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S.C. SUPREME COURT

STATE OF SOUTH CAROLINA
In the Supreme Court

APPEAL FROM THE PUBLIC SERVICE COMMISSION

Appellate Case No. 2018-001107

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.

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VOLUME II of VII
(R. pp. 466 to 965)

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BEFORE
THE PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA
DOCKET NO. 2014-346-WS – ORDER NO. 2017-__

DECEMBER __, 2017

IN RE: Application of Daufuskie Island Utility Company, Incorporated for Approval of an Increase for Water and Sewer Rates, Terms and Conditions	)))))	**PROPOSED ORDER RULING ON APPLICATION FOR ADJUSTMENTS IN RATES**

I. INTRODUCTION

This matter is before the Public Service Commission of South Carolina (the "Commission") on remand from the South Carolina Supreme Court. This case arises from the original Application ("Application") of Daufuskie Island Utility Company, Incorporated ("DIUC" or "the Company") filed on June 9, 2015, seeking approval of a new schedule of rates and charges (the "Proposed Rates") for water and sewer service that DIUC provides to its customers within its authorized service area in South Carolina. The Application was filed pursuant to S.C. Code Ann. Section 58-5-240 and 10 S.C. Code Ann. Regs. 103-712.4.A and 103.512.4.A. Petitions to Intervene were filed by the Haig Point Club and Community Association, Inc. ("HPCCA"); Melrose Property Owner's Association, Inc. ("MPOA"); Bloody Point Property Owner's Association ("BPPOA") (collectively the "POAs"); and by Beach Field Properties, LLC ("Beach Field"). . The South Carolina Office of Regulatory Staff ("ORS") was a party of record in the case pursuant to S.C. Code Ann. § 58-4-10(B) (2015).

The Commission held a hearing on the Application on October 28, 2015, and subsequently issued Order Nos. 2015-846 and 2016-50 (the "Orders"). Pursuant to S.C. Code §

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58-5-240(E), the Company began collecting its Proposed Rates under bond on July 1, 2016. The South Carolina Supreme Court subsequently reversed the Orders, and remanded the case to the Commission. *Daufuskie Island Utility Company v. S.C. Office of Regulatory Staff*, 420 S.C. 305, 803 S.E.2d 280 (2017). (the "Supreme Court Opinion").

II. PROCEEDINGS ON REMAND

On December 6, 2017 the Commission, with Chairman Swain Whitfield presiding, conducted a Rehearing of DIUC's Application beginning at 10:30 am at the Commission Hearing Room located at 101 Executive Center Drive in Columbia, South Carolina. The Rehearing continued on December 7, 2017.

DIUC was represented by G. Trenholm Walker, Esquire and Thomas P. Gressette, Jr., Esquire. The POAs were represented by John F. Beach, Esquire and John J. Pringle, Jr., Esquire. ORS was represented by Jeffrey M. Nelson, Esquire and Andrew M. Bateman, Esquire. The attorneys for Beach Field, M. John Bowen, Jr., Esquire and Margaret M. Fox, Esquire, did not attend the Rehearing.

The Transcript with Exhibits of the October 28, 2015 Hearing was made part of the record of the Rehearing as Rehearing Exhibit 2. Throughout this Order, the Commission may refer to both those exhibits introduced at the October 28, 2015 Hearing ("Hearing Exhibit ....") and those introduced during the Rehearing ("Rehearing Exhibit ...").

DIUC presented the testimony of: John F. Guastella[1] (direct and rebuttal testimony), President of Guastella Associates, LLC ("GA"), a utility management, valuation and rate

[1] Rehearing Exhibit 1 consists of: 1) Guastella Direct Exhibits JFG-R1, JFG-R2, JFG-R3, and JFG-R4; and 2) Guastella Rebuttal Exhibits JFG-R5 and JFG-R6.

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consulting firm headquartered in Boston, Massachusetts; and Gary C. White[2] (direct and rebuttal testimony), Vice President and Director of Accounting at GA. Mr. Guastella and Mr. White testified as a panel about the management and finances of DIUC.

The POAs presented a panel of witnesses, consisting of Charles E. Loy[3] (direct and surrebuttal) and Lynn M. Lanier[4] (direct and surrebuttal), Principals of GDS Associates, Inc., a utility consulting and engineering firm with its principal offices in Marietta, Georgia. POA witness Loy provided expert testimony regarding accounting and rate base issues. POA witness Lanier provided expert testimony on the overall Application and incorporated Mr. Loy's recommended adjustments. Beach Field did not pre-file or present testimony or cross examine any witness at the Commission hearing.

ORS presented the testimony of Douglas H. Carlisle[5] (direct), ORS Economist; Daniel F. Sullivan[6] (direct and surrebuttal), Deputy Director of the ORS Audit Department; and Dawn M. Hipp[7] (direct and surrebuttal), Director of the Utility Rates and Services Department of the ORS. Dr. Carlisle's testimony (which adopted his direct testimony and exhibits filed on October 2, 2015 and provided at the Hearing on October 28, 2015 included an analysis and recommendation

[2] Rehearing Exhibit 3 consists of: 1) White Direct Exhibit GCW-R1; and 2) White Rebuttal Exhibit GCW-R2.

[3] Rehearing Exhibit 5 consists of Loy Direct Exhibits CEL-1, CEL-2, CEL-3, CEL-4, CEL-5, and CEL-6.

[4] Rehearing Exhibit 6 consists of Lanier Direct Exhibits LML-R3, LML-R4, LML-R5, LML-R6, and LML-R7. Rehearing Exhibit 7 is Lanier Surrebuttal Exhibit LML-R8.

[5] Dr. Carlisle's Rehearing Testimony did not include any new exhibits, but his Hearing Exhibit 17 contains Carlisle Direct Exhibits 1 through 10.

[6] Rehearing Exhibit 8 is Sullivan Direct Exhibits DFS-1 through DFS-9. In addition, Mr. Sullivan adopted the prefiled testimony and exhibits of Ivana C. Gearheart from the Hearing. Accordingly, Hearing Exhibit 18 is Gearheart Direct Exhibits 1 through 8

[7] Rehearing Exhibit 9 consists of: 1) Hipp Direct Exhibits DMH-1 through DMH-5; and 2) Hipp Surrebuttal Exhibit DMH-1. In addition, Ms Hipp adopted the prefiled testimony and exhibits of Mr. Willie J. Morgan from the Hearing. Accordingly, Hearing Exhibit 19 is Morgan Direct Exhibits 1 through 8, and Hearing Exhibit 20 is Morgan Surrebuttal Exhibits 1 and 2.

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for an return on equity ("ROE"), capital structure, and rate of return on Rate Base. Mr. Sullivan's testimony (which adopted the prefiled testimony and exhibits of Ivana C. Gearheart from the Hearing) described ORS's examinations of the application and DIUC's books and records as well as the subsequent accounting and pro forma adjustments recommended by ORS. Ms. Hipp's testimony (which adopted the prefiled testimony and exhibits of Mr. Willie J. Morgan from the Hearing) focused on DIUC's compliance with Commission rules and regulations, ORS's business audit of DIUC's water and wastewater systems, test-year and proposed revenue, and performance bond requirements.

III. THE EFFECT OF THE SUPREME COURT OPINION

The Supreme Court Opinion reversed the Orders, concluding that the "Commission erred in admitting into evidence and adopting the Settlement Agreement between ORS and the POAs," stated it was "remanding for a new hearing on all issues," and remanded the case to the Commission "for a de novo hearing." *Daufuskie Island Util. Co.*, 420 S.C. 305, 320, 803 S.E.2d 280, 288. In addition, the South Carolina Supreme Court purported to provide the Commission with "guidance" on three issues: 1) "Rate Base Includes Elevated Tank Site"; 2) "Property Tax Expense"; and 3) "Bad Debt Expense." *See Daufuskie Island Util. Co.*, 420 S.C. 305, 316-320 803 S.E.2d 280, 286-288.

The Commission reads the term "de novo" clearly and plainly to mean that Rehearing ordered by the Supreme Court allowed the parties to present testimony and documentary evidence, and make arguments, about any matter at issue in this Docket. Significantly, the Supreme Court specifically overturned *Parker v. South Carolina Public Service Commission*, 288 S.C. 304, 307, 342 S.E. 2d 403, 405 (1986), "to the extent that it holds the Commission may

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consider new evidence on remand only if explicitly authorized to do so by an appellate court." *Daufuskie Island Util. Co.*, 420 S.C. 305, 316, 803 S.E.2d 280, 286 at Fn. 8. Therefore, the parties were free to submit whatever evidence and make arguments in support of their respective positions.

With respect to the Supreme Court's "guidance," the Commission does not construe that "guidance" to mandate a particular result on remand. With respect to these three issues (and all issues before the Commission in this case), the Commission must render a decision supported by substantial evidence and consistent with applicable South Carolina law. In other words, while the Supreme Court Opinion's "guidance" may suggest what the Commission cannot do on remand, it most certainly does not mandate a particular result with respect to those three issues or any issue before the Commission in this Docket.

IV. REVIEW OF THE EVIDENCE AND EVIDENTIARY CONCLUSIONS

Standards and Required Findings

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

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of undue discrimination. DIUC has also asked this Commission to establish revenues based on an authorized ROE which is established to allow DIUC the opportunity to earn a fair return.

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

The evidence supporting the Company's business and legal status is contained in the Application filed by DIUC, testimony, and in prior Commission Orders in the docket files of the Commission, of which the Commission takes judicial notice. This finding of fact is informational, procedural and jurisdictional in nature, and the matters which it involves are not contested by any party.

Test Year

With respect to the test year, DIUC utilized a historic test year – the twelve months ending December 31, 2014 with adjustments. ORS used the 2014 historical test year for two reasons: 1) because it was chosen by DIUC and 2) the underlying transactions in the 2014 books could be tested to ensure that the transactions were adequately supported, had a stated business purpose, were allowable for ratemaking purposes, and were properly recorded. Consistent with past practice and in accordance with generally accepted regulatory principles and prior Commission orders, ORS adjusted, as necessary, the revenues, expenses, and capital investments to normalize the Company's operating experience and rate base. The POAs also utilized a 2014 historic test year with adjustments.

A fundamental principle of the ratemaking process is the establishment of a historical test year as the basis for calculating a utility's operating margin or, in this case, a return on rate base, and, consequently, the amount of the utility's requested rate increase. In order to determine what

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a utility's expense and revenues are for purposes of determining the reasonableness of proposed rates, one must select a 'test year' for the measurement of the expenses and revenues. *Heater of Seabrook v. Public Service Commission of South Carolina*, 324 S.C. 56, 478 S.E.2d 826, 828 n.1 (1996). While the Commission considers a utility's proposed rate increase based upon occurrences within the test year, the Commission will also consider adjustments for any known and measurable out-of-test year changes in expenses, revenues, and capital investments, and will also consider adjustments for any unusual situations which occurred in the test year. Where an unusual situation exists which shows that the test year amounts are atypical, the Commission should adjust the test year data. *See Southern Bell v. The Public Service Commission*, 270 S.C. 590, 244 S.E. 2d 278 (1978); *see also, Parker v. South Carolina Public Service Commission*, 280 S.C. 310, 313 S.E.2d 290 (1984), *citing City of Pittsburgh v. Pennsylvania Public Utility Commission*, 187 P.A. Super. 341, 144 A.2d 648 (1958); *Southern Bell v. The Public Service Commission*, 270 S.C. 590, 244 S.E.2d 278 (1978). Based on the information available to the Commission and that all parties agreed to a 2014 test year, the Commission is of the opinion, and therefore concludes, that the test year ending December 31, 2014 is appropriate for the purposes of this rate adjustment request.

Rate of Return on Rate Base

DIUC requested that its rates be determined in accordance with the rate of return on rate base methodology. The determination of rate of return on rate base requires three components: 1) capital structure; 2) cost of debt; and 3) cost of equity (or return on equity). However, by statutory requirement, the Commission must also specify an allowable operating margin in all water and wastewater orders. Although the Commission must specify an operating margin in its

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order, this does not mean that the operating margin methodology must be used in determining a fair rate of return. *Heater of Seabrook* at p. 64 and 830. Operating margin "is less appropriate for utilities that have large rate bases and need to earn a rate of return sufficient to obtain the necessary equity and debt capital that a larger utility needs for sound operation." *Id.* No party contested the use of the rate of return on rate base methodology and given DIUC's large rate base, the Commission finds the rate of return on rate base methodology appropriate in this case.

Capital Structure and Cost of Debt

With respect to the capital structure, DIUC recommended a pro forma capital structure of 41.2% debt and 58.8% equity. ORS witness Dr. Carlisle testified there are two concerns with the method DIUC used to calculate its capital structure: 1) DIUC included pro-forma long-term debt in its long-term debt calculation; and 2) DIUC proposed an inflated equity amount. (Carlisle Direct R. p. 472). Dr. Carlisle noted that both result in an increase in the ROE. (Id.) The pro forma debt is based on the cost of debt DIUC expects, and as Dr. Carlisle noted, the outcome of DIUC's negotiations with banks or lenders is unknown at this time; therefore, DIUC's pro forma debt should not be included. (Carlisle Direct, R. p. 473). The POAs also agreed that debt should not include future amounts. (Lanier Direct, R. p. 436, ll. 8-14). Dr. Carlisle further testified that DIUC's capital structure is weighted more heavily with equity, which is more expensive than debt. (Id.) In contrast to a projected or pro forma capital structure, ORS recommended a hypothetical capital structure of 46% long-term debt and 54% equity calculated by averaging the known capital structure used by water companies in the United States with publicly traded stock. (Id.) The POAs produced an adjusted capital structure of 57.55% debt and 42.45% equity

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(Hearing Exhibit 14, Amended Lanier Exhibit 3), based on a downward adjusted rate base, which is discussed later in this Order.

As to the specific cost of debt rate, DIUC recommended 6.20%. The POAs testified that 6.20% is relatively high in the current interest rate environment, but is probably a reasonable rate given DIUC's precarious financial state. In the Rehearing, the POAs adopted the capital structure and debt and ROE proposed by ORS. To calculate the 6.20% debt rate, DIUC included anticipated legal and GA fees in the financing fees. In support of the debt amount, Mr. Guastella testified the debt he used is based on his knowledge of prior financing costs applied to the costs expected to be incurred for future refinancing. As a percentage of the total debt, the anticipated fees are 13.56% per ORS's calculations. ORS did not incorporate the additional fees into the debt rate because the fees are a large percentage of the total debt and did not originate from a lending institution. ORS recommended that the actual debt rate being paid by DIUC to the current lending institution, 5.29%, be used.

