permitted to assign this Agreement to another entity in which at least one of John F. Guastella, Michael J. Guastella, or Gary C. White is employed by or directly or indirectly has an ownership in the assignee.

B. Choice of Law. This Agreement shall be governed by, and construed under, the laws of Florida without regard to the principles of conflict of law. Venue for any legal action under this Agreement shall be in the courts of the State of Florida in Palm Beach County, Florida.

C. Construction of Agreement. The Parties acknowledge that they have read this Agreement and have had the opportunity to be advised by legal counsel of their choice. This Agreement shall not be construed against any party because the party or its attorneys prepared the document. Typewritten or handwritten provisions inserted in this Agreement that are initialed by the Parties shall control over all printed provisions of this Agreement in conflict therewith.

D. Counterparts/Facsimile. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which shall constitute one and the same Agreement. A signature received by facsimile shall be deemed an original.

E. Entire Agreement. This Agreement constitutes the entire agreement between the Parties and cannot be waived or amended except by a written instrument executed by all Parties. None of the Parties have relied upon any information, representation, warranty or statement, whether oral or written, express or implied, made by anyone that is not expressly stated in this Agreement. Neither

this Agreement nor any notice thereof shall be recorded in any public records.

F. Further Documents. The Parties agree to execute all documentation reasonably requested to give full force and effect to this Agreement.

G. Headings. The headings and titles of the Agreement provisions are for the convenience of the Parties only, and are not determinative of the contents of any paragraph. All paragraphs are to be interpreted by reviewing the entire contents of the paragraph.

H. No Waiver. No waiver of any provision of this Agreement shall be effective against any party unless it is in writing and signed by the party waiving such provision. A written waiver shall only be effective as to the specific instance for which it is obtained and shall not be deemed a continuing or future waiver.

I. Notices. All notices, requests, demands, instructions, consents and other communications required or permitted to be given pursuant to this Agreement shall be in writing and shall be deemed to have been duly given if and when (a) personally served, (b) sent by first class certified or registered mail, postage prepaid, return receipt requested, (c) transmitted by prepaid telegram, telex, or facsimile or by electronic mail, or (d) sent by a nationally recognized express courier service, postage or delivery charges prepaid to the parties at the addresses set forth above, or at such other address as either of them shall hereafter specify in writing or by facsimile transmission.

J. Persons Bound. This Agreement shall bind and inure to the benefit of the Parties, their heirs, successors and assigns. Whenever the context permits, singular shall include plural and one gender shall include all.

IN WITNESS WHEREOF, the Parties hereto have signed this agreement on the date specified below.

Guastella Associates, LLC, a Florida
limited liability company

Daufuskie Island Utility Company, Inc., a
South Carolina corporation

By: 
John F. Guastella, Managing Member

By: 
Terry R. Lee, its President

Confirmed and agreed to on behalf of
Daufuskie Island Utility Holding Company,
LLC, a South Carolina limited liability
company, David Hutt, its Member, Ronald
Shimanowitz, its Member and Terry R. Lee, its
Managing Member

By: 
Terry R. Lee, its Managing Member

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

IN RE:) INTERVENORS HAIG POINT CLUB AND
) COMMUNITY ASSOCIATION, MELROSE
) PROPERTY OWNER'S ASSOCIATION
Application of Daufuskie Island Utility) AND BLOODY POINT PROPERTY
Company, Inc. for Approval of an) OWNER'S ASSOCIATION'S RESPONSES
Adjustment for Water and Sewer Rates,) TO SECOND OF INTERROGATORIES
Terms and Conditions) AND SECOND SET OF REQUESTS FOR
) PRODUCTION OF DAUFUSKIE ISLAND
) UTILITY COMPANY, INC.

TO: G. Trenholm Walker, Esquire, and Thomas P. Gressette, Esquire, Attorneys for
Daufuskie Island Utility Company, Inc.:

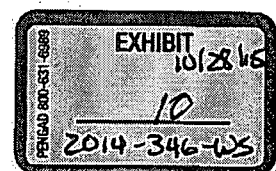
Haig Point Club and Community Association, Inc. ("HPCCA"), Melrose Property
Owner's Association, Inc. ("MPOA"), and Bloody Point Property Owner's Association
("BPPOA") hereby responds to Daufuskie Island Utility Company, Inc. ("DIUC" or the
"Applicant") Second Set of Interrogatories and Requests for Production as follows:

**RESPONSES TO SECOND SET OF INTERROGATORIES
AND REQUESTS FOR PRODUCTION TO INTERVENORS**

Regarding the Prefiled Testimony of Harry Jue:

1. Has Mr. Jue ever prepared a depreciation study using the actuarial, simulated
plant balances method? If so, please list the last three such studies and provide the results in
terms of the average service lives, net salvage values, and depreciation rates for each study.

RESPONSE: No.



2. Has Mr. Jue ever presented a study as to the determination of average service lives, salvage values, or depreciation rates on behalf of a water or sewer utility in a formal rate proceeding? If so, please identify the rate proceedings and provide the last three such studies.

RESPONSE: No.

3. Has Mr. Jue ever been qualified as an expert in depreciation in any rate proceeding or any other formal proceeding? If so, please identify each matter and provide any report prepared by Mr. Jue in each matter.

RESPONSE: No.

Regarding the Prefiled Testimony of Paul Vogel:

4. Please identify and provide all calculations, analyses, work papers and source documents that Mr. Vogel relied upon in support of his testimony.

RESPONSE: Mr. Vogel relied upon the documents that are part of the record in this Docket, those in previous rate case Dockets, and his own personal knowledge.

Regarding the Prefiled Testimony of Charles Loy:

5. Has Mr. Loy ever been employed by a utility regulatory agency? If so, which one(s)?

RESPONSE: No.

6. The list of previous testimony and engagements identified water utilities in Texas, including the preparation of a rate application for Monarch Utilities I, LP ("Monarch") on behalf of SWWC, Inc. ("SWWC").

a. Please briefly describe the utility type and size of Monarch and SWWC.

- b. Please indicate whether at the time of his work for Mr. Loy considered Monarch and SWWC to be well-run and well-managed companies.

RESPONSE:

- a. **Monarch is a water and sewer utility with about 33,000 water customers and 12,000 sewer customers.**
- b. **Yes.**

7. The list of previous testimony and engagements identifies water utilities in Texas, including the preparation of a rate application for Canyon Lake Water Service Company.

- a. Please briefly describe the utility type and size of Canyon Lake Water Service Company.
- b. Please indicate whether at the time of his work for Canyon Lake Water Service Company Mr. Loy considered Canyon Lake Water Service Company to be well-run and well-managed companies.

RESPONSE:

- a. **Canyon Lake is a water company with approximately 12,000 customers.**
- b. **Yes.**

8. Has Mr. Loy ever provided consulting services for a real estate developer in creating a newly formed water/or sewer utility? If so, please identify the last five such assignments and describe the work Mr. Loy undertook.

RESPONSE: No.

9. Has Mr. Loy ever prepared initial water and/or sewer rates for a newly formed developer-related utility?

RESPONSE: No.

10. Has Mr. Loy ever prepared a depreciation study using the actuarial, simulated plant balances method? If so, please list the last three such studies and provide the results in terms of the average service lives, net salvage values, and depreciation rates for each study.

RESPONSE: **No.**

11. In preparing his testimony and exhibits, did Mr. Loy perform any analyses other than the information produced with his prefiled testimony?

a. If so, please produce those analyses and all related source documents.

RESPONSE: **No.**

Regarding the Prefiled Testimony of Lynn M. Lanier:

12. Has Mr. Lanier ever prepared initial water and/or sewer rates for a newly formed developed related utility? If so, please identify which one(s).

RESPONSE: **As indicated in his resume, Mr. Lanier has never been employed by a utility regulatory agency.**

13. Has Mr. Lanier ever provided consulting services for a real estate developer in creating a newly formed water and/or sewer utility? If so, please list the last five such assignments and describe the work Ms. Lanier performed on their behalf.