However, for the rehearing, the POAs Adopted the ORS recommended capital structure, debt rate and ROE rate. (Lanier Rehearing Direct, R. pp. 377-378, and schedules C-3, W-3, and S-3 in exhibits LML-R3, R4, (Rehearing Exhibit 6) and R8 (Rehearing Exhibit Seven)). In its revised Schedules in Support of a Rate Increase (Exhibit GCW-R1, pages 9, 27, and 46) (Rehearing Exhibit 3), DIUC revised its capital structure to 53.8% debt and 46.2% equity, revised the debt rate from 6.2% to 5.75%, but retained the 10.5% ROE rate, resulting in a calculated Rate of Return (ROR) of 7.75% vs 8.73% from the original application.

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

Cost of Equity/Return on Equity

DIUC witness Guastella testified that the requested 10.5% ROE is based on his experience and judgment. The POAs witness Lanier testified in his direct testimony in the Hearing, "This is the same rate the Company requested in its 2012 rate case[8], which was a specified rate, rather than a rate developed through justification of the ROE required to meet its needs for profit margin and to attract the needed debt capital." (Lanier Rehearing Direct, R. p. 437, ll. 1-4). In contrast to DIUC, ORS's Dr. Carlisle recommended an ROE of 9.31% based on a range of 8.91% to 9.71% using results from the Discounted Cash Flow model ("DCF"), Capital Asset Pricing Method ("CAPM") and the Comparable Earnings Model ("CEM"). (Carlisle Direct R. pp. 471 and 474). Dr. Carlisle testified the DCF and CAPM are known and generally accepted methods for determining a recommended ROE. (Id.) The POAs testified in the Hearing that the DCF is the prevailing method used for determining appropriate ROEs. The POAs also testified that while the DCF and CAPM are recognized as methods for calculating ROEs, the DCF and CAPM provide challenges since there are not many publicly traded companies similar to DIUC. For his analyses, Dr. Carlisle examined data on companies with publicly traded stock of which more data is available, because DIUC requested rates based on rate of return. (Carlisle Direct R. p. 475). Companies with publicly traded stock yield more data than what is available for privately held companies. (Id.) Specifically, Dr. Carlisle testified that

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

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he used publicly traded companies classified as "water utilities" by Value Line or *Yahoo! Finance* for his DCF and CAPM since they are in the same line of business as DIUC and share similar risks. (Id.) For his CEM analysis, Dr. Carlisle used companies with comparable betas to those of the companies used in his DCF and CAPM group. (Id.)

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

Connecticut DPUC Formula:		
Average Large Company		9.69%
Small Company Adder		0.50%
Performance Adder		0.50%
		10.69%
Florida PSC Leverage Graph Formula:		
5.6% + (2.279 / Equity Ratio)		= ROE
Range	100%	= 7.88%
	40%	= 11.30%
Equity Ratio	58.8%	= 9.47%

There is no discussion of these components in Schedule A-3 or testimony, with the exception of Mr. Guastella's rebuttal testimony from the Hearing containing the following single sentence, "Under the Connecticut Public Utilities Regulatory Authority formula for return on equity for small companies, the rate of return on equity for DIUC is 10.69%." ORS provided no testimony on either the Connecticut or Florida ROE formulas. The POAs could find no other reference to the Connecticut formula and challenged DIUC's portrayal of the Florida formula. Witness Lanier for the POAs testified, "[S]imply including a formula on a schedule and a calculated number is not sufficient rationale to support a ROE, particularly of 10.5%, when the company is requesting a revenue increase of over 100% in order to achieve such return." (Lanier Rehearing Direct, R. p. 439, ll. 7-9). The POAs acknowledged Dr. Carlisle as a source to

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support an appropriate ROE, and the POAs pre-filed direct testimony in the Hearing recommended an ROE in the range of 8.5% to 9.0% in consideration of a lower rate base and based on various examples of DIUC's "irresponsibility in its operations since the rate increase authorized in 2012 and in the use of debt funds, in view of the critical need for cash." (Lanier Rehearing Direct, p. 441, ll. 2-3).

As noted above, for the rehearing, the POAs Adopted the ORS recommended capital structure, debt rate and ROE rate and DIUC revised its capital structure to 53.8% debt and 46.2% equity, revised the debt rate from 6.2% to 5.75%, but retained the 10.5% ROE rate.

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

Upon consideration of the various witnesses, the Commission adopts the range set forth in evidence as produced by ORS. ORS used the well-known and commonly-accepted DCF method, CAPM, and CEM for developing its range of 8.91% to 9.71%. Those methods, as applied by ORS, are grounded in sound analysis and have been adopted by the POAs. The Commission finds DIUC's ROE recommendation of 10.5% lacking in support and analysis.

Rate Base

As a threshold matter, none of the parties excluded the Elevated Water Tank from rate base on Rehearing, so neither that issue, nor the Supreme Court Opinion's guidance on that topic, is being litigated in the Rehearing.

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DIUC proposed a rate base for combined operations of $6,975,242. (Exhibit GCW-R1) (Rehearing Exhibit 3). ORS proposed a rate base for combined operations of $5,867,632. (Revised Rehearing Audit Exhibit DFS-1) (Rehearing Exhibit 8).

With respect to the overall rate base, the POAs recommended that DIUC's rate base as proposed be reduced to $2,304,944. This reduction resulted from a combination of 1) classifying donated plant as contributions in aid of construction ("CIAC") and 2) applying straight line depreciation to the Company's plant investment, thereby increasing accumulated depreciation and reducing net plant. (LML-R3, Schedule C-2) (Rehearing Exhibit 6).

Simply applying straight-line depreciation to the Company's plant causes an increase in accumulated depreciation and a corresponding decrease in net plant. This adjustment alone reduces combined rate base to $4,613,231. (Exhibit LML-R8, Schedule C-2) (Rehearing Exhibit 7).

Donated Plant as CIAC

The POAs assert that DIUC has "no original costs in a large portion of its Utility Plant because that Plant was donated to DIUC by Haig Point, Inc., the developer of Haig Point." (Loy Rehearing Direct, R. p. 309 ll. 20-21). As shown on Loy Exhibit CEL-R1 (Rehearing Exhibit 5), Haig Point Utility Company, Inc. ("HPUC") (the previous name of DIUC) showed "Plant in Service" of $4,339,598 on its Combined Balance Sheet in support of its rate case before this Commission in Docket No. 2005-34-WS. However, this "Plant in Service" amount was an adjustment to the Company's "Property, Plant and Equipment" balance of $0.0 as of "Total Year Ended 6/30/04" as shown on its Trial Balance (Loy Exhibit CEL-R2, Rehearing Exhibit 5). Mr. Loy testified that HPUC's Water Annual Reports for the years 2000-2003 showed no plant

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balances at all. (Loy Rehearing Direct, R. p. 381).According to the POAs, this "zero balance" for Plant in Service on June 30, 2004 demonstrates that Haig Point, Inc. donated the Plant in Service to DIUC, as do the deeds and conveyances through which Haig Point, Inc. transferred the land and property comprising water and sewer plant to DIUC "for no consideration." (Loy Exhibit CEL-R3) (Rehearing Exhibit 5).

Moreover, International Paper (IP), the owner of Haig Point, Inc. disclosed in its 1999 SEC Form 10-K (at Exhibit One, Note C), that it wrote off its entire Haig Point investment in 1997. (The 1999 IP Form 10-K was an Exhibit to Mr. Loy's Surrebuttal Testimony in the Hearing). And the financials associated with HPUC's initial rate case before this Commission in Docket No. 87-333-W/S show that the rates established by HPUC – and that were in place until 2005 – only recovered the operating costs (as opposed to the capital costs associated with Plant, Property and Equipment) of the Utility. According to the POAs, these factors demonstrate that this particular Utility Plant was donated to DIUC by Haig Point, Inc. Finally, the purchase price for the stock of HPUC ($1.75 million) paid by CK Materials, LLC in 2008 is much lower than the plant value claimed by HPUC/DIUC. (Exhibit CEL-R6) (Rehearing Exhibit 5).

According to the POAs, and contrary to NARUC Uniform System of Accounts ("USoA"), Accounting Instruction 18, "*Utility Plant – To Be Recorded at Cost*" Part D, DIUC erroneously booked the donated "Property Plant and Equipment" by crediting "Paid-in Capital" (Note 8 of Loy Exhibit CEL-R2, Rehearing Exhibit 5) instead of Contributions in Aid of Construction (CIAC). The NARUC USoA requires that entries to utility plant accounts for plant donated to the utility must be offset by credits to CIAC. As set out in Mr. Loy's Rehearing Direct Testimony (Rehearing R. p. 312, ll. 4-17), NARUC USoA, Accounting Instruction 18,

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"Utility Plant - To be Recorded at Cost" Part D describes how the values of the donated plant should have been initially booked. Part D states:

> Utility plant accounts shall be charged with construction costs (estimated, if not known) of the utility plant contributed by others or constructed by the utility using contributed cash or its equivalent. For contributed utility plant, the accumulated depreciation or amortization account shall be charged with the estimated amount of depreciation or amortization applicable to the property at the time it was contributed to the utility. Account 271 - Contributions in Aid of Construction shall be credited with the net of the amounts charged to the plant and the accumulated depreciation or amortization accounts. For plant constructed using contributed cash or its equivalent, account 271 - Contributions in Aid of Construction shall be credited with the amount of the cash or its equivalent contribution.

NARUC defines CIAC as "[a]ny amount or item of money, services or property received by a utility, from any person or governmental agency, **any portion of which is provided at no cost to the utility**, which represents an addition or transfer to the capital of the utility, and which is utilized to offset the acquisition improvement or construction costs of the utility's property, facilities, or equipment used to provide utility services to the public. (emphasis added). NARUC Section 271(A). (Loy Rehearing Direct, R. p. 312, ll. 18-26).

DIUC witness Guastella admitted in the Rehearing (Rehearing R. p. 50-51) that HPUC did not pay anything in exchange for the plant assets in question. Mr. Guastella, nevertheless, asserts that the manner in which the plant assets in question were transferred from Haig Point to HPUC and booked by HPUC was customary in his experience. Mr. Guastella described the process as follows: "And the way it's established is all of the construction costs and the utility assets that had to be paid for by the developer [Haig Point], because the utility [HPUC]was a paper corporation and no revenues, no ability to finance it, and those facilities were turned over

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to the utility [HPUC] and they're turned over as an investment by the developer [Haig Point, Inc.] in the form of an equity investment in the utility [HPUC]. It doesn't ask the utility to pay for the utility facilities." (Rehearing R. p. 51, ll. 15-24). Mr. Guastella also testified that the treatment of the plant assets in question as proposed by the POAs "would end the utility" because DIUC would not be able to obtain financing. (Rehearing R. p. 52).

In addition, Mr. Guastella claims in his Rehearing Rebuttal Testimony (Rehearing R. pp. 101-103) that various Commission Orders and proceedings, as well as the positions that the parties in those cases (e.g. the POAs and ORS) have taken or not taken, support rejecting the POAs' proposed adjustments to net plant and therefore rate base.

The testimony of the ORS witnesses does not specifically adopt or support the POAs' treatment of utility plant as donated plant/CIAC, but ORS witness Hipp testified that approach is reasonable and consistent with generally accepted ratemaking principles. (Rehearing R. p. 494 ll. 18-24, p. 495, l.1).

Commission Decision

After reviewing the evidence and arguments presented by DIUC, ORS, and the POAs, the Commission accepts the rate base determination methodology and adjustments proposed by the POAs. The POAs have offered compelling testimony and evidence that DIUC did not pay for that portion of its Utility Plant that was placed on its books as an adjustment in 2004. As such, the Utility Plant in question squarely meets the definition of "contributions in aid of construction" as that term is used by NARUC:

> "[a]ny amount or item of money, services or property received by a utility, from any person or governmental agency, **any portion of which is provided at no cost to the utility**, which represents an addition or transfer to the capital of the utility,

> and which is utilized to offset the acquisition improvement or construction costs of the utility's property, facilities, or equipment used to provide utility services to the public. (emphasis added). NARUC Section 271(A).

The Utility Plant in question was provided to HPUC by Haig Point at no cost to HPUC. Accepting for the sake of argument that Mr. Guastella's contention that the Utility Plant in question was "turned over as an investment by the developer [Haig Point, Inc.] in the form of an equity investment in the utility [HPUC]" were true, there is no evidence that HPUC paid anything to Haig Point, Inc. in exchange for that "investment." In fact, the evidence provided by the POAs shows just the opposite. And Mr. Guastella himself conceded that HPUC did not pay Haig Point for the Utility Plant.

The Commission is not convinced by Mr. Guastella's contentions in his Rebuttal Testimony (Rehearing R. pp. 101-103) that current and previous Commission and/or ORS decisions or positions establish that the Commission cannot or should not reclassify assets as CIAC for purposes of establishing rate base. No previous Commission Order has foreclosed the POAs' ability to challenge the rate base proposed by DIUC, and DIUC simply has put forth no evidence or argument supported by any legal or regulatory authority that the assets in question are not donated plant that should have been classified as CIAC.

Finally, the Commission finds Mr. Guastella's testimony regarding the fate the Company would face were the Commission to accept these adjustments as speculative at best. Moreover, those contentions do not address or refute the proposition put forth by the POAs (and unrefuted by DIUC) that the Utility Plant in question was donated and appropriately treated as CIAC.

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Accumulated Depreciation

POAs' witness Mr. Loy testified that, contrary to the practices of DIUC, "the full straight-line depreciation must be recorded to *accumulated* depreciation in order to comply with NARUC and rate making guidelines." (Loy Rehearing Direct, Rehearing R. p. 321, ll. 9-10). As cited in Mr. Loy's testimony, the NARUC Uniform System of Accounts ("USoA") requires straight-line depreciation over the useful life of plant in service:

> *"Straight-line method" as applied to depreciation accounting means the plan under which the service value of property is charged to operating expenses (and to clearing accounts if used), and credited to the accumulated depreciation account through equal annual charges during its service life. Estimates of the service life and salvage will be reexamined periodically and depreciation rates will be corrected to reflect any changes in these estimates.*

DIUC, however, is depreciating its plant according to its "Complete System" methodology, which calculates depreciation expense based on the percentage of customers currently using the system relative to the total number of customers at system capacity. This results in depreciation expense calculated based on 47% of water plant and 35% percent of the sewer plant. (Rehearing Direct Testimony of Charles Loy, R. p. 319, ll. 7-8). As a result, only part of the depreciation expense that represents the useful life is expensed and placed into accumulated depreciation on the books of the Company. (Loy Rehearing Direct, R. p. 329, ll. 10-11). In addition, Mr. Loy testified that an adjustment increasing accumulated depreciation "reflects the proper age and condition of the utility property," (Loy Direct, R. p. 371).

As a result, and as shown in Exhibit LML-8, Schedule C-1 (Rehearing Exhibit 7), the calculation of "straight-line" accumulated depreciation results in a total amount of accumulated depreciation of $3,055,943, which reduces DIUC's combined net plant for rate base to $5,083,318.

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The testimony of the ORS witnesses does not specifically adopt or support the POAs' application of straight-line depreciation and its effect on accumulated depreciation.

DIUC did not offer any specific testimony or evidence in opposition to the adjustments to accumulated depreciation proposed by the POAs, other than the fact that its proposal offered a different figure for accumulated depreciation.

Commission Decision

The Commission adopts the proposal of the POAs to adjust accumulated depreciation as set out in Exhibit LML-8, Schedule C-1 (Rehearing Exhibit 7). The NARUC USoA requires full straight-line depreciation expense to be recorded to accumulated depreciation. DIUC's failure to do so is also inconsistent with the NARUC publication "Public Utility Depreciation Practices," which states:

> It is essential to remember that depreciation is intended only for the purpose of recording the periodic allocation of cost in a manner properly related to the useful life of the plant. It is not intended. for example, to achieve a desired financial objective or to fund modernization programs.

Neither DIUC nor ORS witnesses provided any testimony suggesting that unutilized plant does not lose service value over time, or even that unutilized plant loses service value over time at a slower rate than used and useful plant. The Commission is particularly concerned with the information set out in Mr. Loy's Table Four (Loy Rehearing Direct, R. p. 322, l. 5), which shows that DIUC's proposed accumulated depreciation in this case ($777,854) is 57% *lower* than that approved by the Commission in Docket 2005-34-W/S. Any benefits to DIUC customers in the form of lower depreciation rates are outweighed by the effects of lower accumulated

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depreciation on return and taxes (Loy Table 3, Loy Rehearing Direct, R. p. 320, l. 11). For these reasons, the Commission adjusts accumulated depreciation as proposed by the POAs.

Utilization Factors

POA witness Loy offered an alternative approach in his Rehearing Direct Testimony. (Rehearing R. pp. 324-330). DIUC's rate base must be adjusted to reflect the level of plant that is actually in service. In the 2005 rate case, ORS applied this concept in its recommendations in its Audit Report[9]. ORS proposed removing "plant in service based on most recent system utilization factors of 40.94% for water and 34.16% for sewer".[10] The utilization factors were developed by the Company to identify the portion or percentage of the water and sewer systems that are "used and useful". In the 2005 Rate Case test year, the utility was serving only 40.94% of the potential customers its water system could serve, and only 34.16% of the potential customers its sewer system could serve. ORS applied the utilization factors to the Company's proposed plant by these percentages, which resulted in a $2,277,603 reduction in that component of DIUC's rate base.

According to Mr. Loy, this approach follows the key rate making concept of "used and useful," and his proposed adjustment assures that a utility's customers do not bear the economic burden of excess capacity and possibly a developer's imprudent decision to overbuild a water or sewer system. As Mr. Loy explained, a developer has the ability to either construct a utility system in phases, as the development proceeds, or construct a much larger system initially - one that could serve the entire development, if and when it is entirely built-out. Here, the developer

[9] *See* Docket No. 2005-34-W/S, Testimony of Sharon G. Scott, p 24, Audit Exhibit SGS-11, relevant portions included in **Exhibit CEL-R5, Rehearing Exhibit 5**.

[10] *See Id.*, Note (G) to ORS Audit Exhibit SGS-11 in **Exhibit CEL-R5, Rehearing Exhibit 5**.

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decided to initially build a system large enough to serve a fully-built out Haig Point development, before determining whether the development would even be a success. (Rehearing R. p. 325).

In 2004, roughly twenty years after development of the Haig Point community began, system utilization was only 41% (water) and 34% (sewer). ORS's proposal to reduce the utility's gross plant to these actual utilization percentages ensured that current customers did not bear an undue economic burden otherwise caused by the developer's decision to construct such a large system at the beginning of the development. (Rehearing R. p. 325).

System utilization has not changed materially in the last 12 years. Since 2004, the water system utilization has increased from 41% to 47% and sewer system utilization has increased from 34% to 35%. This essentially immaterial growth in system utilization over the twelve years period demonstrates that the developer grossly overbuilt the water and sewer systems when it began developing Haig Point in the 1980s. Including all the plant in Rate Base, as proposed by DIUC, would unfairly burden DIUC's customers and unfairly compensate DIUC. DIUC should not be allowed to charge rates that cause DUIC's customers to bear the burden of the developer's initial decision to build out the entire system when future success of the development was unknown. (Rehearing R. p. 326).

The adjustment follows the well-known rate making concept that only plant that is "used and useful" should be included in rate base. Numerous authoritative texts on utility ratemaking cite this principle or rule. For example, "Accounting for Public Utilities" by Robert L. Hahne, states:

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> "Only plant currently providing service or capable or providing utility service to the consuming public is allowed in rate base."

"The Regulation of Public Utilities" by Charles F. Phillips Jr. states:

> "For decades, used and useful referred to needed capacity; that is, a determination as to whether a plant was actually used in service and was useful in providing service."

"Principles of Water Rates, Fees, and Charges" also known as the "Manual of Water Supply Practices M1" published by the American Water Works Association states:

> "The primary issue related to including plant in the rate base is whether the plant is used and useful in providing utility service."

Further, the 2005 ORS adjustment agrees with the "Rate Case and Audit Manual" developed by NARUC to assist utility commission staffs with rate case audits which states:

> "In reviewing specific rate base items, the auditor will want to continually be considering the concept of used and useful. This principle is widely adopted by regulatory commissions and requires that plant be functioning and necessary to be included in the revenue requirement. Plant that is considered to be excessive may not be appropriate for inclusion in rates at this time." (Emphasis added).

According to Mr. Loy, the same factors supporting ORS's proposed adjustment in 2005 apply today with even more force. As discussed above, customer growth over the last twelve years has been materially insignificant. Like in 2005, DIUC's system today is largely unutilized. Table 8 (Rehearing R. p. 328) shows how the booked plant values must be reduced to reflect actual utilization and demonstrates how that reduction is computed.

DIUC does not agree with the POAs' plant utilization approach. The testimony of the ORS witnesses does not specifically adopt or support the POAs' plant utilization adjustment, but

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ORS witness Hipp testified that approach is reasonable and consistent with generally accepted ratemaking principles. (Rehearing R. p. 495 ll. 8-13).

Commission Decision

Because the Commission is accepting the POAs' recommendation to reclassify DIUC's donated plant from paid-in capital to Contributions in Aid of Construction, we decline to adopt their alternative "used and useful" adjustment to rate base. Although the Commission finds the ratemaking principles supporting this adjustment to be sound, the vast majority of the proposed adjustments would be made to the plant that was originally donated to the utility. The Commission's decision to remove donated plant entirely from rate base makes this proposed alternative unnecessary.

Rehearing Accounting and Pro Forma Adjustments

The parties offered various revised rehearing accounting and pro forma adjustments based upon the Opinion. Those adjustments as proposed by DIUC and the Company are set out in Revised Rehearing Audit Exhibit DFS-4 (Rehearing Exhibit 8). The Commission adopts those adjustments with which no party disagreed as just and reasonable, and proceeds below to consider those adjustments upon which the parties could not agree.

Management Fees

DIUC proposed management fees of $171,365. (Exhibit GCW-R1) (Rehearing Exhibit 3).

ORS proposes to adjust outside management fees to $132,211, an amount which was approved by the Commission in Docket No. 2011-229-WS. This results in an adjustment of

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($25,439) to the original per book amount of $157,650, and an adjustment of ($39,154) to the amount of $171,365 proposed by DIUC in Rehearing Exhibit 3.

The management fees sought by DIUC are described in a Management Agreement with Guastella and Associates, Inc. ("GA"). (Hearing Exhibit 9); and (Exhibit DMH-4) (Rehearing Exhibit 9). Through the Management Agreement, DIUC, its parent company, Daufuskie Island Holding Company, LLC, ("DIUC Holding Company"), and DIUC Holding Company's stockholders (together "Clients") delegated to GA the authority to act on behalf of the Clients and for the benefit of DIUC. (Hipp Rehearing Direct, R. p. 477, ll. 9-13). Ms. Hipp testified that the services provided to DIUC did not increase during the test year from those provided by GA in Docket No. 2011-229-WS. (Hipp Rehearing Direct, p. 477, ll. 13-14).

As set out in the Management Agreement and confirmed through cross examination of Mr. Guastella by the POAs and ORS, and in response to questions from the Commissioners, the Management Agreement entitles GA to the following:

1. a management fee of $13,596.85 a month ($163,162 annually) with an annual 3.5% increase;
2. a finance fee of 2% of the principal amount of any loan or GA's actual total hourly rates for handling the loan, whichever is greater;
3. a capital fee of 10% for the first $50,000 of construction and 8% for construction costs over $50,000;
4. an annual incentive fee of 20% of the total net utility operating income;
5. an incentive fee if DIUC is sold;
6. rate case expenses;

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7. travel expenses; and

8. expenses related to regulatory investigations and proceedings.

POA witness Lanier testified that the Commission should not allow DIUC to use its higher expenses related to GA to justify the need for a rate increase, given that the GA Management Contract expenses allow for an inflation-based increase of 3.5% per year, whereas the actual inflation rate over the last three years was less than 2.0% per year. (Lanier Direct, R. pp. 432-433).

Commission Decision

Upon review of the evidence, the Commission adopts ORS's adjustments for management fees. We agree that GA provides services to the ratepayers, but disagree that the services are at a level that warrant the amount set forth in the management services contract. We think it is appropriate for DIUC stockholders to have responsibility for the difference. While customer service complaints are few in number, this Commission did hear testimony at the night hearing and the merits hearing that GA was an absentee management company and had very little presence on the island. It is undisputed that DIUC did not pay property taxes under GA's tenure (resulting in the tax sale described above), that required regulatory reports and fees have been filed and paid late (R. p. 244), and that the South Carolina Department of Health and Environmental Control (DHEC) issued a notice of violations against DHEC (Vogel Direct, R. p. 319, ll. 14-16). We conclude the ORS-recommended amount for management expenses strikes a reasonable balance.

Moreover, and as we explained in Order No. 2016-50, although expenses of a public utility are presumed to be reasonable when incurred in good faith, the presumption does not

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apply to affiliate payments. When payments are made by a regulated public utility to an affiliate, mere showing of actual payment does not establish a prima facie case of reasonableness. Clearly, DIUC and its management company GA are affiliates, as per the Management Agreement (Hearing Exhibit 9). (An "affiliate" is defined by Black's Law Dictionary Free Online Legal Dictionary 2nd edition as "Companies that have a shared resources, interests, or business dealings.") Further evidence of affiliation between GA and DIUC is shown in the Utility's 2014 Annual Report to the Commission and ORS. John Guastella, the Managing Member of Guastella Associates, LLC, has been a member of the Board of Directors of DIUC since July 9, 2008.[11] Further evidence of Mr. Guastella's membership on the DIUC Board of Directors is found at page 227 of the Transcript of the Hearing Record, wherein Mr. Guastella admitted that he was still a DIUC Board of Directors member at the time of his testimony in this case, and in similar testimony in the Rehearing.

The following interchange between Mr. Guastella and Commissioner Bockman is clearly demonstrates the affiliation between his company and DIUC:

> Q: You tell [majority DIUC shareholder and President, Terry Lee] what to do, or he tells you what to do?
>
> A. [Guastella] I pretty much tell him what to do....

(Rehearing R. p. 206).

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

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Additionally, as discussed at the Hearing and the Rehearing, several of the provisions of the Management Agreement suggest less than an arm's length relationship between DIUC/DIUC Holding Company and GA. For example, Article V. "Termination" allows GA to terminate the Management Agreement "without cause by giving the Company sixty (60) days advance written notice ...." However, the same Article V does not extend the same "termination for convenience" right enjoyed by GA to the Clients, but instead allows only termination "for cause." DIUC's total inability to cancel the Management Agreement for any reason other than "for cause" is particularly significant in light of the Management Agreement's *automatic* renewal every three years. The combination of these two provisions creates an inequity between DIUC and Guastella Associates that shows who controls whom. Additionally, Mr. Guastella testified at the Rehearing 1) he drafted the Management Agreement and presented same to the Clients (Rehearing R. p. 168); 2) there was little if any negotiation of the Management Agreement Rehearing R. p. 197); and 3) generally the Clients answer to GA (with respect to construction matters, for example), rather than a situation where GA answers to the Clients. (Rehearing R. p. 206).

Finally, the payment of unexplained expenses to affiliates does not entitle a regulated water and sewer utility to a requested increase in rates and charges. The rule is that if there is an absence of data and information from which the reasonableness and propriety of the services rendered and the reasonable cost of rendering such services can be ascertained by the Commission, allowance is properly refused. *Hilton Head Plantation Utilities, Inc. v. The Public Service Commission of South Carolina*, 312 S.C. 448, 441 S.E.2d 321 (1994). This language from the *Hilton Head Plantation Utilities* case requires the PSC to review and analyze these

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intercompany dealings and determine if they are reasonable. *Kiawah Property Owners Group v. The Public Service Commission of South Carolina*, 338 S.C. 92, 525 S.E. 2d 863 (1999). Again, ORS found no apparent increases in the amount of management services provided by GA since the last rate proceeding, and, accordingly, recommended that no increased amount be granted in the present case, and this Commission adopted the ORS finding. Since the Company did not provide a reasonable explanation for its request for an increase in this area, the extra expense was properly denied.

Property Taxes

DIUC and the ORS agreed upon an adjusted expense amount for "Property Taxes" of $188,093. (Revised Rehearing Audit Exhibit DFS-4) (Rehearing Exhibit 8). The POAs testified that the annual Property Taxes as adjusted due to a reduced rate base would equal $59,213. (Exhibit LML-R2, Schedule WP-1) (Rehearing Exhibit 6). The POAs also testified that taxes for previous years would decrease from a total of $526,844 to $164,894. (Lanier Rehearing Direct R. p. 374, ll. 14-15).

Commission Decision

Because we agree with the POAs that DIUC's rate base must be reduced to reflect CIAC, we also agree with the Property Tax adjustments proposed by the POAs. The POAs also recommended a means through which DIUC could recover property taxes it is obligated to pay, and which cannot be altered through amended returns to the S.C. Department of Revenue, via a surcharge which would be authorized by the Commission, following DIUC's efforts to reduce its property tax burden through amended returns which would reflect lower plant balances and CIAC credits. (Lanier Rehearing Direct, R. p. 375-376). In view of the magnitude of the

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property taxes and the impact on revenue requirements and rate levels, this appears to be a reasonable approach and the Commission accepts this recommendation.