RESPONSE: **Mr. Lanier has never provided consulting services for a real estate developer in creating a newly formed water and/or sewer utility.**

14. Has Mr. Lanier ever prepared initial water and/or sewer rates for a newly formed developer-related utility?

RESPONSE: **Mr. Lanier has never prepared initial water and/or sewer rates for a newly formed developer-related utility.**

15. Has Mr. Lanier ever prepared a depreciation study using the actuarial, simulated plant balances method? If so, please list the last three such studies and provide the results in terms of the average service lives, net salvage values, and depreciation rates for each study.

RESPONSE: **Mr. Lanier did not offer any testimony in regard to depreciation, but only incorporated the depreciation related testimony of Mr. Loy in his testimony in regard to revenue requirements.**

16. Has Mr. Lanier prepared any analyses or studies in support of his testimony that are not included with the prefiled testimony and exhibits? If so, please provide each such study and/or analysis, along with related source information relied upon.

RESPONSE: All of Mr. Lanier's analyses developed as part of this case are included in his testimony.

17. With respect to page 25 of Mr. Lanier's prefiled testimony:

a. Please provide a detailed explanation of each and every act of "irresponsibility" that Mr. Lanier accuses the Company (aka DIUC) of demonstrating, along with all facts that led Mr. Lanier to conclude said act constitutes "irresponsibility."

Response: The acts of irresponsibility are set out in detail in the record in this Docket, including in Mr. Guastella's May, 2015 report to the Commission (DHEC violations, the tax sale of the water tower, the surprise related to the huge increase in property taxes); the substantial increases in operating expenses, particularly since the 2012 rate case, incurred by the Company as presented in Mr. Lanier's testimony; having to use long-term debt to pay operating expenses, etc.

b. Please also include a detailed explanation of the specific uses of debt funds that Mr. Lanier claims were irresponsible.

RESPONSE: In the Company's response to Intervenor's Second Interrogatories, dated 9/21/15, the response stated that the proceeds of the \$500,000 line of credit, which the Company now seeks to roll-into and convert to long-term debt, were used, in part, to pay down accounts receivable to Guastella Associates (\$380,205) and for operating expenses (\$24,278). Long-term debt should be used to fund long-term investments, not provide short-term working capital and once the funds are expended, there is nothing for collateral on the loan. In the same response, in regard to the use of proceeds of the \$2,750,000 long term loan, some of the funds were used for legal fees (\$175,583.05), equal to 6.4% of the principal, legal fees for the closing (\$18,460), equal to 0.7% of the principal, title and recording fees (\$9,449), equal to 0.3% of the principal, and payment of past due property taxes (\$7,783), equal to 0.3% of the principal. All of these costs represent together 7.7% of the principal. While the payment of legal fees, closing costs, and recording fees are legitimate costs associated with financing, the amounts are large in relation to the loan. And while it may be acceptable, it is questionable to consume so much of the loan with closing related costs, and such costs are often funded separately from operating funds of entities, rather than with the principal proceeds of the loan. And the use of proceeds to pay off past due property taxes is certainly not an appropriate use of long term debt.

18. Before preparing his testimony, did Mr. Lanier review all of DIUC's, ORS's and Intervenors' discovery requests as well as all of DIUC's responses? If not, please identify the specific requests and responses that Mr. Lanier did review.

RESPONSE: Mr. Lanier did review all of DIUC's responses to ORS's and Intervenors' discovery requests and all of DIUC's responses, to the extent that DIUC provided a response.

ADAMS AND REESE, LLP

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

Columbia, South Carolina

October 23, 2015

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

RE:)
)
)
Application of Daufuskie Island Utility) **CERTIFICATE OF SERVICE**
Company, Inc. for Approval for Water)
and Sewer Rates, Terms and Conditions)

This is to certify that I have caused to be served this day the **Responses to First Requests for Production of Daufuskie Island Utility Company, Inc.** by Haig Point Club and Community Association, Inc. ("HPCCA"), Melrose Property Owner's Association, Inc. ("MPOA"), and Bloody Point Property Owner's Association ("BPPOA") via electronic mail service as follows:

G. Trenholm Walker, Esquire
gtw@p-tw.com

Thomas P. Gressette, Esquire
tpg@p-tw.com

Nancy Jane Dennis
njd@p-tw.com

s/John J. Pringle, Jr.

October 23, 2015
Columbia, 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 Adjustment of Rates and Charges

**RESPONSE TO APPLICANT'S FIRST SET OF INTERROGATORIES AND
REQUESTS FOR PRODUCTION TO OFFICE OF REGULATORY STAFF**

TO: Thomas P. Gressette, Jr., Esquire and G. Trenholm Walker, Esquire

Counsel ("Counsel") for the Office of Regulatory Staff ("ORS") assert attorney/client privileges and immunities as to all communications between ORS and its legal counsel, and thus objects to producing or discussing such communications.

Counsel assert work product privileges and immunities as to their own work product.

ORS asserts work product privileges and immunities as to all communications and documentation prepared in anticipation of litigation and objects to producing such work product.

Documentations and information revealed and produced in discovery shall not waive such privileges and immunities.

Subject to the above objections, ORS responds to the Daufuskie Island Utility Company ("DIUC") Interrogatories and Requests for Production as follows:

Regarding the Prefiled Testimony of Ivana C. Gearheart:

1. In preparing her testimony and exhibits, did Ms. Gearheart perform any analyses other than the information previously provided to DIUC and/or Guastella Associates ("GA") in connection with ORS's exit audit and follow-up work papers?

Response: No

- a. If so, please produce those analyses and all related source documents.

Response: N/A.

2. With respect to Ms. Gearheart's proposed adjustment to utility plant in service for the cost of the elevated storage tank, well, and facilities on the "Sabry" parcel of land:
 - a. What did Ms. Gearheart rely on?
 - b. Please explain in detail the basis for the adjustment.

Response to (a) and (b): Ms. Gearheart relied on the tax sale document shown in Exhibit WJM-7 of Mr. Morgan's Direct Testimony. For the adjustment, ORS rolled forward plant from the last rate case. At that time, these assets were disallowed by ORS for the same reason they are being disallowed now – lack of ownership.

3. With respect to Ms. Gearheart's proposed adjustments to utility plant in service for the fees of GA related to capital improvements:
 - a. Is it ORS's position that the consulting services related to capital improvements were not performed?
 - b. Is it ORS's position that the consulting services related to capital improvements were not in accordance with provisions GA's management agreement with DIUC?
 - c. Is it ORS's position that no work is necessary to initiate, implement, supervise, and account for capital improvements?
 - d. Is it ORS's position that no costs should be incurred for such work?
 - e. Is it ORS's position that the facilities to which those consulting services related are not used and useful in providing service to DIUC's customers?

Response: No to all above.

4. With respect to Ms. Gearheart's proposed adjustments to utility plant in service for the facilities for which invoices could not be found:
 - a. Is it ORS's position that the facilities are not used and useful in providing service to DIUC's customers?

Response: No.

- b. Does ORS agree that costs were incurred for those items of utility plant?

Response: ORS objects to this question as being vague and ambiguous. With respect to this specific rate case, ORS cannot opine whether costs were incurred since invoices were not provided to support the utility plant claimed by DIUC.

- c. Does ORS agree that costs were booked for those items of utility plant?

Response: ORS objects to this question as being vague and ambiguous. With respect to this specific rate case, it appears DIUC booked costs.

- d. Is it ORS's position that the costs as booked are unreasonable as to the level of cost, and were it not for a lack of specific invoices, ORS would still have made an adjustment for their total cost?

Response: ORS objects to this question as being vague, ambiguous and compound. With respect to this specific rate case, DIUC provided no invoices, and ORS cannot speculate as to what it would have done

- e. If some costs for which DIUC lacks invoices would have been acceptable if corresponding invoices were presented, please indicate which ones.