Rate Case Expenses

DIUC seeks total rate case expenses of $794,210 ($674,210 actually incurred through September 2017, plus $120,000 projected to complete the rehearing phase) to be amortized over three years. (Guastella Rehearing Rebuttal, R. p. 85, ll. 10-12). In addition, DIUC, seeks recovery of $60,782 in bond costs, also to be amortized over a permit of three years. (Guastella Rehearing Rebuttal, R. p. 77, l. 4).

The ORS recommends that DIUC be allowed to recover $272,832 of the total requested $794,210 in rate case expenses. ORS did not include $88,999 in unsupported rate case expense. (Hipp Rehearing Direct Testimony, R. p. 474, ll. 18-20). In addition, ORS recommends that rate case expenses be recovered over a period of five (5) years because that amortization period is a "reasonable balance between the shareholders and ratepayers . . ." (Hipp Rehearing Direct, R. p. 476-477).

In support of the ORS decision to disallow $542,878 in rate case expenses requested by DIUC, ORS witness Hipp testified regarding the criteria the ORS applied to ensure that invoices supplied by DIUC and supporting documentation included for ratemaking meet "known and measurable" standards:

1) The invoice is mathematically correct;

2) The invoice is for a valid business purpose;

3) The expense was incurred during the period under review;

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4) The invoice was properly recorded on the books and records of the Company; and

5) The invoice was paid by the Company.

(Hipp Rehearing Direct, R. p. 474). The GA invoices supplied by DIUC failed to meet these standard criteria because they 1) contain mathematical errors; 2) Do not contain sufficient detail to describe the work performed, the specific dates and hours of work, employee name, and business purpose; 3) Contain expenses such as air fare, lodging, and meals for which no detail and or receipt was provided; and, 4) Do not appear to be paid by DIUC. (Hipp Rehearing Direct, R. p. 476, ll.11-18).

The POAs incorporated rate case expense of 364,600, amortized over 5 years, as shown on LML Exhibit LML-R3, Schedule C-5 (Rehearing Exhibit 6), consisting of $289,600 in prior rate case expense and $75,000 in current rate case expense.

The Commission agrees with ORS's judgment that $ 272,832 in rate case expenses is a reasonable amount to pass to ratepayers for this rate case. The ORS criteria are standard and uniform, and applied with respect to every regulated utility and in every rate case. We also agree that the amortization period and the inclusion of unamortized rate case expenses from the last rate case are reasonable. The reasons set forth for excluding the non-allowable expenses is based on sound rate-making principals and those costs should not be passed to ratepayers. In addition, our analysis and application of the *Hilton Head Plantation Utilities* case described above, in view of the affiliation between DIUC and GA, further supports our decision to adjust the rate case expenses recovered by DIUC.

It is easy to see why sound ratemaking principles require denial of rate case expenses that are inadequately documented and unpaid. Rate case expenses can materially raise a utility's

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revenue requirement and, accordingly its rates. Here, DIUC's requesting rate case expenses of approximately $800,000, amortized over three years, *dramatically* increase the utility's proposed rates. It would be easy for a utility to inflate its asserted revenue requirement with unpaid and undocumented expenses, with the (stated or unstated) intent it would only pay those expenses if and when the Commission approves them as part of the utility's new rate structure.

Bad Debt Expense

The Company proposes adjusted bad debt expense of $108,349 (Exhibit GCW-R1, Rehearing Exhibit 3), and ORS proposes adjusted bad debt expense of $105,383, based on a negative adjustment of $284 to the Company's per books amount from its original filing of $105,667. (Revised Rehearing Audit Exhibit DFS-4, Rehearing Exhibit 9, based on the calculation of bad debt employed by ORS witness Gearheart in Exhibit ICG-4 in the Hearing).

The POAs propose bad debt expense of $14,762. In its Application, DIUC's actual test year bad debt expenses were listed as $105,667. Excluding "Misc. Other Revenues," that amount of bad debt expense is 10.1% of DIUC's revenue. According to POA witness Lanier, "[s]uch a rate of bad debt expense is unheard of and simply cannot be justified." (Lanier Rehearing Direct, R. p. 366, ll. 2-3). Significantly, this amount is also far in excess of the $25,423 the Company proposed in its 2012 rate case, which ORS then adjusted down to $9,332 (1.3% on revenues of $714,996) (ORS Witness C. Stutz, Audit Exhibit CAS-1, Page 1 of 2).

In the present case, DIUC reduced its actual test year bad debt expenses (of $105,667) by $90,905, and proposed bad debt expense of $14,762 (approximately 1.37% of its adjusted annual revenues of $1,085,421). ORS provided testimony (in the original case and in this Rehearing) proposing to adjust that expense upward to $105,384, adjusting the DIUC actual test year amount

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($105,667) by $284. (Revised Rehearing Audit Exhibit DFS-4) (Rehearing Exhibit 8). As set out in her Audit Exhibit ICG-4 (p.3 of 9) adopted by Mr. Sullivan, Ms. Gearheart applied a rate of 9.816% [DIUC's per book bad debt expense ($105,668) as a percentage of its annual revenue ($1,076,463)] multiplied by the ORS pro forma adjusted revenues of $1,073,577, to arrive at the amount of $105,384.

In contrast, Mr. Lanier's Exhibit LML-R3 (Rehearing Exhibit 6) calculates bad debt expense based on a composite rate of 1.36% of total revenues (0.5% of rate revenues and 2.5% of availability fee billings), arriving at bad debt expense of $6,676 of the Water System and $8,086 for the Sewer System, for a total of $14,762, exactly what DIUC requested in its original application.

The Commission adopts the bad debt expense of $14,762 proposed by the POAs. The composite rate of 1.36% of total revenues and the methodology used by POA witness Lanier is just and reasonable, in part because it encourages DIUC to collect those debts it is owed. Moreover, this percentage of bad debt expense was utilized previously for DIUC by the ORS in Docket No. 2011-329-WS, and we see no reason to approve a bad debt expense that almost 8 times that amount in this case. And the fact that DIUC recognized the reasonableness of this amount when it filed this rate case also supports this figure.

Other Adjustments

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

Performance Bond

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

The Commission finds, based on the testimony of DIUC, the POAs and ORS, that an increase in rates is supported by the evidence presented. DIUC has not applied for a rate increase in several years as it was prevented from doing so pursuant to the settlement agreement approved in its last rate case in Docket No. 2011-229-WS. Expenses have increased during the last four years, and the Company is entitled to a fair and reasonable return to: 1) allow it to serve its customers at the same level and 2) place it in a more favorable position to borrow or acquire capital.

After reviewing the evidence in this case, approve the Rates in Attachment A [No Rate Schedule Attached]. The Rates revenue amount produces an operating margin of 2.6%. Further, the 9.31% ROE was recommended by the ORS. These rates will permit the Company to cover operating costs and provide an opportunity to earn the approved rate of return on rate base. The resulting ROE allows DIUC the opportunity to earn a fair return and are in the public interest.

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V. FINDINGS OF FACT

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

2. The Company provides service to 462 customers on Daufuskie Island, South Carolina.

3. The Company's prior rates were approved in Docket No. 2011-229-WS.

4. As of the original Hearing date, the Company had rate schedules relating to its water and sewer charges, broken down into residential and commercial rate classes and further into water, sewer, and irrigation charges. The Company's base quarterly residential water service charge was $62.09 in the Haig Point Subdivision and $80.72 in the Melrose Subdivision, with consumption charges of $2.76 per thousand gallons (Haig Point) and $2.44 per thousand gallons for consumption over 22,500 gallons per quarter (Melrose). The Company's base quarterly residential sewer service charge was $110.38 in the Haig Point Subdivision and $80.72 in the Melrose Subdivision, with volumetric charges of $1.32 per thousand gallons (Haig Point) and volumetric charges of $1.95 per thousand gallons over 22,500 gallons per quarter (Melrose). The Company's tap fees were $500 for both water and sewer for residential customers. (Company Application, Statement of Proposed Rates).

5. The rates that the Company proposed, and that the Company has been charging since July 1, 2016, are found in the Company's Statement of Proposed Rates. In lieu of

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discussing all of the proposed changes in the Company's rate schedules, the Commission will highlight the changes initially requested in the Company's residential service rates and terms of service. The Company initially proposed, and is currently charging under bond, pursuant to S.C. Code Ann. § 58-5-240(E), a base quarterly water charge of $149.30 (for both Haig Point and Melrose), and quarterly consumption charges of $4.41 per thousand gallons (for both Haig Point and Melrose). Likewise, the Company initially proposed, and is currently charging, a base quarterly sewer charge of $218.18 (for both Haig Point and Melrose), and a quarterly volumetric charge of $2.38 per thousand gallons.

6. The Company's Rehearing Testimony purports to include a "Statement of Proposed Rates." (Exhibit GCW-R1) (Rehearing Exhibit 3). The Commission agrees with ORS witness Hipp that these "proposed rates" are different from and exceed the Proposed Rates that were noticed to the public and to the customers of DIUC.

7. Under the Company's rates approved in Docket No. 2011-229-WS, the Company stated that its operating revenues for the test year were $1,073,581. (Exhibit GCW-R1) (Rehearing Exhibit 3).

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

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

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

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

12. The Commission adopts and approves the following as it sets forth a fair return along with just and reasonable rates.

13. Donated plant should be removed from rate base according to NARUC treatment of Contributions In Aid of Construction (CIAC). This consists of $1,757,399 of gross water plant and $2,656,660 of gross sewer plant.

14. The Commission shall utilize a capital structure of 46% long-term debt and 54% equity; a cost of debt rate of 5.29%; and an ROE of 9.31%.

15. The ROE of 9.31% produces additional operating revenue of $219,993 consisting of a water revenues increase of $169,694 and a sewer revenue increase of $50,928. (Exhibit LML-R3, Schedule C-4) (Rehearing Exhibit 6).

16. We hereby set DIUC's rate base at $2,304,944.

17. The approved revenues and expenses establish a fair and reasonable operating margin of 2.6%. S.C. Code Ann. § 58-5-240(H).

VI. CONCLUSIONS OF LAW

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

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

2. The "Statement of Proposed Rates" included in the Company's Rehearing Testimony (Exhibit GCW-R1, Rehearing Exhibit 3) are not properly before the Commission

pursuant to S.C. Code Ann. § 58-5-240(B), and the Commission cannot consider or approve these rates.

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

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

5. In order for DIUC to have the opportunity to earn the 9.31% ROE, found fair and reasonable herein, DIUC must be allowed additional revenues of $219,993.

6. The rates as set forth in the attached Order Attachment No. 1 [Rates Not Provided] are approved for use by DIUC and are designed to be just and reasonable without undue discrimination and are also designed to meet the revenue requirements of DIUC.

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

8. Pursuant to S.C. Code § 58-5-240(E), the Company is hereby Ordered to report to the Commission and to the parties the total amount of revenues that it has collected under the Proposed Rates, as well as the total amount of revenues that it would have collected based upon the rates ordered hereby, during the time period that the Proposed Rates were in effect.

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IT IS THEREFORE ORDERED THAT:

1. The proposed rates, fees, and charges in Order Attachment 1 [Attachment One Not Provided] are both fair and reasonable and will allow DIUC to continue to provide its customers with adequate water and wastewater services.

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

3. A return on equity of 9.31% and operating margin of 2.6%, based on the new rates, fees, and charges, is approved for DIUC.

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

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

6. Pursuant to S.C. Code § 58-5-240(E), the Company is hereby Ordered to report to the Commission and to the parties the total amount of revenues that it has collected under the Proposed Rates, as well as the total amount of revenues that it would have collected based upon the rates ordered hereby, during the time period that the Proposed Rates were in effect.

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

BY ORDER OF THE COMMISSION:

Swain E. Whitfield, Chairman

ATTEST:

Randy Randall, Vice-Chairman

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BEFORE THE PUBLIC SERVICE COMMISSION

OF SOUTH CAROLINA

DOCKET NO. 2014-346-WS – ORDER NO. 2017-__

DECEMBER __, 2017

IN RE: Application of Daufuskie Island Utility Company, Incorporated for Approval of an Increase for Water and Sewer Rates, Terms and Conditions	))))))	**PROPOSED ORDER RULING ON APPLICATION FOR ADJUSTMENTS IN RATES AND INCORPORATING ORDER OF SUPREME COURT**

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IT IS THEREFORE ORDERED THAT: 33

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I. INTRODUCTION

This re-hearing is before the Public Service Commission of South Carolina ("Commission") upon a remittitur from the South Carolina Supreme Court ("Supreme Court").

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

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

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

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

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

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

Subsequent to their intervention, the POAs requested the Commission to schedule a public night hearing at a convenient time and location for customers of DIUC to present their comments regarding the service and rates of DIUC. In response, the Commission held a public night hearing pursuant to Order No. 2015-586. Under this Order, a public hearing was set and noticed by the Commission, and the Company provided an affidavit certifying that it had provided notice of the date, time and location of the local public hearing via publication in the Beaufort Gazette and The

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Island Packet. On September 15, 2015, the Commission held a night hearing beginning at 6:00 pm at the Haig Point Club Clubhouse, 130 Clubhouse Lane, Daufuskie Island, South Carolina.[1]

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

DIUC was represented by G. Trenholm Walker, Esquire and Thomas P. Gressette, Jr., Esquire. The POAs were represented by John J. Pringle, Jr., Esquire, John F. Beach, Esquire and Lyndey Ritz Zwing, Esquire. Beach Field was represented by M. John Bowen, Jr., Esquire and Margaret M. Fox, Esquire. ORS was represented by Shannon Bowyer Hudson, Esquire and Andrew M. Bateman, Esquire.

At the October 28, 2015 hearing, a Settlement Agreement between the POAs and ORS was entered into the record after an objection to it by DIUC was overruled. DIUC, the POAs and ORS presented testimony and exhibits after one public witness, Mr. Reid Delaney,[2] testified. Mr. Delaney testified that he owns property on which assets are located and utilized by DIUC for its regulated water and sewer business.

DIUC presented the testimony of: John F. Guastella[3] (direct and rebuttal testimony), President of Guastella Associates, LLC ("GA"), a utility management, valuation and rate consulting firm headquartered in Boston, Massachusetts; Gary C. White (direct), Vice President and Director of Accounting at GA; Eric Johanson (direct), DIUC Chief Operator; and the

[1] Hearing Exhibit 1 consists of the night hearing sign-in sheets and Hearing Exhibit 2 consists of comments filed by public witness Andy Mason.
[2] Hearing Exhibit 4 is a survey provided by Mr. Delaney.
[3] Hearing Exhibit 7 consists of Guastella Direct Exhibits A and B. Hearing Exhibit 8 consists of Guastella Rebuttal Exhibits 1 through 5. Hearing Exhibit 9 is the GA Management Agreement. Hearing Exhibit 10 consists of the ORS and POAs responses to DIUC's discovery requests.

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Honorable Maria Walls[4] (rebuttal), Beaufort County Treasurer. Mr. Guastella and Mr. White testified as a panel about the management and finances of DIUC. Mr. Johanson's testimony addressed the operations of DIUC. Mr. Johanson was excused from the hearing without appearing before the Commission after his testimony was accepted into the record without objection from the other parties. Ms. Walls provided testimony on property taxes.

The POAs presented two panels of witnesses. The first panel consisted of Paul Vogel[5] (direct), Haig Point Club and Community Association resident; Doug Egly[6] (direct), Chief Operating Officer of the Haig Point Association; and Tony Simonelli (direct), real estate broker on Daufuskie Island. The second panel consisted of Lynn M. Lanier[7] (direct) and Charles Loy[8] (direct and surrebuttal), Principals of GDS Associates, Inc., a utility consulting and engineering firm with its principal offices in Marietta, Georgia; and Harry Jue[9] (direct), water and sewer consultant with Hussey Gay Bell Engineering. POA witnesses Vogel, Egly, and Simonelli presented testimony illustrating the points of view of their respective organizations, and each providing various facts and opinions opposing DIUC's request. POA witness Loy provided expert testimony regarding accounting and rate base issues. POA witness Lanier provided expert testimony on the overall Application and incorporated Mr. Loy's recommended adjustments. Beach Field did not pre-file or present testimony or cross examine any witness at the Commission hearing.

ORS presented the testimony of Douglas H. Carlisle[10] (direct), ORS Economist; Ivana C.

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

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Gearheart[11] (direct), ORS Audit Manager; and Willie J. Morgan[12] (direct and surrebuttal), ORS Deputy Director for the Water and Wastewater Department. Dr. Carlisle's testimony included an analysis and recommendation for an ROE. Ms. Gearheart's direct testimony described ORS's examinations of the application and DIUC's books and records as well as the subsequent accounting and pro forma adjustments recommended by ORS. Mr. Morgan's direct testimony focused on DIUC's compliance with Commission rules and regulations, ORS's business audit of DIUC's water and wastewater systems, test-year and proposed revenue, and performance bond requirements.

On December 8, 2015, this Commission issued an Order approving the Settlement between the POAs and ORS and accepting the adjustments to rates laid out therein.

On December 21, 2015, counsel for DIUC filed a Petition for Reconsideration and/or Rehearing with the Commission. According to the Petition for Reconsideration and/or Rehearing, if DIUC were forced to implement the rates as established by the Settlement Agreement, it would default on its obligations and its ability to provide service would be threatened.

On January 20, 2016, DIUC filed a Petition for Bond Approval in which it notified the Commission that, pursuant to S.C. Code Ann. § 58-5-240, DIUC intended to put its originally requested rates into effect under bond during the pendency of its appeals.[13]

On February 25, 2016, the Commission issued an Order denying DIUC's Petition for Reconsideration and/or Rehearing. In that Order, the Commission stated that the evidence

[11] Hearing Exhibit 18 is Gearheart Direct Exhibits 1 through 8.
[12] Hearing Exhibit 19 is Morgan Direct Exhibits 1 through 8. Hearing Exhibit 20 is Morgan Surrebuttal Exhibits 1 and 2.
[13] While the Commission Order denying DIUC's Petition for Reconsideration and/or Rehearing was not issued until February 25, 2016, the Commission issued a Directive denying DIUC's Petition for Reconsideration and/or Rehearing on January 13, 2016.

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presented by ORS in the original hearing was competent and credible. Additionally, the only adjustment put forth to the Commission as part of the Settlement Agreement that was not an ORS adjustment was DIUC's original bad debt adjustment, for which DIUC provided support in its Application.

On March 1, 2016, the Commission approved the proposed surety and bond in the amount of $787,867, effective July 1, 2016, for a period of one year.[14]

On March 22, 2016, DIUC filed a Notice of Appeal with the Supreme Court in which DIUC appealed the Decision and Order of the Commission that Approved the Settlement Agreement between the ORS and POAs.

On December 14, 2016, the Supreme Court held oral arguments between the Appellant, DIUC, and the Respondents, ORS and the POAs. On July 26, 2017, the Supreme Court issued its Order, reversing the Commission's order and remanding the matter back to the Commission for a *de novo* hearing. In its opinion, the Supreme Court held that the Commission erred in approving and adopting the Settlement Agreement, and that DIUC is entitled to a new hearing in which the parties may present additional evidence. In addition, the Supreme Court gave guidance to the Commission on three matters: inclusion of the Elevated Tank Site in rate base, property tax expense, bad debt expense.[15]

On August 11, 2017, the Supreme Court issued a remittitur, thereby remitting the matter back to the Commission.

[14] Due to the length of the Appellate and remand process, a Joint Request was filed on June 15, 2017, by DIUC and the POAs that sought to extend DIUC's surety bond by an additional six months. This Commission issued an Order on June 30, 2017, approving the joint request.

[15] Despite the fact that this case was remanded to the Commission for a *de novo* hearing, the parties that participated in the re-hearing primarily confined their testimony previously unresolved issues and issues brought about by newly introduced evidence. Therefore, much of this Order's discussion on issues not litigated at the re-hearing remains unchanged from the previous Commission Order.

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On August 24, 2017, DIUC filed a Motion for Costs with the Supreme Court in which it sought attorney's fees and costs against Respondents in the amount of $60,382.37.[16]

On November 15, 2017, the Supreme Court issued an Order on DIUC's Motion for Costs granting DIUC the amount of $6,656.37 to be recovered against ORS, Haig Point Club and Community Association, Inc., Bloody Point Property Owner's Association, and Beach Field Properties, LLC. These costs were directed by the Supreme Court to be added to the remittitur. The Supreme Court's Order denied the $56,726 amount for bond premiums that DIUC sought.

On December 6 and 7, 2017, the Commission, with Chairman Swain E. Whitfield presiding, heard the re-hearing on the matter of DIUC's Application beginning at 10:30 am at the Commission Hearing Room located at 101 Executive Center Drive in Columbia, South Carolina.

At the re-hearing, DIUC was represented by G. Trenholm Walker, Esquire and Thomas P. Gressette, Jr., Esquire. The POAs were represented by John J. Pringle, Jr., Esquire and John F. Beach, Esquire. Beach Field did not participate in the re-hearing. ORS was represented by Jeffrey M. Nelson, Esquire and Andrew M. Bateman, Esquire.

At the re-hearing, DIUC presented the testimony of: John F. Guastella[17] (re-hearing direct and re-hearing rebuttal testimony) and Gary C. White[18] (re-hearing direct and re-hearing rebuttal). Mr. Guastella and Mr. White testified as a panel about the management and finances of DIUC.

The POAs also presented its two witnesses as a panel. The panel consisted of Lynn M. Lanier[19] (re-hearing direct and re-hearing surrebuttal) and Charles Loy[20] (re-hearing direct and re-

[16] Of the $60,382.37, $53,726 is attributable to bond premiums for bonds obtained pursuant to S.C. Code Ann. § 58-5-240(D), while the remaining, $6,656.37 is attributable to Court fees, copy fees, and capped attorney's fees.
[17] Re-hearing Exhibit 1 consists of Guastella Direct and Rebuttal Exhibits.
[18] Re-hearing Exhibit 3 consists of White Direct and Rebuttal Exhibits.
[19] Re-hearing Exhibit 6 consists of Lanier Exhibits 1 through 7 corresponding to his re-hearing direct testimony. Re-hearing exhibit 7 consists of Lanier Exhibits Exhibit LML-8, corresponding to his re-hearing surrebuttal testimony.
[20] Re-hearing Exhibit 5 is Loy re-hearing direct Exhibits 1 through 6.

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hearing surrebuttal), Principals of GDS Associates, Inc., a utility consulting and engineering firm with its principal offices in Marietta, Georgia. POA witness Loy provided expert testimony regarding accounting and rate base issues. POA witness Lanier provided expert testimony on the overall Application and incorporated Mr. Loy's recommended adjustments.[21]

ORS presented the testimony of Douglas H. Carlisle (re-hearing direct), ORS Economist; Daniel F. Sullivan[22] (re-hearing direct and re-hearing surrebuttal), ORS Deputy Director of Auditing; and Dawn M. Hipp[23] (re-hearing direct and re-hearing surrebuttal), ORS Director for the Utility Rates and Services Department. Dr. Carlisle's testimony adopted and re-affirmed the positions taken in his direct testimony and exhibits, which were filed on October 2, 2015, and his oral testimony given to the Commission on October 28, 2015. Mr. Sullivan's re-hearing direct testimony adopted the previously filed testimony of ORS witness Ivana C. Gearheart. Additionally, Mr. Sullivan's testimony described ORS's examinations of the re-hearing testimony and exhibits filed by DIUC in conjunction with the guidance provided by the Supreme Court in its Opinion No. 27729 and any accounting and pro forma adjustments recommended by ORS resulting therefrom. Ms. Hipp's re-hearing direct testimony adopted the direct testimony and exhibits of ORS witness Willie J. Morgan, and re-affirmed the positions taken by ORS witness Morgan during the hearing, with the exception of any changes made to comply with the guidance given by the Supreme Court. Additionally, Ms. Hipp presented ORS's findings and recommendations related to ORS's review of the re-hearing testimony and exhibits filed by John Guastella and Gary White on behalf of DIUC and applicable discovery related to DIUC's rate case

[21] At the hearing, the Commission overruled a DIUC objected to the introduction of the POAs witnesses' testimonies and exhibits.
[22] Re-hearing Exhibit 8 is Sullivan re-hearing Direct Exhibits 1 through 9.
[23] Re-hearing Exhibit 9 is Hipp re-hearing Direct Exhibits 1 through 5. Re-hearing Exhibit 10 is Hipp Surrebuttal Exhibit 1.

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invoices, management fees, and requested deferral of $155,328. Ms. Hipp's re-hearing surrebuttal testimony responded to DIUC witness John Guastella's rebuttal testimony. Specifically, Ms. Hipp addressed ORS's recommendation to remove certain rate case expenses, a 5 year amortization period for recovery of rate case expenses, ORS's analysis of management fees, and DIUC's assertions regarding Guastella and Associates help to assure the financial stability of DIUC.

II. REVIEW OF THE EVIDENCE AND EVIDENTIARY CONCLUSIONS

Standards and Required Findings

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

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

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

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procedural and jurisdictional in nature, and the matters which it involves are not contested by any party.

Test Year[24]

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

A fundamental principle of the ratemaking process is the establishment of a historical test year as the basis for calculating a utility's operating margin or, in this case, a return on rate base, and, consequently, the validity of the utility's requested rate increase. In order to determine what a utility's expense and revenues are for purposes of determining the reasonableness of a rate, one must select a 'test year' for the measurement of the expenses and revenues. *Heater of Seabrook v. Public Service Commission of South Carolina*, 324 S.C. 56, 478 S.E.2d 826, 828 n.1 (1996). While the Commission considers a utility's proposed rate increase based upon occurrences within the test year, the Commission will also consider adjustments for any known and measurable

[24]At the re-hearing, the Test Year was not actively litigated. As a result, the evidence relied upon in this section was primarily obtained during the October 28, 2015, hearing.

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out-of-test year changes in expenses, revenues, and investments, and will also consider adjustments for any unusual situations which occurred in the test year. Where an unusual situation exists which shows that the test year figures are atypical, the Commission should adjust the test year data. *See Southern Bell v. The Public Service Commission*, 270 S.C. 590, 244 S.E. 2d 278 (1978); *see also, Parker V. South Carolina Public Service Commission*, 280 S.C. 310, 313 S.E.2d 290 (1984), *citing City of Pittsburgh v. Pennsylvania Public Utility Commission*, 187 P.A. Super. 341, 144 A.2d 648 (1958); *Southern Bell v. The Public Service Commission*, 270 S.C. 590, 244 S.E.2d 278 (1978). Based on the information available to the Commission and that all parties agreed to a 2014 test year, the Commission is of the opinion, and therefore concludes, that the test year ending December 31, 2014 is appropriate for the purposes of this rate request.

Rate of Return on Rate Base[25]

DIUC requested that its rates be determined in accordance with the rate of return on rate base methodology. The determination of rate of return on rate base requires three components: 1) capital structure; 2) cost of debt; and 3) cost of equity (or return on equity). However, by statutory requirement, the Commission must also specify an allowable operating margin in all water and wastewater orders. Although the Commission must specify an operating margin in its order, this does not mean that the operating margin methodology must be used in determining a fair rate of return. *Heater of Seabrook* at p. 64 and 830. Operating margin "is less appropriate for utilities that have large rate bases and need to earn a rate of return sufficient to obtain the necessary equity and debt capital that a larger utility needs for sound operation." *Id.* No party actively contested

[25]At the re-hearing, the Rate of Return on Rate Base was not actively litigated. As a result, the evidence relied upon in this section was primarily obtained during the October 28, 2015, hearing.

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the use of the rate of return on rate base methodology and given DIUC's large rate base, the Commission finds the rate of return on rate base methodology appropriate in this case.

Capital Structure and Cost of Debt[26]

With respect to the capital structure, DIUC recommended a pro forma capital structure of 41.2% debt and 58.8% equity. During the October 28, 2015, hearing ORS witness Dr. Carlisle testified there are two concerns with the method DIUC used to calculate its capital structure: 1) DIUC included pro-forma long-term debt in its long-term debt calculation; and 2) DIUC proposed an inflated equity amount. (October 28, 2015, Hearing Tr. p. 472, ll. 17-20). Dr. Carlisle noted that both result in an increase in the ROE. (Id.) The pro forma debt is based on the cost of debt DIUC expects, and as Dr. Carlisle noted, the outcome of DIUC's negotiations with banks or lenders is unknown at this time; therefore, DIUC's pro forma debt should not be included. (October 28, 2015, Hearing Tr. p. 473). The POAs also agreed that debt should not include future amounts. (October 28, 2015, Hearing Tr. p. 436, ll. 8-14). Dr. Carlisle further testified that DIUC's capital structure is weighted more heavily with equity, which is more expensive than debt. (Id.) In contrast to a projected or pro forma capital structure, ORS recommended a hypothetical capital structure of 46% long-term debt and 54% equity calculated by averaging the known capital structure used by water companies in the United States with publicly traded stock. (Id.) The POAs produced an adjusted capital structure of 57.55% debt and 42.45% equity (Hearing Exhibit 14, Amended Lanier Exhibit 3), based on a downward adjusted rate base, which is discussed later in this Order.