Response: Itemized invoices were not provided, so ORS cannot provide an opinion or speculate on what would have been acceptable.

5. With respect to Ms. Gearheart's proposed adjustments to utility plant in service for legal and consulting costs related to the condemnation of the "Sabry" parcel of land:

- a. Is it ORS's position that the legal and consulting services were not provided on behalf of DIUC?

Response: No.

- b. Please explain in detail the basis for this proposed adjustment.

Response: Based on information and belief, condemnation- related expenses would not exist had DIUC paid Beaufort County taxes.

6. With respect to Ms. Gearheart's proposed adjustment to property taxes related to the amended eight-year installment plan under the agreement between Beaufort County and DIUC:

- a. Does ORS agree that the agreement between Beaufort County and DIUC addresses taxes due for 2012, 2013, 2014 and 2015?

Response: Yes.

- b. Does ORS agree that the agreement was negotiated on behalf of DIUC by Pratt-Thomas & Walker and GA?

Response: ORS does not know.

- c. Does ORS agree that those negotiations were successful in eliminating back taxes for DIUC for 2010 and 2011?

Response: Based on information and belief, the negotiations appear successful.

- d. Does ORS agree that negotiations with the Department of Revenue, with the participation of Beaufort County, resulted in a reduction of DIUC's property taxes for 2012, 2013, 2014 and 2015?

Response: Based on information and belief, property taxes appear to be reduced, but ORS does not know if that is the result of negotiations.

- e. Does ORS agree that the amount Ms. Gearheart proposes to include in rates for the installment payments over the eight-year period is less than half of the actual cost DIUC must pay monthly pursuant to its agreement with Beaufort County?

Response: No.

- 7. With respect to Ms. Gearheart's proposed allowance in rates for ongoing annual property taxes:

- a. Did Ms. Gearheart identify the method that the Department of Revenue uses for determining the assessed value of DIUC's taxable utility property? If so, please identify that method and produce any documents Ms. Gearheart reviewed regarding that method.

Response: No.

- b. Did Ms. Gearheart consider applying the method that the Department of Revenue uses for determining the assessed value of DIUC's taxable utility property?

Response: No.

- c. Does ORS agree that DIUC's schedules in its rate increase application reflect the method that the Department of Revenue uses for determining the assessed value of DIUC's taxable utility property?

Response: ORS does not know.

- d. Does ORS agree that the funds for paying property taxes due January 2017 must be collected during 2016, otherwise DIUC will not have the funds to pay the total amount due in January 2017?

Response: ORS objects to this question as being compound. No.

- e. Was Ms. Gearheart aware when preparing her testimony that Beaufort County requires full payment of 2016 taxes in January 2017 or it will impose interest and penalties?

Response: Based on information and belief, ORS understands taxes are due in January.

- f. Was Ms. Gearheart aware when preparing her testimony that Beaufort County requires full payment of 2016 taxes in January 2017 and that Beaufort County does not accept partial payments?

Response: ORS objects to this question as being compound and requiring speculation. Based on information and belief, ORS understands full payments are desirable; however, Beaufort County is currently accepting installment payments from DIUC. ORS does not know whether Beaufort County will require full payment of 2016 taxes in January 2017.

8. With respect to Ms. Gearheart's proposed adjustment to the GA management fee:
- Is it ORS's position that GA does not perform the services as set forth in its management agreement with DIUC?

Response: No.

- Is it ORS's position that the management services performed by GA are not necessary for the operation and management of DIUC?

Response: No.

- Is it ORS's position that GA is not qualified to perform the management services?

Response: No.

- Does ORS agree that DIUC's customers have benefitted by the management services provided by GA?

Response: ORS objects to this question as being vague and ambiguous. ORS cannot say whether the customers have benefited.

- Please explain, in detail, the basis for the proposed adjustment to GA's management fees.

Response: See page 6, lines 1-5 of Ms. Gearheart's direct testimony.

Regarding the Prefiled Testimony of Willie J. Morgan:

9. With respect to Mr. Morgan's proposed adjustments for the costs of the storage tank, well, and related facilities located on the "Sabry" parcel of land and the Bloody Point Well #1:

- Does Mr. Morgan rely only Exhibits WJM-7 and WJM-8 for that position, or is there other information that is alleged to support those adjustments? If there is other information that is alleged to support those adjustments, please identify that information and explain how it supports the proposed adjustments.

Response: ORS objects to the form of the question and request as being compound and ambiguous. ORS also contacted Beaufort County and reviewed the County's website.

- b. Does ORS agree that those facilities are used and useful in providing service to DIUC's customers?

Response: Yes.

- c. Does ORS agree that those facilities have continued to be used and useful from their installation until now, regardless of the ownership of the parcels of land on which they are located?

Response: Yes.

- d. Does ORS agree that the costs of those facilities were incurred by the respective utility companies when they were installed?

Response: No. ORS does not know who installed the facilities or who incurred cost at the facilities' installation.

- e. Does ORS agree that the value of those facilities are being taxed by Beaufort County as taxable property owned by DIUC?

Response: No.

- f. Does ORS agree DIUC should continue to use and maintain these facilities for the benefit of DIUC's customers?

Response: Yes.

Regarding the Prefiled Testimony of Dr. Douglas H. Carlisle:

10. With respect to Dr. Carlisle's assertion that the outcome of DIUC's negotiations with banks for refinancing is not known:

- a. Please explain how the use of a 46% debt ratio is more of a known and measurable change in future debt than Mr. Guastella's debt ratio, which he explained is estimated on the basis of DIUC's financing needs and discussions with SunTrust Bank.

Response: DIUC utilizes future debt and equity. The capital ratios utilized by Dr. Carlisle do not represent future debt and equity.

- b. Does ORS agree that DIUC's proposed equity ratio of 58.8% is within the range shown in Exhibit DHC-1 (48.4% to 60.9%)?

Response: Yes.

- c. Does ORS agree that DIUC's proposed equity ratio of 58.8% is equal to or less than three of the nine utilities shown in Exhibit DHC-1?

Response: Yes.

- d. Please explain why Dr. Carlisle imputed an equity ratio to DIUC based on the average equity ratio of the nine utilities within the proxy group when DIUC's equity percentage was already within the proxy group's range?

Response: It is based upon a typical water company with traded stock.

- e. Does ORS agree that the settlement in DIUC's last rate case used a proposed financing, not closed or completed financing?

Response: ORS objects to this question as being ambiguous. ORS does not understand the question.

- f. Does ORS agree that at the time of the last rate case and before the last financing, DIUC's capital structure consisted entirely of equity?

Response: Yes, and based on information and belief, ORS understands this is why DIUC utilized a hypothetical capital structure at that time.

- g. Does ORS agree that in DIUC's last rate application, Mr. Guastella proposed converting a significant portion of equity into debt?

Response: Yes, based on information and belief.

11. With respect to Dr. Carlisle's recommendation to use the nominal interest rate of DIUC's current long term debt instead of an effective rate of interest:

- a. Does ORS agree that Dr. Carlisle's statement that the Company included \$372,879.71 in financing fees from Guastella Associates, LLC in the calculation of its debt rate is not correct? (Please refer to DIUC's response to ORS Request WWW#3.)

Response: ORS objects to this question as being ambiguous and compound. Based on information and belief, ORS accepts that the cost of the financing was \$372,879.71, of which \$159,357.50 was paid to Guastella Associates and the rest of which appears to be unitemized per responses to ORS information requests. ORS understands that Guastella Associates managed the loan and therefore payments were administered by Guastella Associates.

- b. Does ORS agree that the nine large water utilities in Dr. Carlisle's proxy group do not incur transaction costs when undertaking a financing?

Response: No.

- c. If ORS asserts the proxy group of utilities does incur transaction costs, has ORS or Dr. Carlisle made an effort to determine:
- i. What those costs are in absolute dollar amounts?
 - ii. Whether those costs have any impact in determining their effective interest rates?
 - iii. If so, please provide that information.