[26]At the re-hearing, the Capital Structure and Cost of Debt was not actively litigated. As a result, the evidence relied upon in this section was primarily obtained during the October 28, 2015, hearing.

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As to the specific cost of debt rate, during the original hearing DIUC recommended 6.20%. The POAs testified that 6.20% is relatively high in the current interest rate environment, but is probably a reasonable rate given DIUC's precarious financial state. To calculate the 6.20% debt rate, DIUC included anticipated legal and GA fees in the financing fees. In support of the debt amount, Mr. Guastella testified the debt he used is based on his knowledge of prior financing costs applied to the costs expected to be incurred for future refinancing. As a percentage of the total debt, the anticipated fees are 13.56% per ORS's calculations. ORS did not incorporate the additional fees into the debt rate because the fees are a large percentage of the total debt and did not originate from a lending institution. ORS recommended that the actual debt rate being paid by DIUC to the current lending institution, 5.29%, be used.

At the re-hearing, Dr. Carlisle reaffirmed his previously recommended capital structure of 46% long-term debt and 54% equity. (Rehearing Tr. p. 433, ll. 1-2).

Upon consideration of evidence, the Commission adopts the capital structure, 46% long-term debt and 54% equity, and debt rate, 5.29%, recommended by ORS since they are based on known data instead of expected events. The Commission declines to use the POAs capital structure because it is based on a downward adjusted rate base (discussed in the Rate Base section below) that this Commission declines to use.

Cost of Equity/Return on Equity[27]

At the October 28, 2015, hearing, DIUC witness Guastella testified that the requested 10.5% ROE is based on his experience and judgment. The POAs witness Lanier testified, "This

[27]At the re-hearing, the Cost of Equity/Return on Equity was not actively litigated. As a result, the evidence relied upon in this section was primarily obtained during the October 28, 2015, hearing.

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is the same rate the Company requested in its 2012 rate case[28], which was a specified rate, rather than a rate developed through justification of the ROE required to meet its needs for profit margin and to attract the needed debt capital." (October 28, 2015, Hearing Tr. p. 437, ll. 1-4). In contrast to DIUC, ORS's Dr. Carlisle recommended an ROE of 9.31% based on a range of 8.91% to 9.71% using results from the Discounted Cash Flow model ("DCF"), Capital Asset Pricing Method ("CAPM") and the Comparable Earnings Model ("CEM"). (October 28, 2015, Hearing Tr. p. 471 and 474). Dr. Carlisle testified the DCF and CAPM are known and generally accepted methods for determining a recommended ROE. (Id.) The POAs testified that the DCF is the prevailing method used for determining appropriate ROEs. The POAs also testified that while the DCF and CAPM are recognized as methods for calculating ROEs, the DCF and CAPM provide challenges since there are not many publicly traded companies similar to DIUC. For his analyses, Dr. Carlisle examined data on companies with publicly traded stock of which more data is available, because DIUC requested rates based on rate of return. (October 28, 2015, Hearing Tr. p. 475). Companies with publicly traded stock yield more data than what is available for privately held companies. (Id.) Specifically, Dr. Carlisle testified that he used publicly traded companies classified as "water utilities" by Value Line or *Yahoo! Finance* for his DCF and CAPM since they are in the same line of business as DIUC and share similar risks. (Id.) For his CEM analysis, Dr. Carlisle used companies with comparable betas to those of the companies used in his DCF and CAPM group. (Id.)

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

Connecticut DPUC Formula:
Average Large Company 9.69%

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

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Small Company Adder		0.50%
Performance Adder		0.50%
		10.69%

Florida PSC Leverage Graph Formula:

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

There is no discussion of these components in Schedule A-3 or testimony, with the exception of Mr. Guastella's rebuttal testimony containing the following single sentence, "Under the Connecticut Public Utilities Regulatory Authority formula for return on equity for small companies, the rate of return on equity for DIUC is 10.69%." ORS provided no testimony on either the Connecticut or Florida ROE formulas. The POAs could find no other reference to the Connecticut formula and challenged DIUC's portrayal of the Florida formula. Witness Lanier for the POAs testified, "[S]imply including a formula on a schedule and a calculated number is not sufficient rationale to support a ROE, particularly of 10.5%, when the company is requesting a revenue increase of over 100% in order to achieve such return." (October 28, 2015, Hearing Tr. p. 439, ll. 7-9). The POAs acknowledged Dr. Carlisle as a source to support an appropriate ROE, and the POAs pre-filed direct testimony recommended an ROE in the range of 8.5% to 9.0% in consideration of a lower rate base and based on various examples of DIUC's "irresponsibility in its operations since the rate increase authorized in 2012 and in the use of debt funds, in view of the critical need for cash." (October 28, 2015, Hearing Tr. p. 441, ll. 2-3).

In summary, at the October 28, 2015 hearing, DIUC requested an ROE of 10.5%; ORS recommended an ROE of 9.31% based on a range of 8.91% to 9.71%; and the POAs recommended an ROE in the range of 8.5% to 9.0%.

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At the re-hearing, Dr. Carlisle reaffirmed his previously recommended ROE range of 8.91% to 9.71%. (Rehearing Tr. p. 433, l. 2).

Upon consideration of the various witnesses, the Commission adopts the range set forth in evidence as produced by ORS. ORS used the well-known and commonly-accepted DCF method, CAPM, and CEM for developing its range of 8.91% to 9.71%. Those methods, as applied by ORS, are grounded in sound analysis. While the POAs also used the well-known analyses, this Commission declines the range proposed by the POAs. The Commission finds DIUC's ROE recommendation lacking in support and analysis.

Rate Base

At the October 28, 2015 hearing, the rate base proposed by DIUC for combined operations was $7,085,475.[29] In support of its rate base, DIUC included several plant assets, particularly a 125,000 gallon elevated water storage tank, well and facilities (the "facilities") which are located on real property not owned by DIUC. Specifically, the facilities are located on real property (the "Site") that, as described below, was sold at a delinquent tax sale. DIUC does not dispute that it is not the owner of the Site. However, DIUC offered testimony and evidence that it owns these facilities, namely that 1) the tax sale did not include the storage tank, well and facilities, only the Site; 2) DIUC pays property taxes to Beaufort County for the facilities; 3) DIUC has the right to operate those facilities on any parcel of land in the Haig Point development; and 4) these facilities are "used and useful" in providing water service. (October 28, 2015, Hearing Tr. p. 195 and pp. 82-83). DIUC offered the testimony of the Beaufort County Treasurer who stated the Company is paying a utility tax on water system infrastructure. (October 28, 2015, Hearing Tr. p. 83).

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

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At the October 28, 2015 hearing, both ORS and the POAs excluded the facilities from rate base. ORS testified that DIUC did not provide enough information for ORS to determine whether or not DIUC is the owner of those facilities. (October 28, 2015, Hearing Tr. p. 502 and p. 517).

In its Opinion No. 27729, the Supreme Court stated that on remand, when the Commission recalculates DIUC's rate base, it should take into account DIUC's ownership of the water tank, well, pipes, and other utility equipment located on the property sold at a tax sale in October 2010 to Mamdouh Sabry Abdelrahman ("Elevated Tank Site").

In accordance with the guidance handed down by the Supreme Court, at the re-hearing ORS added the water tank, pipes, and other utility equipment located on the Elevated Tank Site into DIUC's rate base.

At the October 28, 2015 hearing, with respect to the overall rate base, the POAs recommended that DIUC's rate base as proposed $7,085,475 be reduced by $3,745,530 as a result of 1) increased accumulated depreciation, 2) contributions in aid of construction ("CIAC") and 3) CIAC amortization. (October 28, 2015, Hearing Tr. p. 371). Witness Loy for the POAs testified that Generally Accepted Accounting Principles ("GAAP") and appropriate regulatory accounting required that accumulated depreciation be calculated on a straight-line basis from the "in service" date through the end of the test year. (Id.) In addition, Mr. Loy testified that an adjustment increasing accumulated depreciation "reflects the proper age and condition of the utility property," (Id.) At the October 28, 2015 hearing, POAs witness Mr. Jue echoed Mr. Loy's conclusion, opining that the DIUC system "would be expected to reflect accumulated depreciation of approximately 30%." (October 28, 2015, Hearing Tr. p. 362). Mr. Loy also testified that certain DIUC plant purchased from Haig Point Utility Company ("HPUC") should be classified as CIAC rather than invested plant. According to Mr. Loy, International Paper (the original owner of

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HPUC) and later Haig Point, Inc. ("HPI") treated the utility plant in HPUC as inventory, expensed those costs, and donated those assets to HPUC. (October 28, 2015, Hearing Tr. p. 380). As support for this conclusion, Mr. Loy testified that HPUC Water Annual Reports for the years 2000-2003 showed no plant balances at all. (October 28, 2015, Hearing Tr. p. 381). The failure to classify plant as CIAC requires adjustments to both to net plant and CIAC amortization. Mr. Loy also testified that the appropriate characterization of DIUC plant as CIAC would greatly reduce the DIUC property tax burden, both for back taxes (a reduction of $402,108 for tax years 2011-2013) and in the test year (a reduction of $115,995 for tax year 2014). (October 28, 2015, Hearing Tr. p. 396).

In sum, at the October 28, 2015 hearing, the POAs recommended adjustments, largely to net utility plant, accumulated depreciation, contributions in aid of construction, and accumulated amortization to CIAC that would reduce the rate base for combined operations to $3,276,311.

At the re-hearing, Witness Loy testified that DIUC's proposed rate base is overstated due to an erroneous $4.6 million accounting adjustment. (Rehearing Tr. p. 308, ll. 11-13). According to witness Loy, because a large portion of DIUC's utility plant was donated, and thus DIUC had no original cost to pay for that plant, it was improper for DIUC to claim the cost of the utility plant to its balance sheet as paid in capital. (Rehearing Tr. p. 309, ll. 19-22, p. 310, ll. 1-2).

Additionally, Witness Loy testified that DIUC significantly overstated net plant by under recording accumulated depreciation. (Rehearing Tr. p. 308, ll. 17-18). According to witness Loy, the net plant values of DIUC are artificially high because plant representing excess capacity has not been depreciated according to NARUC guidelines, which require straight-line depreciation over the useful life of the plant in service. (Rehearing Tr. p. 308, ll. 17-20).

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At the re-hearing, DIUC witness Guastella testified that the accounting methodology has been relied upon by DIUC and other parties in the past, and that in previous rate cases the balance sheets have been determined to accurately reflect the books and records. (Rehearing Tr. p. 102-103).

In contrast to the position taken by the POAs[30], ORS carried forward the amount of rate base from the last rate case in Docket No. 2011-229-WS, $4,615,755, and made adjustments through December 31, 2014[31]. (October 28, 2015, Hearing Tr. p. 524). Using DIUC's utilization factor method with ORS's adjustments, and taking into account the Supreme Court guidance, ORS recommended that $1,134,068 be deducted from the Company's December 31, 2014 Application rate base. (Rehearing Tr. p. __, ORS Audit Exhibit DFS-1, Re-Hearing Exhibit 8). Of the amount deducted, $699,361 is gross plant in service representing non-allowable plant, adjustments from the previous case not carried forward by DIUC in this Application, and asset retirements. (Id.) ORS Audit Exhibit DFS-5 (re-hearing Exhibit 8) shows the specific items composing the $699,361. (Rehearing Tr. p. __, ORS Audit Exhibit DFS-5, Re-Hearing Exhibit 8). ORS also deducted $180,067 from rate base for accumulated depreciation and deducted $254,853 from rate base for Construction Work in Progress ("CWIP"). (Rehearing Tr. p. __, ORS Audit Exhibit DFS-1, Re-Hearing Exhibit 8). Accumulated amortization of CIAC added $213 to the rate base to arrive at a total net rate base deduction of $1,134,068. (Id.) When $87,676 in working capital was added to rate base, the total net rate base reduction became $1,046,392. (Id.) After deducting the rate base adjustment from the Application Schedule W-B and S-B December 31, 2014, per books rate

[30] At the re-hearing, ORS testified that while it found the POA methodology to be reasonable, it chose to follow the same carryforward method it utilized at the October 28, 2015 hearing, and in past rate cases.
[31] For the carryforward amount, ORS used the rate base it calculated in the prior rate case instead of using the settlement agreement rate base in Docket No. 2011-229-WS.

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base of $6,914,024, ORS's recommended rate base for combined operations was $5,867,632. (Id.) In summary, DIUC's recommended adjusted rate base was $7,085,475, the POAs' was $2,304,944, and ORS's was $5,867,632.

The POAs arguments are compelling. However, given the number of rate cases that have occurred since International Paper owned the utility, the Commission declines to adopt a different rate base than the one carried forward from the last rate case by ORS. However, the Commission's conclusions regarding DIUC's rate base do not preclude the POAs or the ORS from taking a different position in future proceedings.

After reviewing the evidence presented by DIUC, ORS, and the POAs, the Commission accepts the rate base determination methodology and adjustments proposed by ORS. The ORS methodology accounts for the guidance given by the Supreme Court and is logical in its steps, follows the same procedure this Commission has approved in the past cases, and sets forth sound methods for determining a proper rate base on which a return may be granted.

Property Taxes

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

After learning about the delinquent taxes, DIUC and the Beaufort County Treasurer entered into a settlement agreement that was entered into evidence. The settlement agreement allowed DIUC to pay Beaufort County monthly payments of $5,487.95 to cover property taxes totaling

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$526,843.39 for 2012, 2013, 2014, and 2015. The Beaufort County Treasurer testified that the monthly payment was derived by amortizing the $526,843.39 over eight years. Originally the amount was $651,267.27, but the settlement agreement was amended to the reduced amount of $526,843.39 after the SC Department of Revenue ("DOR") submitted lower asset values to Beaufort County.

With respect to its property tax request in this case, DIUC requested additional annual property tax expense of $65,856 for the 2012, 2013, 2014 and 2015 taxes and $ 188,093 for the annual amount of taxes going forward. DIUC's property tax expense request totaled $258,158 ($4,209 per books plus $65,856 plus $188,093).

At the October 28, 2015 hearing, the POAs recommended that DIUC's tax expense be based on the POAs' downward-adjusted rate base. ORS testified that DIUC's current books reflected approximately $4,000 annually for property taxes and, with the ORS adjustments, DIUC would have $171,492 annually to pay property taxes. Specifically, ORS recommended that DIUC receive $30,612 annually for the 2012 and 2013 taxes totaling $244,899 amortized over 8 years and $140,880 for the 2014 or test year taxes. ORS based its 2012 and 2013 adjustment amount and amortization period on DIUC's settlement with Beaufort County. The 2014 adjustment was based on the actual tax bills/assessment. ORS witness Gearheart testified that ORS allowed amounts for the 2012 and 2013 taxes, because DIUC did not have an opportunity to request a rate increase to pay the taxes after agreeing to a moratorium through July 1, 2014 in the settlement in Docket No. 2011-229-WS. ORS declined to allow property taxes for 2015 since ORS utilizes a historical test year.

In its Opinion No. 27729, the Supreme Court stated that an annual bill of $65,856 is a substantial expense for which the Commission should have adjusted the test year data.

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As a result of the guidance given by the Supreme Court, ORS computed an adjustment to amortization expense for property taxes of $526,848 amortized over eight (8) years for an annual amortization of property taxes of $65,856. (Rehearing Tr. p. 450, ll. 15-19). DIUC did not disagree with this approach taken by ORS and the resulting adjustment recommended by ORS. (Rehearing Tr. p. 450, ll. 18-19).

Additionally, based on guidance from the Supreme Court, ORS computed an adjustment to property taxes to reflect calendar year 2015 level. (Rehearing Tr. p. 451, ll. 1-5). Calendar year 2015 property taxes amounted to $192,302 less the per book amount of $4,210, for an adjustment to $188,092. (Id.) DIUC agrees with this adjustment in its rehearing testimony and exhibits. (Rehearing Tr. p. 451, ll. 4-5).

Based on the evidence in the record and the guidance given by the Supreme Court, the Commission adopts the property tax amounts as computed by ORS as they are based on known and measurable amounts and incorporate the guidance given by the Supreme Court.

Management Fees and Other Expenses[32]

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

[32] Management fees were not specifically mentioned in South Carolina Supreme Court Opinion No. 27729; however, in keeping with the Supreme Court's Opinion that this case be remanded to the Commission for *de novo* hearing, this issue was litigated at the re-hearing.

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utility operating income; an incentive fee if DIUC is sold; rate case expenses; travel expenses; and expenses related to regulatory investigations and proceedings.

In its Application, DIUC requested that ratepayers pay $171,364 for management services paid to GA. Per ORS, DIUC also included an incentive fee in its test year management fees. (October 28, 2015, Hearing Tr. p. 493). POA witness Lanier testified that the Commission should not allow DIUC to use its higher expenses related to GA to justify the need for a rate increase. ORS recommended that GA's management fees be limited to the previously Commission-approved amount of $132,211 a year. ORS testified that it found no apparent increases in the management services provided by GA and did not find the requested increase justified. ORS also testified at the re-hearing that the management agreement lacks sufficient checks and balances to protect DIUC, its parent company, and its ratepayers from decisions made by its vendor, GA. (Rehearing Tr. p. 477, ll. 15-17). ORS testified that under GA's management, the Elevated Tank Site was sold to a third party after GA's failure to pay property taxes. (Rehearing Tr. p. 477, ll. 17-18). This oversight did not reflect a goal set by DIUC for GA which was to, "...operate the Company efficiently and manage its assets in order to minimize the rates charged to customers...." (Rehearing Tr. p. 477, ll. 18-20). Additionally, ORS presented evidence indicating that the management fees requested by DIUC are in excess of what other similarly situated investor owned water and wastewater utilities pay for similar services. (Rehearing Tr. p. 478, ll. 3-9).

At the re-hearing, DIUC witness Guastella testified that the GA Management Agreement contains a provision that allows the Client to terminate the agreement; therefore, sufficient checks and balances do exist. (Rehearing Tr. p. 95, ll. 18-22, p. 96. ll. 1-2). Additionally, DIUC witness Guastella testified that the utilities to which ORS compared DIUC are not similarly situated. (Rehearing Tr. p. 96, ll. 24-26, pp. 97, 98).

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ORS excluded from operating and maintenance expenses the incentive fee[33] included in the test year and $25,439[34] representing GA's management fee, legal expenses related to the property tax appeal and tax sale of the water tower, and other expenses not allowable for rate making purposes. DIUC witness Guastella disputed all exclusions noting "[GA's] efforts reflect an unequivocal commitment to provide adequate service to the customers, some of which were achieved because of GA's rate setting expertise that is not typical of other managers." "Having consulted for some 600 developer-related water and sewer utilities, I am not aware of any that had managers with the regulatory, utility accounting, valuation, or rate setting experience that GA applied in meeting the challenges of managing DIUC." DIUC witness Guastella also testified, contrary to ORS's testimony, that the existing and proposed rates do not include any allowance for GA's incentive fee.

Upon review of the evidence, the Commission adopts ORS's adjustments for management fees, rate case expenses, and non-allowable expenses. We agree that GA provides services to the ratepayers, but disagree that the services are at a level that warrant the amount set forth in the management services contract. Additionally, we believe that evidence was presented that calls into question the arms-length negotiations and transactions that occur between GA and DIUC. We think it is appropriate for DIUC stockholders to have responsibility for the difference. While customer service complaints are few in number, this Commission did hear testimony at the night hearing and the merits hearing that GA was an absentee management company and had very little presence on the island. It is undisputed that DIUC did not pay property taxes under GA's tenure (resulting in the tax sale described above), that required regulatory reports and fees have been filed

[33] *See* ORS Adjustment 4(m).
[34] *See* ORS Adjustment 4(g).

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and paid late (R. p. 244), and that the South Carolina Department of Health and Environmental Control ("DHEC") issued a notice of violations against DIUC (October 28, 2015, Hearing Tr. p. p. 319, ll. 14-16). We conclude the ORS-recommended amount for management expenses strikes a reasonable balance.

Rate Case Expenses[35]

At the re-hearing, DIUC requested $794,210 for current and unamortized rate case expenses to be recovered over 3 years. (Rehearing Tr. p. 473, ll. 15-17). ORS proposed that rate case expenses total $272,382 and be amortized over five years. (Rehearing Tr. p. 474, ll. 18-22, p. 476, ll. 21-22, p. 477, ll. 1-2). The $272,382 consists of capped current rate case expenses in the amount of $75,000 for GA's preparation of the Application[36], developing rate models, calculating test year data, filing other rate case documents and legal expenses. (Rehearing Tr. p. 450, ll. 8-14). ORS recommended $75,000 as a reasonable amount for rate case expenses in the last rate case. Additionally, $22,500 of the $272,382 is unamortized rate case expenses from the previous rate case. The remaining amount is accounted for by legal services. (Id.)

At the re-hearing ORS testified regarding a number of adjustments to rate case expenses that were not contested by DIUC. (Rehearing Tr. p. 86, ll. 4-7). The one rate case expense adjustment DIUC did contest at the hearing was ORS's adjustment of $542,978, which corresponded to GA invoices. (Rehearing Tr. p. 476, l. 11). According to ORS witness Hipp, GA Invoices contained mathematical errors, lacked sufficient detail, and/or did not appear to be

[35] Rate Case expenses were not specifically mentioned in South Carolina Supreme Court Opinion No. 27729; however, in keeping with the Court's Opinion, DIUC introduced new evidence that altered its original Rate Case expense request. As a result, this issue was litigated at the re-hearing.

[36] The $75,000 is a figure that was used in the previous hearing and was arrived at during Settlement Negotiations between the ORS and POAs.

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paid. (Rehearing Tr. p. 476, ll. 11-18). ORS witness Hipp testified that when reviewing invoices, ORS checks for mathematical accuracy, whether the invoice is for a valid business purpose, whether the expense was incurred during the period under review, whether the invoice was properly recorded on the books and records of the Company, and whether the invoice was paid. (Id.) ORS testified that generally the GA invoices failed this criteria, and also offered specific examples. (Rehearing Tr. p. 476, ll. 11-18, ORS DMH Surrebuttal Exhibit 1, Re-hearing Exhibit 10). During her testimony ORS witness Hipp specifically cited a number of examples of invoices that were insufficient for reasons varying from lack of detailed description of work performed to mathematical errors. (ORS DMH Surrebuttal Exhibit 1, Re-hearing Exhibit 10). Additionally, ORS witness Hipp attached an exhibit detailing the problems with each invoice for which ORS recommended an adjustment. (Id.) Furthermore, ORS witness Hipp testified that on August 24, 2015, ORS discussed certain GA invoice deficiencies. (Rehearing Tr. p. 486, l. 22, p. 487, ll. 1-3). Finally, ORS witness Hipp testified that it is not the role of ORS to properly support the rate case of a company seeking a rate increase, and it was DIUC that failed to provide additional support for the work performed by GA. (Rehearing Tr. p. 487, ll. 4-9).

DIUC's witness Guastella testified that DIUC is seeking $794,201.17, plus the $60,781.56 incurred for the bonds and associated letter of credit, for rate case expenses. (Rehearing Tr. p. 76, ll. 8-12). According to DIUC witness Guastella, no regulatory agency has every raised any questions about the amount of detail in GA's invoices. (Rehearing Tr. p. 87, ll. 16-17). Additionally, he testified that without any notice, ORS suddenly declared GA's invoicing insufficient. (Rehearing Tr. p. 88, ll. 9-10). DIUC witness Guastella also testified that delayed payments that create accounts payable does not mean that costs incurred are not allowable for rate setting purposes. (Rehearing Tr. p. 89, ll. 19-21).

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At the re-hearing DIUC requested a 3 year amortization period for rate case expenses. (Rehearing Tr. p. 92, ll. 7-23). ORS affirmed its position that a 5 year amortization period is a reasonable balance between the shareholders and ratepayers for this proceeding. (Rehearing Tr. p. 476, ll. 21-22, p. 477, ll. 1-2). DIUC witness Guastella testified at the re-hearing that a 5 year amortization period would mean that actual rate case expenses would not be fully recovered until January 2023. (Rehearing Tr. p. 92, ll. 20-21). ORS witness Hipp testified that the rate case amortization period should begin on July 1, 2016, which is the same date that DIUC chose to implement higher rates under bond. (Rehearing Tr. p. 490, ll. 13-18).

The Commission agrees with ORS's judgment that a rate case expense total of $272,382 is a reasonable amount for this rate case. The evidence shows that a large sum of what DIUC seeks corresponds to invoices that cannot be verified. It cannot be the responsibility of the regulating agency, nor this Commission, to arbitrarily determine a value for services where one cannot be independently verified. We also agree that the amortization period of five (5) years and the inclusion of unamortized rate case expenses from the last rate case are reasonable. The reasons set forth for excluding the non-allowable expenses is based on sound rate-making principals and those costs should not be passed to ratepayers.

Bad Debt Expense

In its Application, DIUC proposed bad debt expense associated with its proposed increase in revenues to equal $30,852. Initially, ORS provided testimony proposing to adjust the bad debt expense upward to $213,732. (October 28, 2015, Hearing Tr. p. 498). In the Settlement Agreement between the ORS and the POAs, and consistent with DIUC's request in its Application, ORS revised its adjustment to bad debt expense to utilize the methodology proposed by DIUC in its Application. (October 28, 2015, Hearing Tr. pp. 502-503). When discussing the bad debt

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expense, the Supreme Court stated that the evidence in the record establishes DIUC's bad debt expense to exceed $100,000. In compliance with the Supreme Court's guidance, ORS applied its calculated bad debt percentage of 9.82% to DIUC's re-hearing proposed increase to calculate an adjustment to bad debt expense of $116,056, for a total bad debt expense of $221,439. (Rehearing Tr. p. 453, ll. 16-20). Without expounding any further on the topic, DIUC witness Guastella stated that he disagreed with ORS adjustment to the bad debt expense. (Rehearing Tr. p. 84, l. 8).

The POA's witness Lanier testified that ORS's evaluation of bad debts at the re-hearing failed to fully analyze the Company's actual test year bad debt expense and failed to consider the prudency of the amount of $105,667. (Rehearing Tr. p. 370, ll. 16-19). Therefore, witness Lanier proposes exactly what the Company included in its Application, 0.5% on water and sewer rate revenues and 2.5% on water and sewer availability revenues. (Rehearing Tr. p. 371, ll. 4-8).

We conclude the bad debt expense methodology performed by ORS, and the resultant bad debt percentage of 9.82% by which to adjust the bad debt expense, is just and reasonable and complies with guidance handed down by the Supreme Court.

Deferral of $155,328

DIUC seeks to have $155,328 deferred for future rate recognition. (Rehearing Tr. p. 80, ll. 8-12). ORS testified that it believes that to the extent DIUC has incurred recoverable rate case expenses, those expenses should be recovered in the case presently before the Commission. (Hipp Rehearing Revised. p. 9, ll. 1-10). DIUC testified that the $155,328 is the amount in excess of the 108.9% increase DIUC originally requested in its Application, and its recovery is necessary to make DIUC whole and delay a portion of the rate increase to the customers. (Rehearing Tr. p. 101, ll. 13-15).

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The Commission concludes that the expenses properly incurred should be recoverable in the present case, to the extent allowable. Therefore, the Commission does not believe that $155,328 should be deferred to a future rate case.

Performance Bond

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

Other Adjustments

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

III. FINDINGS OF FACT

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

2. DIUC requested in its Application to increase revenues for combined operations by $1,182,301, consisting of a water revenue increase of $590,454, and a sewer revenue increase of $591,847, based on the rate of return on rate base methodology utilizing an ROE of 10.5% and a 2014 historical test year. At the re-hearing, DIUC re-affirmed that it sought the Application's originally proposed revenue requirement of $2,267,721.

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

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

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

6. The Commission adopts the capital structure of 46% long-term debt and 54% equity; a cost of debt rate of 5.29%; and ROE of 9.31%.

7. The Commission sets DIUC's rate base at $5,867,632.

8. The Commission approved revenues and expenses establish a fair and reasonable operating margin of 15.22%. S.C. Code Ann. § 58-5-240(H).

9. The Management Agreement lacks characteristics required of an arms-length transaction and, therefore, should be carefully reviewed.

10. For certain rate case expenses, DIUC failed to provide invoices that could be verified; as a result, DIUC is ineligible for cost recovery of those expenses.

11. A five (5) year amortization period for rate case expenses is a reasonable balance between DIUC's shareholders and the ratepayers. Additionally, the amortization period began running on the date which DIUC first implemented its higher rates.

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12. A bad debt percentage of 9.82% applied to DIUC's re-hearing proposed increase is a reasonable and appropriate manner of calculating DIUC's bad debts.

13. The deferral of $155,328 is not appropriate where it could reasonably be recovered in the current rate case.

IV. CONCLUSIONS OF LAW

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

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

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

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

4. In order for DIUC to have the opportunity to earn the 9.31% ROE, found fair and reasonable herein, DIUC must be allowed additional revenues of $864,817.