Response: ORS objects to this question as being compound. No to responses (i) and (ii) above. A response to (iii) is unnecessary since the response to (i) and (ii) is "No."

- d. Has ORS or the PSC, to ORS's knowledge, ever allowed effective rates for debt (instead of only nominal rates) in a South Carolina utility rate cases? If yes, please provide for each of the latest three such allowances information showing the difference between the nominal rates and the effective rates, as well as the absolute dollar amount of the transaction costs.

Response: ORS objects to the form of the question and on the grounds that this request is ambiguous, overly broad, and unduly burdensome.

- e. Prior to preparing his testimony, was Dr. Carlisle aware that DIUC's requests for financing were denied by three banks before obtaining a loan from SunTrust Bank?

Response: Yes, based on information and belief.

- f. Is it ORS's position that DIUC did not incur any costs for the following when seeking and ultimately obtaining financing from SunTrust: bank loan fee(s), flood monitoring fee(s), tax monitoring fee(s), environmental fee(s), title agency fee(s), recording fee(s), document fee(s), tax lien and debtor search fee(s), survey(s) of all properties, lender counsel fee(s), DIUC's attorneys' fee(s) and GA consulting fee(s)?

Response: No.

- g. Is it ORS's position that the DIUC's attorneys and GA did not perform the work for which they billed DIUC related to the SunTrust loan?

Response: No.

- h. Is it ORS's position that DIUC could have obtained a conventional bank loan without incurring the fees described in 2f, above?

Response: ORS objects to the form of the question. This is a hypothetical, and requires speculation.

- i. One of the reasons Dr. Carlisle proposes for disallowing an effective interest rate is that the fees originate from GA and not from a lending institution. Is it ORS's position that if the fees were for a lending institution, ORS would have allowed them?

Response: ORS objects to the form of the question. This is a hypothetical, and requires speculation.

- j. Is it accurate to state that none of the ORS witnesses proposed that DIUC be allowed to recover expenses and/or fees actually incurred in obtaining financing?

Response: ORS objects to this question as being ambiguous. Yes, as presented in the instant rate case.

- k. Is it ORS's position that DIUC should not recover any costs or transaction fees for seeking financing and ultimately obtaining financing with SunTrust?

Response: ORS objects to this question as being ambiguous. Yes, for this rate case.

12. With respect to Dr. Carlisle's use of the CEM, DCF and CAP-M methods to determine the rate of return on equity:

- a. Did Dr. Carlisle adjust for the relative size of DIUC and the nine utilities in the proxy group? If so, please explain how and provide the analysis and any conclusion(s).
- b. Did Dr. Carlisle perform any analysis or consider the relative sensitivity to earnings erosion of DIUC and the proxy group? If so, please explain how and provide the analysis and any conclusion(s).
- c. Did Dr. Carlisle compare DIUC's achieved return on equity for the last 3, 4, or 5 years with that of the proxy group? If so, please explain how and provide the analysis and any conclusion(s).
- d. Did Dr. Carlisle determine whether any of the stockholders of the utilities in his proxy group were required to provide personal guarantees in order for the utility to obtain financing? If so, please identify those utilities and the terms of any guarantees.

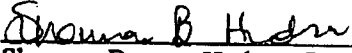
Response: No for all of the above.

Regarding the Prefiled Testimony of all ORS witnesses:

13. If the PSC were to accept Dr. Carlisle's recommended rate of return as well as the combined adjustments of other ORS witnesses in this case, has ORS analyzed:

- a. Whether DIUC would be able to meet the requirements of the existing SunTrust loan that was approved by the PSC? If so, please produce those analyses and all related source documents.
- b. Whether DIUC will be able to attract capital to refinance the short term line of credit and make further capital improvements that are necessary to provide adequate service to DIUC's customers? If so, please produce those analyses and all related source documents.

Response: No for all of the above.


Shannon Bowyer Hudson, Esquire
Andrew M. Bateman, Esquire
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Columbia, South Carolina 29201
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abateman@regstaff.sc.gov

October 23, 2015
Columbia, South Carolina

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

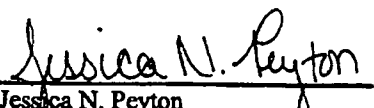
IN RE: Application of Daufuskie Island Utility Company,)
Incorporated for Approval of an Increase for Water) **CERTIFICATE OF SERVICE**
and Sewer Rates, Terms and Conditions)

This is to certify that I, Jessica N. Peyton, have this date served one (1) copy of the **RESPONSE TO APPLICANT'S FIRST SET OF INTERROGATORIES AND REQUESTS FOR PRODUCTION TO OFFICE OF REGULATORY STAFF** in the above-referenced matter to the person(s) named below by causing said copy to be electronically mailed as shown below:

Representing Daufuskie Island Utility Company, Inc.

Pratt-Thomas Walker, P.A.
G. Trenholm Walker PA, Esquire gtw@p-tw.com
Thomas P. Gressette, Jr., Esquire tpg@p-tw.com

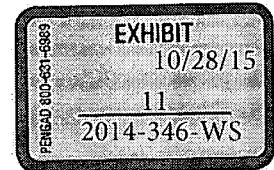
Guastella Associates, LLC
John F. Guastella jfg@guastella.com



Jessica N. Peyton

October 23, 2015
Columbia, South Carolina

PAUL R. VOGEL



PROFESSIONAL SUMMARY

48 years of successful domestic and international management of projects, people, project operations and companies providing engineering master planning and construction services. Regional and country management was performed in the US, Canada, Germany, Poland, South Korea, Ireland, Puerto Rico, Belgium, and Saudi Arabia. Specific direct management experience includes ethanol, pharmaceutical, food processing, corn wet milling, chemical, electronic, and airports. Prior experience includes 9 years in the management of design, construction and operation of food facilities.

SPECIFIC COMPANY AND AREA OF EXPERIENCE:

Global Performance 8/07 to Present

Consulting:

- Post hurricane reconstruction strategic plan for a LNG facility in the Dominican Republic
- Development of a corporate standard engineering and construction process for a mining company.
- Contract management consulting for a major Korean car company building a major US facility.

Fagen Sr Project Manager 3/06 to 5/07

Responsible for the construction of a 110 million gallon, \$145 million, VeraSun ethanol facility in Charles City Iowa.

Contract - self perform all crafts plus manage special specialty subcontracts on a cost plus fixed fee basis. Sub contracts consisted of stainless steel tanks and concrete slip formed silos and the associated material handling for grain and DDG storage.

The entire facility constructed to the start of making ethanol in 13 months and 3 months ahead of client schedule with in the approved budget and man hour estimate

Parsons – Sr. Project Manager 2/05 to 11/05

DuBiotech Biotechnology and Research Park Project in Dubai UAE.

Responsible for Master Plan development from vision to publication and tender documents for all site development. The success of this contract led to the un-tendered award of an incubator laboratory and the Iconic Head Quarters Building.

The Biotech Park is a 184 Hectar first of a kind in the Mid East to compete with Biotech parks in other areas of the world. This park consists of a 467,000 sqft head quarters, 347,000 laboratory, manufacturing, and support facilities zones. The scope was from vision to tender documents.

Kings Hawaiian Bakery Project Manager - Torrance CA 7/02 to 5/04

Responsible for the total management of \$60mm project including engineering, contract management and construction management. Fluor was awarded the task of completing the engineering, contract management and construction management after another contractor failed. This 137,000-sqft roll and bread bakery is a state of the art totally automated facility built to the most stringent standards of a family owned business and Los Angeles inspectors. In addition the project included an 18,000-sqft office designed and contract managed by Fluor.

Jacobs Engineering Corporation 9/99 to 1/00

Senior Advisor for Design and Construction - National Ignition Facility - Livermore, California.

Senior Advisor for the Government Project Manager for Conventional Facilities and Infrastructure during a major restructuring phase of the project. This \$ 350mm portion of a \$ 1.2 billion project required a major change in direction to meet its objectives. Specific areas addressed included the acquisition strategy, organizational structure, and safety program implementation.

Fluor Daniel International

Vice President and Director of Operations Ireland

Director Fluor Daniel - EEL 2/98 to 7/99

Responsible for the Fluor Daniel Operations in Ireland. The prime activity was to launch Fluor Daniel in the Republic of Ireland, and North Ireland, leading to an equity buy out and a Limited Liability Company by managing the relationship, support and expansion of the local partnership Fluor Daniel - EEL. Operational activities consisted of local management support for the over \$600mm in construction projects in Ireland for the pharmaceutical, chemical, and electronics industries

Vice President and Managing Director Fluor Daniel Eastern 6/97 to 2/98

Responsible for infrastructure projects in South Korea. The major effort was to lead the foreign advisory team for the construction management of the Incheon main terminal building consortium. This consortium included Hanjin, Daewoo, and Samsung

Vice President Operations Poland 1/93 to 6/97

Responsible to locate, analyze, select, recommend for investment, negotiate inter-company agreements, upgrade, and manage two Central European low cost engineering and CM centers for Fluor Daniel. These were successfully upgraded and provided with a technology transfer program in ISO 9001, engineering and construction management procedures, accounting and finance, marketing, legal, CAD operations, safety, technical support, information technology, control procedures, and project management procedures. The areas of project operations consist of refinery expansions, chemical facilities, pharmaceutical, and food facilities.

Vice President and General Manager - German Operations Centers 7/91 to 1/93

Overall management of Fluor Daniel Offices in Dusseldorf, Wiesbaden, and Leipzig. Responsible for meeting business resource needs, German Operations coordination, and budgets. Markets include food, pharmaceutical, industrial, maintenance, hydrocarbon, and chemical and plastics.

Vice President and Division Manager - Chicago Operations 1/90 to 7/91

Overall management of Business Unit offices responsible for operations, sales, and profits. Offices served mainly food processing and manufacturing.

Greenville SC Regional Manager/Manager of Projects 10/88 to 1/90

Overall management of projects out of the Greenville office Fluor Daniel office. Major clients were in the food processing and manufacturing.

Sample Projects personally managed with International Involvement

Teepak Casing Plant

Provided total engineering management to build Teepak's first international facility in Lommel, Belgium. This is a chemical facility producing viscose sausage casings, which includes extrusion, drying and packaging equipment. Engineering management consisted of coordinating the process design by Badger Antwerp, and Fluor Daniel design.

Knorr Soup Plant in Asheboro NC

Provided total project management for a first of its kind in the US, which required the integration of the all previously used European systems to an American Plant. This is a fully automated plant with considerable material handling, process, and an automated warehouse system. Services included site selection, engineering, procurement, construction, maintenance, and training.

Dynamit Nobel Electronics Facility in NC

Provided total project management for a facility to produce Silicon Wafers. This was the first facility for the Italian Company in the US, which required the integration of the European requirements in the US plant. This facility had sophisticated building, HVAC, Class 100 clean room requirements.

Canada Starch plant in Canada

As Task Force Project Director, responsibilities included providing the total management of engineering, procurement, and construction of a \$64 million corn wet milling facility in Canada.

New Jeddah International Airport

Deputy Manager responsible for a management joint venture with Fluor Daniel, which provided control for half of all engineering work for a \$4.5 billion airport in Saudi Arabia. Specific work consisted of coordinating the design of Skidmore Owens and Merrill, the shop drawing review of Hochtief and the project site requirements.

Pharmaceutical facilities in Puerto Rico

Managed the engineering for a Squibb Formulating Package Building, an Alcan Formulating Packaging Building, and a Formulating/Packaging Building, Warehouse and Administration Building for Upjohn. Assistant Project Manager for a Merck, Sharp & Dome Fermentation and Pharmaceutical Facility. Responsible for the coordination between Lummus, Catalytic, Fluor Daniel, and all field engineering, cost and schedule control.

Previous Experience

Union Carbide and Nabisco

EDUCATION:

Bachelor of Marine Engineering, State University of New York.

CITIZENSHIP

USA

PROFESSIONAL LICENSES

Professional Engineer-Mechanical licenses in Illinois and South Carolina; now on an inactive basis..

CONTACT DATA: 25 Prestwick Green, Daufuskie Island SC 29915 Phone 843 842 8297 Email PVogel4588@aol.com

Doug Egly, PGA

3271 N. Spyglass Village Path
Lecanto, FL 34461
dougely@pga.com

Mobile: (941) 737-4296
Office: (352) 414- 5080

Regional GENERAL MANAGER / COO Exclusive Private Residential Country Clubs and Yacht Clubs

More than 15 years of Regional Management / General Management successes in every facet of club operations. Progressive and diverse experience at exclusive private, residential golf and yacht clubs. Significantly strengthened each club in terms of member growth, service quality and fiscal soundness and staffing. Built, trained and led highly professional, loyal teams of up to 150 that have a thorough understanding of discriminating club members' expectations and how to deliver and exceed on those expectations. In-depth knowledge of Food & Beverage, financials, including forecasting and budgeting for clubs with \$3 million to \$7 million in annual revenue. Creative in problem solving and conceptualizing special events and member traditions at new clubs. Impeccable attention to detail that exceeds Member and Guest expectations.

General Management Strengths

- P&L Management
- Operations Management
- Financial Management / Forecasting / Budgeting
- Member Growth & Retention
- Food & Beverage (F&B) Operations
- Purchasing & Inventory Management
- Golf Course Operations
- Marina Operations
- Staff Training, Development & Promotion
- Renovations / Capital Improvements

PROFESSIONAL EXPERIENCE

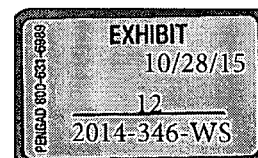
REGIONAL GENERAL MANAGER/COO – BLACK DIAMOND RANCH / ESCALANTE GOLF, FL • 2011 to Present

Private, exclusive and upscale, privately-owned golf and country club located in the rolling hills of Lecanto, FL with 400 members; an exceptional and world-renown golf community boasting 45 holes of Tom Fazio-designed golf courses. Rated "#1 Golf Community in Florida" by both Golfweek and Florida Golf Magazine; the famed Quarry course is one of the highest rated courses in the country and has garnered significant praise by Golf Digest; Top 100 club for 22 consecutive years. Newly redesigned clubhouse, expanded wedding/banquet facilities, fitness center, tennis courts, golf pro shop with extreme attention to all 50,000 sq. ft. of club space; \$7.5 million annual revenue; \$1.7 million F&B revenue.

Selected to re-establish the Club's reputation as the top club in Florida while increasing member participation in every club amenity. Manage day-to-day operations: budgeting (operating and capital), policy and procedure development, member services, events, F&B operations, purchasing, inventory control, staffing, training, community relations, and facilities. Provide leadership and direction to over 100 employees. Hired and developed 11 Department Heads, including Club Manager, Golf Course Superintendent, Director of Golf, Director of Instruction, Facility Manager, Controller, Executive Chef, Director of Real Estate Sales, Residential Property Manager and Director of Private Events. Manage positive relationships with key corporate customers and community leaders.

Achievements:

- Drove and effectively managed annual revenue to \$7.5 million while meeting budget requirements each year.
- F&B revenue grew from \$1.2 million to \$1.6 million with over 65% of increased revenue derived from ala carte and retail wine sales. Reduced food cost of goods sold from 46% to 35% while increasing overall member dining satisfaction.
- Oversaw concept, re-design and renovation of Club Dining and Banquet facility. Also managed complete renovation and upgrade of the fitness facility and Real Estate Welcome Center.
- Created popular member traditions that include: Fine dining (increased Tuesday and Friday night dining covers from 60 to 120), Featured Wine Dinners, Trivia Night, Turkey Buffet, Family Theme Night, Tripled Family participation in all Holiday and special events.
- Recruited top-performing, career-minded team members. Trained and developed 5 Assistant Managers for promotion to General Manager; 2 Sous Chefs to Executive Chef, 2 Assistant Golf Professionals to Head Golf Professionals.



**REGIONAL GENERAL MANAGER/COO – WATERLEFE GOLF & RIVER CLUB and TIDEWATER PRESERVE –
Bonita Springs, FL • July 1999 to 2011 (Member owned in 2008)**

WCI Communities, Incorporated, Bonita Springs, FL- Recognized as Florida's premier developer of master planned communities with more than 30 outstanding communities with award winning homes from \$100s to over \$10 million. WCI offers vast array of world- class amenities including boating, golf, tennis, fine dining with equity memberships from the \$70s to the \$250s. WCI has numerous business partners such as the Ritz Carlton and Hyatt Resorts with golf courses designed by the great names of Greg Norman, Raymond Floyd, Tom Fazio and Pete Dye.

Responsible for complete start-up and development of 3 separate communities- Tidewater Preserve, Venetian Golf and River Club and Waterlefe Golf and River Club; all amenities, including design and construction of 59 slip Marina, full service dining facilities, fitness center, golf club/pro shop and grill room. Developed the club's annual business plan and long-range strategic vision including operating and capital budgets. Directed and managed all aspects of the club including activities and relationships between the club and Board of Directors, members, guests, employees, community, government and industry. Directed overall operations including budgeting (operating and capital) and financials, F&B operations, customer service, facilities management, and special events. Supervised a staff of 100 employees through 7 department heads, including Accountant, Membership Director, Chef, Catering Director, Dining Room Manager, Bar Manager and Marina Manager.

Achievements:

- Successful transition from developer to members.
- Most successful build out of 614 residential homes in WCI Communities history. Grew golf revenues to \$3.5 million.
- Established several innovative member traditions that are still in place including annual holiday boat parade; family fishing tournaments and summer kids' camps.
- Plotkin Survey- Scored highest rated member satisfaction of every WCI Clubs surveyed, including the Tiburon Ritz Carlton.

DIRECTOR OF GOLF – RIVER WILDERNESS COUNTRY CLUB - Parrish, FL • 1994 to 1999

Privately owned, exclusive golf and country club, with multiple dining areas, tennis courts, swimming pool and fitness center; approximately 320 members;

Achievements:

- Successfully transitioned from bank owned to new ownership group; key liaison between bank, members and new ownership group.
- Single-handedly increased club membership from 200 to 320 through advertising and sales presentations.
- Spearheaded formation of Men's Golf Association- increased membership.
- Launched Member-Guest event in 1995 increased participation by 50%. Sold out yearly – ongoing.
- Acted as key liaison between Developer and Members/Residents to successfully address member issues.
- Contributed to improvement of service quality and member satisfaction while reducing labor costs through better labor management and scheduling.

WOMEN'S GOLF COACH- UNIVERSITY OF NORTH TEXAS- Denton, TX * 1987 to 1994

Achievements:

- Selected by the NCAA to coach the United States Women's Team in the U.S. - Japan matches held at the Green Academy Country Club in Japan.
- Member of the NCAA Championship Selection Committee.
- Created an endowed academic scholarship for women that participate at the Division 1 level and maintain a 3.5 G.P.A.
- Increased graduation rate to highest level in women's golf team history.

EDUCATION / CERTIFICATION

University of North Texas – Denton, TX
Bachelor of Business Administration
PGA Business School I, Dallas
PGA Business School II, Oklahoma City

PGA Teaching and Coaching Summit, San Francisco
PGA Teaching and Coaching Summit, New Orleans
Member - PGA of America
Executive Director for over 18 NCAA Golf Tournaments

Reference:

James Brand, CCM and Past President of Florida CMAA, 941-720-7496

HUSSEY GAY BELL

Established 1958

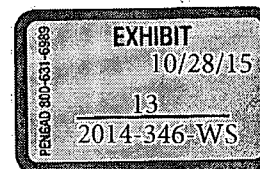
HARRY JUE – SENIOR TECHNICAL ADVISOR, WATER/WASTEWATER

EDUCATION

Bachelor of Science, Environmental Health Science / University of Georgia

CERTIFICATION

Georgia Class I Water Treatment Operator



PROFESSIONAL AFFILIATIONS

Water Environmental Federation, American Water Works Association, Georgia Association of Water Professionals, Georgia Rural Water Association, American Public Works Association and Association of Metropolitan Water Agencies

Based in Savannah, Georgia, Mr. Jue brings more than 40 years of expertise to Hussey Gay Bell. Previously, Mr. Jue served as the Water Operations Director and Water and Sewer Bureau Director for the City of Savannah for a combined total of 30 years. His responsibilities included overall budgeting, operation and compliance with all federal and state laws for the planning, designing and construction of all major water and sewer infrastructure projects including pump stations, sewer lines and wastewater treatment plants.

Of unique importance, Mr. Jue:

- Served as Project Coordinator with HGBD-Arabia. His responsibilities included preparing plans and specifications for sewage pump stations, sewer lines and 36 advanced sewage treatment plants in the Baha and Northern Borders region in the Kingdom of Saudi Arabia. He provided efficient coordination with both the Arabia Team and personnel in the U.S., effective communication with the Ministry of Water and Electricity in Riyadh and the Local Ministries in Baha and the Northern Borders.
 - Served on numerous State of Georgia legislative study committees, to develop a statewide water plan to develop a coastal strategy to protect the Floridan aquifer from saltwater contamination and to develop a recommendation for the Governor for a statewide water conservation plan.
 - Has extensive experience with Georgia EPD, regarding water issues and permitting in Coastal Georgia, including development of the original Sound Science Initiative as well as the State's Plan for Managing Saltwater Intrusion in Coastal Georgia.
 - Has prior relevant experience includes more than 30 years with the City of Savannah, having served as the Water Operations Director for 15 years and as the Water and Sewer Bureau Director for 15 years, thereby bringing unmatched familiarity and expertise with the challenges and needs of coastal Georgia's residents.
 - **Is the recipient of numerous individual industry awards and accolades for his work, including:**
 - 1994: President's Award, Georgia Water and Pollution Control Association*
 - 1995: Select Society of Sanitary Sludge Shovelers, State of Georgia
 - 2002: Charter Member of the Institute for Georgia Environmental Leadership
 - 2003: Hugh A. Wyckoff Award, Georgia Water and Pollution Control Association*
 - 2007: Honorary Lifetime Membership Award, Georgia Association of Water Professional
- * Denotes renamed Georgia Association of Water Professionals in 2005.*

Experience Highlights:

Water and Sewer Bureau Director

City of Savannah, Georgia

June 1993 – 2008

Directed the operations of the Water and Sewer Bureau for the City of Savannah; planned and scheduled infrastructure improvements to ensure that the water and sewer system met current needs. Reviewed and approved budget submissions of Water and Sewer departments; developed and/or approved internal auditing procedures for inventory and purchasing procedures; ensured that all procurement procedures were in compliance with City policy.

Responsibilities included the management, planning, expansion, organization and operation of the Water and Sewer departments of the City of Savannah which consisted of development and funding of a five-year \$52 million capital plan; administration of a \$36.7 million operating budget for 42 deep wells, 62.5 MGD surface water treatment plant, four advanced wastewater treatment plants, reclaim water facility, 165 sewage pump stations, over 1400 miles of water and sewer infrastructure and 259 water and sewer employees.

Served on numerous legislative study committees to develop a statewide water plan to develop a coastal strategy to protect the Floridan aquifer from saltwater contamination; and to develop a recommendation for the governor for a statewide water conservation plan.

Served on the Georgia and South Carolina Savannah River Study Committee to determine future allocation of wasteload capacity of the river; to determine the benefits and the negative impacts of inter-basin transfers and to study the environmental impacts of past and future harbor deepening on the river to promote the use by large container ships at the Georgia Ports Authority.

Planned and scheduled projects for system expansion to ensure that the water and sewer system could meet future needs. Developed work programs and operating procedures to ensure that both the water supply and wastewater treatment facilities were in compliance with existing and future federal and state mandates.

Developed water and sewer agreements with developers; made recommendations to City Manager and Council regarding Water and Sewer agreements and surcharges. Coordinated planning, regulations, expansion, financing, and infrastructure improvements with federal, state, county and city governments. Communicated and interacted with various stakeholder groups.

Ensured engineering quality and design of Water and Sewer department projects; ensured construction quality of all projects. Analyzed effectiveness of department programs to increase productivity, efficiency, and cost effectiveness.

Elected and served on the Georgia State Board for the Examination of Water and Wastewater Treatment Operators from 2002 to present.

Water Operations Director

City of Savannah, Georgia

November 1978 – June 1993

Directed the operation of the potable water supply for the City of Savannah; supervised, directed and evaluated assigned staff; handled employee concerns and problems; directed work; counseled and disciplined staff; completed employee performance appraisals; recruited, appointed, and trained staff. Planned, organized, and directed the operations and budgets of a well

ground water system, a surface water system and of water distribution mains. Established policies and procedures for the operation of water supply, water distribution and industrial and domestic systems; inspected operations to ensure compliance with safety rules and regulations and to ensure compliance with all state and federal water supply rules and regulations.

Developed an aggressive water leak repair program which has reduced unaccounted-for water lost in the Savannah system from 25% to 8% and reduce the total annual water leak repairs by 79%.

Developed and implemented the first cross connection control policy in Savannah, Georgia which has served as a model for similar water systems in Georgia. The objective of the policy was to protect the public drinking water supply from contamination from various sources.

Environmental Specialist III

Georgia Department of Natural Resources

June 1974 – November 1978

Provided technical assistance and regulatory compliance in water supply, air quality, wastewater treatment and solid waste disciplines to a 34-county region in southeast Georgia. Investigated and documented hazardous waste spills and initiated cleanup procedures; coordinated and participated in the Georgia Shellfish program. Enforced state and federal laws such as: Safe Water Drinking Act; Water Quality Control Act; Solid Waste Management Act; Georgia Air Quality Control Act; Groundwater Use Act.

LIST OF EXHIBITS TO ACCOMPANY TESTIMONY

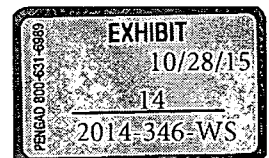
EXHIBIT 1 – Professional resume Regulatory Experience of Lynn M. Lanier

**EXHIBIT 2 – Schedule A-4 from DIUC's Filing, with Operating Margin Calculations
calculations**

EXHIBIT 3 – LML Financial Schedules

EXHIBIT 4 – FPSC Price Index Guideline

EXHIBIT 5 – FPSC Leverage Formula Order and Staff Report



Lynn M. Lanier
Principal

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EDUCATION: Bachelor of Science in Industrial Management,
Co-Operative Plan, Georgia Institute of Technology, 1975

EXPERIENCE:

Mr. Lanier is a Principal in the Firm and has over forty years' experience in the electric utility industry with an extensive background in the areas of management, operations, and finance, primarily with electric distribution systems. His experience includes a broad range of retail and wholesale rate, financial analysis, marketing, operational analysis, valuation, and merger/acquisition consulting projects. He also served as General Manager/CEO of an electric cooperative in South Carolina for 5-1/2 years.

Employment Experience:

1988 - Present: GDS Associates, Inc. - Mr. Lanier is responsible for providing services to and directing projects primarily for electric distribution systems in a number of areas including financial analysis and planning; reorganization studies such as mergers and acquisitions, consolidations, and valuation studies; marketing programs; demand-side planning and analysis; productivity studies; retail and wholesale rates; and various costs analyses, including outdoor/street lighting rates, joint pole use attachment rates, etc.

His experience at GDS includes demand-side planning, end-use analysis, marketing program analyses and development, development of demand-side/marketing program incentives, the development of electric service contracts, agreements, and easements, revenue and power cost forecasting and budgeting, competitive rate analyses, evaluation and development of industrial service rates, retail rate and cost-of-service studies, policy and service rule development, development of special rates, wholesale rate design, operational/management evaluations, cost reduction studies, valuation studies, privatization/acquisition projects, and certificated service area dispute resolution, along with a number of related projects. Since 1995, he has been the Firm's Practice Leader in the federal DOD Utility Privatization Program, primarily representing electric and water/wastewater utility companies and affiliates in efforts to acquire utility privatization contracts.

1983 - 1988: Lynches River Electric Cooperative, Inc. - As General Manager, Mr. Lanier was Chief Executive Officer responsible for the operation of the Cooperative. Major achievements include: development of planning, budgeting, and cost tracking systems; implementation of automated accounting systems; rate analyses and development of special industrial rates

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and contracts; development of industrial service proposals; and development of automated feasibility analysis for facilities investment. Mr. Lanier also developed numerous forms of contracts, agreements, and easements.

Particularly noteworthy among his accomplishments were his successful efforts in the acquisition of a small private power company, including all feasibility analyses, REA lien accommodation for 100% private financing, negotiation of terms of sale and closing of same, filings and testimony before the South Carolina Public Service Commission, and timely integration into the Cooperative's distribution system.

Mr. Lanier was instrumental in the development of a G&T-wide power marketing program and led its implementation by developing and implementing the first member system comprehensive marketing program, including selective appliance promotion toward target markets, incentive rates, financing and cost sharing program, and general promotional program.

In addition, Mr. Lanier was personally involved and participated extensively in numerous system engineering studies, power requirements studies, loan applications, borrower environmental reports, load management system implementation, and numerous "service territory" related matters.

1978 - 1983: Walton Electric Membership Corporation, Monroe, Georgia - As Manager of Administrative Services, Mr. Lanier was responsible for organizational planning, management development, personnel administration, staff services, retail rates and service rules and regulations. Mr. Lanier's activities included annual business plans and budgets, rate and cost-of-service studies, industrial service proposals, long-range organizational plan, safety management program, development of an extensive management performance report, extensive bylaw revisions, and policy development.

1976 - 1978: Colquitt Electric Membership Corporation, Moultrie, Georgia - As Administrative Assistant, Mr. Lanier's responsibilities included organization planning, budgeting, management systems, policy development, and general administrative responsibilities. His activities included development of a planning and budgeting system, a large power load research project, data processing study, re-writing the policy manual, and numerous other general analyses and activities.

1971 - 1976: Southern Engineering Company of Georgia, Atlanta, Georgia - Mr. Lanier began work with Southern Engineering Company as a rate analyst while a student at Georgia Institute of Technology. Upon graduation in 1975, he

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was employed as a rate and financial consultant. His responsibilities included retail rate and cost-of-service analyses, preparation and delivery of expert testimony before various public service commissions, presentation of reports to management and boards of directors of various utilities, preparation of financial forecasts for electric cooperatives, and providing other financial and rate related advice and services to electric utilities, including assistance with service rules, regulations, and contracts.

REGULATORY EXPERIENCE:

Mr. Lanier has presented expert testimony and/or prepared testimony and exhibits in retail and wholesale rate and cost-of-service matters before the following state utility regulatory commissions:

Louisiana Public Service Commission
Vermont Public Service Commission
Public Service Commission of Indiana
Virginia State Corporation Commission
Public Utility Commission of Texas
Michigan Public Service Commission
Mississippi Public Service Commission
South Carolina Public Service Commission

In addition, Mr. Lanier also submitted testimony and appeared before the South Carolina Public Service Commission as a Company witness on two separate occasions concerning a territorial matter and in regard to the acquisition of a small private power company.

Mr. Lanier has also submitted an expert report and testified before the US Tax Court on behalf of the Internal Revenue Service. He has also provided expert reports in State Courts.

SPECIFIC CONSULTING EXPERIENCE – SELECTED EXAMPLES:

[* Projects in which Mr. Lanier had a significant role but not exclusive project responsibility]

- VECO Alaska, Inc.
 - **Utility Privatization Proposal - Alaska Installations** – Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- TDX Power
 - **Natural Gas Privatization with ENSTAR** - Project involved the inventory of all

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natural gas distribution plant and classification in accordance with FERC Uniform System of Accounts for Gas Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.

- First Electric Cooperative Corp.
 - **Privatization Assistance: Little Rock AFB** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- C&L Electric Cooperative Corporation
 - **Pine Bluff Arsenal Utility Privatization Proposal** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Gulf Coast Electric Cooperative, Inc.
 - **NWS CSS Panama City Privatization Proposal** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
 - **Tyndall AFB Privatization Proposal** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- North Georgia Electric Membership Corporation
 - **Outdoor Lighting Rate Study** – Project involved the review of TVA prescribed lighting rate designs and review of all non-power related Street and Outdoor lighting related operating costs and margin requirements and establishment of schedule of non-power related fixed charges for each type of fixture and configuration offered.
- Rayle Electric Membership Corp.
 - **Rate And Cost Of Service Study** – Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Colquitt Electric Membership Corp.

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- **Development Of Outdoor Lighting Rates** – Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for existing and new Street and Outdoor Lighting options offered or proposed to be offered
 - **Retail Rate And Cost Of Service Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
 - **Retail Rate And Cost Of Service Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Hart Electric Membership Corp.
 - **Cost of Service Analysis And Retail Rate Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Satilla Rural Electric Membership Corporation
 - **Retail Rate & Cost of Service Study (1992)** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
 - **Rate and Cost of Service Study (1998)** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Mitchell Electric Membership Corporation
 - **Financial Review And Rate Adjustment** - Project involved comprehensive revenue requirements study and limited redesign of retail rates, including the Street and Outdoor Lighting rates
 - **Privatization: MCLB-Albany, GA** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.

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- Ocmulgee Electric Membership Corporation
 - **Retail Rate & Cost Of Service Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Cobb Electric Membership Corporation
 - **Privatization-Dobbins, AFB** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Three Notch Electric Membership Corporation
 - **Retail Rate And Cost of Service** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
 - **Develop School Rate, Lighting Package** - Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for proposed new Street/Parking Lot Lighting options to be offered to consumer
 - **Acquisition Analysis** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Tri-County (GA) Electric Membership Corporation
 - **Develop Lighting Rates *** - Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for existing and new Street and Outdoor Lighting options offered or proposed to be offered
- Coastal Electric Cooperative
 - **Outdoor Lighting Schedule *** - Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for existing and new Street and Outdoor Lighting options offered or proposed to be offered
- Coweta-Fayette Electric Membership Corporation
 - **Ft. McPherson and Ft. Gillem Privatization Proposal** - Project involved the inventory of all electric distribution plant and classification in accordance with

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FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.

- Cooperative Power, Inc.
 - **Privatization of Ft. Benning Distribution System** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Leavenworth-Jefferson Electric Cooperative
 - **Proposal to Own, Operate, and Maintain the Lighting at Fort Leavenworth** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Pennyrile Rural Electric Cooperative Corp.
 - **Privatization Assistance – Ft. Campbell** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Blue Grass Energy, Inc.
 - **Privatization Assistance: Blue Grass Army Depot (BGAD)** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Nolin Rural Electric Cooperative Corp.
 - **Fort Knox RFP Review and Proposal** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Chicopee Municipal Lighting Plant
 - **Westover ARB Electric System Privatization** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.

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- 4-County Electric Power Association
 - **Privatization Assistance: Columbus Air Force Base** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Singing River Electric Power Assn.
 - **Privatization Assistance – Pascagoula** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Laclede Electric Cooperative
 - **Privatization Assistance: Ft. Leonard Wood** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Haywood Electric Membership Corporation
 - **Cost Of Service And Rate Design** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Otero County Electric Cooperative, Inc.
 - **Privatization of White Sands Mis. Range** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- The Energy Cooperative
 - **Retail Rate Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Aiken Electric Cooperative, Inc.

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- **Retail Rate And Cost Of Service Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Fairfield Electric Cooperative, Inc.
 - **Rate And Cost Of Service Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
 - **Retail; Rate & Cost Of Service Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Berkeley Electric Cooperative, Inc.
 - **Retail Rate, Cost of Service, And Marketing Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
 - **Retail Rate and Cost of Service Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
 - **Commercial Lighting Program** - Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for existing and new Street and Outdoor Lighting options offered or proposed to be offered to Commercial consumers.
 - **Financial Review and Rate Revision** - Project involved comprehensive revenue requirements study and limited redesign of retail rates, including the Street and Outdoor Lighting rates
- Horry Electric Cooperative, Inc.
 - **Retail Rate & Cost of Service Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting

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options offered to consumers.

- Mid-Carolina Electric Cooperative, Inc.
 - **Lighting Rate Analysis** - Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for existing and new Street and Outdoor Lighting options offered or proposed to be offered
 - **Retail; Rate And Cost Of Service Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Blue Ridge Electric Cooperative, Inc.
 - **Athletic Field Lighting Facilities *** - Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for proposed new Athletic Field Lighting options to be offered to consumer
- Palmetto Electric Cooperative, Inc.
 - **Cost Of Service And Rate Study 1988 *** - Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for existing and new Street and Outdoor Lighting options offered or proposed to be offered
 - **Cost Of Service And Rate Study *** - Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for existing and new Street and Outdoor Lighting options offered or proposed to be offered
 - **End Use Cost And Rate Analysis *** - Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for existing and new Street and Outdoor Lighting options offered or proposed to be offered
- York Electric Cooperative, Inc.
 - **Retail Rate Study** - Project involved comprehensive revenue requirements study and limited redesign of retail rates, including the Street and Outdoor Lighting rates
 - **Retail Rate Study** - Project involved comprehensive revenue requirements study and limited redesign of retail rates, including the Street and Outdoor Lighting rates
 - **Update 1999 Rate Study** - Project involved comprehensive revenue requirements study and limited redesign of retail rates, including the Street and Outdoor Lighting rates

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- Tri-County (TN) Electric Membership Corp.
 - **Cost of Service and Retail Rate Study – 1997** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Southwest Tennessee Electric Membership Corp.
 - **NSA Mid-South Utilities Privatization** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Sequachee Valley Electric Cooperative, Inc.
 - **Arnold AFB Utility Privatization** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Upshur-Rural Electric Cooperative, Inc.
 - **Outdoor Lighting Rate Schedule Revision *** - Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for existing and new Street and Outdoor Lighting options offered or proposed to be offered
- Fort Belknap Electric Cooperative, Inc.
 - **Privatization of Sheppard AFB Electric System** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Tri-County (TX) Electric Cooperative, Inc.
 - **Privatization Assistance - NAS JRB Ft. Worth** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Rio Grande Electric Cooperative, Inc.
 - **Privatization of Laughlin RFB Eclectic System** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on

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the basis of Replacement Cost Depreciated and Original Cost Depreciated.

- EG&G / KPMG
 - **Transfer of Kelly AFB Elec. & Gas Systems to CPS** - Project involved the inventory of all electric and natural gas distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric and Gas Systems, respectively, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Southside Electric Cooperative
 - **Privatization Assistance - Fort Pickett** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Prince George Electric Cooperative
 - **Privatization Assistance: Ft. Lee** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
 - **Privatization Assistance - Defense Supply Center, Richmond, VA** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Community Electric Cooperative
 - **Privatization Assistance: FT. Eustis, FT. Monroe, & FT. Story** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
 - **Privatization Assistance - Norfolk Naval Bases** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Alaska Power and Telephone
 - **Ft. Buchanan Utility Privatization** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.

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- **Fort Lewis Electric Distribution Privatization** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Bluestem Electric Cooperative
- D.S.& O. Rural Electric Coop. Association
- Flint Hills Rural Electric Coop. Assoc., Inc.
- **Privatization Assistance: Ft. Riley Electric System** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.