5. The Commission sets the amount to be recovered for management fees at $132,211.

6. The Commission concludes that the appropriate amount to be recovered for rate case expenses at $272,382.

7. The Commission concludes that the appropriate amortization period to recover rate case expenses is 5 years.

8. The Commission concludes that the appropriate bad debt expense adjustment is $9.82% of the revenue requirement.

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9. The Commission concludes that DIUC cannot defer the $155,328 until the next rate case.

10. The rates as set forth in the attached Order Attachment No. 1 are approved for use by DIUC and are designed to be just and reasonable without undue discrimination and are also designed to meet the revenue requirements of DIUC.

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

12. Pursuant to S.C. Code Ann. § 58-5-240(D), "[a]ll increases in rates put into effect under the provisions of this section which are not approved and for which a refund is required shall bear interest at a rate of twelve percent annum. The interest shall commence on the date the disallowed increase is paid and continue until the date the refund is made. In all cases in which a refund is due, the Commission shall order a total refund of the difference between the amount collected under bond and the amount finally approved."

IT IS THEREFORE ORDERED THAT:

1. The proposed rates, fees, and charges in Order Attachment 1 are both fair and reasonable and will allow DIUC to continue to provide its customers with adequate water and wastewater services.

2. Appeal costs in the amount of $6,656.37 will be shared equally between ORS, Haig Point Club and Community Association, Inc., Bloody Point Property Owner's Association, and Beach Field Properties, LLC and paid to DIUC.

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

4. A return on equity of 9.31% and operating margin of 15.22%, based on the new rates, fees, and charges, is approved for DIUC.

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

6. The Company shall implement all Commission approved adjustments on its books and records.

7. The Company's books and records shall be maintained according to the NARUC Uniform System of Accounts. The Company is directed to make any necessary adjustments to its accounting system to conform to the NARUC Uniform System of Accounts.

8. The Company shall refund the difference between the amount it collected under bond and the amount this Commission approves herein to the parties that paid the excessive rates at an interest rate of twelve percent annum. The interest commenced on the date the disallowed increase was paid and continues until the date the refund is made.

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

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BY ORDER OF THE COMMISSION:

Swain E. Whitfield, Chairman

ATTEST:

Comer H. "Randy" Randall, Vice-Chairman

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

		Haig Pt. Proposed Rates	Melrose Proposed Rates
I. Residential Rates			
A. Water:			
1) Tapping Fees & 3/4" Meter Box		$500.00	$500.00
2) Base Quarterly Charge		$103.25	$118.09
3) Consumption Charge (per 1,000 gallons)	0 to 22,500 gallons per quarter	$4.41	$4.41
	Over 22,500 gallons	$4.41	$4.41
B. Sewer:			
1) Tapping Fees & Service Lateral		$500.00	$500.00
2) Base Quarterly Charge		$161.47	$134.23
3) Volumetric Charge (per 1,000 gallons)	0 to 22,500 gallons per quarter	$2.38	$2.38
	Over 22,500 gallons	$2.38	$2.38
C. Irrigation:			
1) Tapping Fees & 3/4" Meter Box		$500.00	$500.00
2) Consumption Charge (per 1,000 gallons)	0 to 18,000 gallons per quarter	$4.85	$4.85
	18,001 to 60,000 gallons	$5.73	$5.73
	Over 60,000 gallons	$6.61	$6.61
II. Commercial Rates			
A. Water:			
1) Tapping Fees per Hotel or Inn Room		$250.00	$250.00
2) Tapping Fees up to 1-1/2" Meter		$500.00	$500.00
3) Tapping Fees 2" or 3" Meter		$1,500.00	$1,500.00
4) Tapping Fees for 6" Meter		$3,500.00	$3,500.00
Note: Larger meters on a case by case basis.			
5) Base Quarterly Charge		$144.62	$199.83
6) Consumption Charge (per 1,000 gallons)	0 to 22,500 gallons per quarter	$4.41	$4.41
	Over 22,500 gallons	$4.41	$4.41
B. Sewer:			
1) Tapping Fees per Hotel or Inn Room		$250.00	$250.00
2) Tapping Fees 4" - 8" Sewer Pipe		$500.00	$500.00
3) Base Quarterly Charge		$260.70	$227.15
4) Volumetric Charge (per 1,000 gallons)	0 to 22,500 gallons per quarter	$2.38	$2.38
	Over 22,500 gallons	$2.38	$2.38
C. Irrigation:			
1) Tapping Fees & 3/4" Meter Box		$500.00	$500.00
2) Consumption Charge (per 1,000 gallons)	0 to 18,000 gallons per quarter	$4.85	$4.85
	18,001 to 60,000 gallons	$5.73	$5.73
	Over 60,000 gallons	$6.61	$6.61
III. Availability Rates (Quarterly)			
A. Water		$100.00	$107.49
B. Sewer		$130.00	$140.73

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IV. 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*

$$\frac{\text{Total Equity Investment}}{\text{System Water or Sewer}}$$

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.

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BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 2014-346-WS

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

DIUC'S PETITION FOR RECONSIDERATION OF ORDER ON REHEARING

This Commission's Order on Rehearing entered January 31, 2018, addressed many of the complex issues presented in this case and significantly reduced the outstanding questions. However, the Order on Rehearing's analysis of rate base/utility plant in service, accumulated depreciation/depreciation expense, and rate case expense requires additional refinement. The Commission's disallowance of specifically identified, used and useful assets in rate base/utility plant in service, its disallowance of certain expenses in accumulated depreciation/depreciation expense, and its disallowance of significant rate case expense are not based upon the reliable, probative, and substantial evidence in the record. Additionally, these rulings are contrary to the evidence and result in a punitive impact upon DIUC. Therefore, pursuant to SC Code § 58-5-330, DIUC requests this Commission reconsider its Order on Rehearing and substitute DIUC's Proposed Order on Remand submitted December 15, 2017, to replace the Commission's Order in its entirety. Alternatively, the Commission should revise its Order on Rehearing to adjust the rate base for the disallowed assets and corrected accumulated depreciation, and adjust depreciation expense and a sufficient portion of the rate case expenses in order to achieve DIUC's original 108.9% rate increase.

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1. RATE BASE / UTILITY PLANT IN SERVICE

Repeating the same error that resulted in appeal of Order 2015-846, the Order on Rehearing adopts the ORS recommendation to exclude $699,361 worth of DIUC's gross plant from rate base. The Order on Rehearing describes the excluded $699,361 as "gross plant in service representing non-allowable plant, adjustments from the previous case not carried forward by DIUC in its Application, and asset retirements." Order on Rehearing at 26. However, the Order on Rehearing cites no testimony to justify this adjustment and purported finding; instead, the Order on Rehearing merely references ORS Audit Exhibit DFS-5 (Rehearing Exhibit 8) then repeats ORS's inaccurate assertion that Rehearing Exhibit 8 "shows the specific items composing the $699,361." Order on Rehearing at 26.

The reason the Order on Rehearing cites to no testimony from ORS in support of the $699,361 exclusion is because there was no testimony from ORS in the first hearing or the second hearing to support of the $699,361 exclusion. Regarding the DIUC plant, ORS witness Daniel Sullivan only stated that after he corrected ORS's previous exclusion of the Elevated Tank Site and related facilities, "ORS now computes an adjustment to gross plant in service of ($699,361) which is shown on Rehearing Audit Exhibit DFS-5." Rehearing Transcript at 451. At rehearing ORS did not provide any additional support for this adjustment of $699,361; instead, ORS relies solely on the previous testimony of Ivana C. Gearheart at the initial hearing and the updated Exhibit DFS-5 which merely copied over Gearheart's conclusions. *See* Rehearing Transcript at 451 and Rehearing Exhibit 8 at DFS-5.

A. ORS never identified the specific items of plant alleged to support the $699,631 adjustment.

First, it must be made clear that neither Ms. Gearheart's Exhibit ICG-5 (Hearing Exhibit 18) nor Mr. Sullivan's Revised Rehearing Audit Exhibit DFS-5 (Rehearing Exhibit 8) identifies

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the specific items that are tallied to reach the $699,631 adjustment. Those exhibits only list primary plant accounts; they do not identify items of plant. The ORS adjustments by plant account cannot be identified by or matched with specific items of plant, the specific cost of the items being adjusted is not provided, and there is no information about ORS's reasons for the adjustments. The excluded amount of $699,631 was simply repeated by reference to previous ORS witness Ivana Gearheart's exhibits and a review of Ms. Gearheart's testimony clearly reveals that Ms. Gearheart failed to itemize the specific assets or costs that are the basis of ORS's proposed adjustment of $699,361 to utility plant in service. *See* Hearing Exhibit 18.

ORS failed to provide the Commission with the required reliable, probative, and substantial evidence on the whole record necessary to justify the adjustment. Rather, this finding and corresponding adjustment are based on impermissible conjecture and speculation. The Commission should revise its Order on Rehearing to reflect the absence of evidence necessary to support the adjustment.

B. ORS's adjustment for the absence of contemporaneous documentation of costs is not supported by the evidence or by application of NARUC principles.

ORS premised a portion of its total adjustments to utility plant on the alleged absence of specific contemporaneous documentation of the precise cost of construction of facilities. It is undisputed, however, these facilities are used and owned by DIUC. Mr. Guastella testified, however, that the absence of those invoices does not constitute a lack of documentation of cost for ratemaking when there is no question the facilities are in service, used and usable, as is the case here. *See* Hearing Transcript at 150-152. The record establishes, via Mr. Guastella's explanation, that DIUC provided ORS with itemized assets, by primary plant account, description of original costs as booked, year of installation and in-service dates. *See* Hearing Transcript at 150-153. Further, it is undisputed these assets are real and in service and DIUC is paying utility property

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taxes on them. Finally, Mr. Guastella also testified at the hearing it was the now defunct Melrose Utility Company that failed to retain many of the invoices now sought by ORS to review past transactions. *Id.*

As DIUC pointed out in the primary case, ORS witness Gearheart's proposed adjustments for land, capital costs and other unspecified assets in various accounts but she failed to provide any evidence to support her adjustments; Ms. Gearhart merely attached descriptive words like "non-allowable," "adjustments from the previous case," or "undocumented." Ms. Gearheart did not provide any other testimony or analyses to support her adjustments. The Commission cannot determine from Audit Exhibit ICG-5 or the entire record as a whole what items of plant were adjusted for "non-allowable plant" or what costs were adjusted for "non-allowable plant." *See* Hearing Exhibit 18. Moreover, merely stating that an item of plant is non-allowable is not justification as to why it is not allowable and it is certainly not sufficient evidence to support inclusion of the adjustment in the Order on Rehearing.

In his rebuttal testimony, Mr. Guastella explained the basis for and justification of the costs included in the $699,361 of hard assets in service that ORS recommended be disallowed.

With respect to Ms. Gearheart's claim that costs were "undocumented," Mr. Guastella testified:

> In fact, itemized costs at specific amounts, by primary plant account and the year in service, are recorded on the DIUC's books, which certainly constitute "documentation". The ORS does not claim that the assets in question do not exist and are not used and useful, nor does it question the reasonableness of the amounts that it clearly observed from DIUC's records. Some missing invoices for a relative small portion of plant, particularly for the Melrose Utility Company that essentially abandoned its system, does not constitute an absence of evidence of the reasonable of the utility plant costs for assets that are providing service. Even the Intervenors' expert, Mr. Loy, understands such circumstances.

Hearing Transcript at 203 to 204.

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Mr. Guastella also explained the proper and NARUC-endorsed role of estimating costs and using estimation studies.

> These studies are typically performed when there are no supporting cost records of plant. The NARUC USoA requires an 'estimate' of plant values when there is no supporting documentation available. Original cost studies have been an accepted methodology to establish these values.
>
> Although Mr. Loy applies that statement to his opinion with respect to an issue he raised with which I disagree and will discuss later, he is correct that the cost of plant is not properly disallowed because of a lack of documentation, but instead it is proper and consistent with the NARUC USoA to use estimates. In this case, however, it is not necessary to estimate the costs because the costs are known and recorded, and the assets are used and useful in providing service to our customers.

Hearing Transcript at 204.

The POAs' expert Mr. Loy agreed with DIUC's approach to estimate the plant values, testifying:

> These studies are typically performed when there are no supporting cost records of plant. The NARUC USoA requires an 'estimate' of plant values when there is no supporting documentation available. Original cost studies have been an accepted methodology to establish these values.

Hearing Transcript at 202-203.

When asked on cross-examination about this estimating procedure, Ms. Gearheart testified that she was not aware of that provision in the NARUC USoA. *See* Hearing Transcript at 530.

Mr. Guastella's testimony on these issues was not refuted by any surrebuttal testimony in the primary case and Mr. Loy's agreement with the DIUC estimations also remains unchanged. None of ORS's or Intervenors' witnesses in the rehearing have added to Ms. Gearheart's testimony regarding her proposed exclusion of $699,361 of utility plant in service. ORS witness Sullivan merely adopted Gearheart's unsupported conclusions; he did not provide any additional evidence. At rehearing no one for ORS of Intervenors addressed Mr. Guastella's rebuttal testimony in the

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primary case regarding these adjustments. As such, the record does not support the adjustment reflected in the Order on Rehearing.

The alleged lack of invoices does not constitute reliable, probative, and substantial evidence to disallow in their entirety the value of a utility's assets that are in place providing service. ORS should have estimated the reasonableness of the costs recorded and booked rather than excluding an unspecified amount for alleged "undocumented expenses," which implies some inappropriate action by DIUC. The Commission's finding that the absence of invoices is equivalent to a total absence of documentation of the cost of these particular assets that are unquestionably in service is unsupported by substantial evidence.

C. ORS failed to support its adjustment to exclude capital costs and legal costs associated with plant in service.

The record does not include any ORS testimony in support of excluding capital costs and legal costs associated with plant in service (i.e., the "Land and Land Rights" as shown in Exhibit DFS-5). Therefore, the Order on Rehearing's inclusion of the adjustment is not based on the evidence in the record which is Mr. Guastella's testimony about specific costs that are properly included in those categories. That testimony is included in the following exchange:

> Q. What adjustments did the ORS propose with respect to legal and consulting fees that are reflected in DIUC's utility plant in service?
>
> A. Ms. Gearheart's testimony and exhibits do not specifically identify the amounts of those adjustments. They are lumped in with her adjustment to utility plant in service. It is our understanding that she proposes to eliminate the legal fees incurred in connection with the condemnation of the Sabry parcel and to eliminate GA consulting fees that were capitalized. I would note that Ms. Gearheart's statement that the legal costs of $29,511 were for condemnation of the water tower is incorrect. DIUC is condemning the land, not the water tank that DIUC already owns.
>
> Q. Why was the condemnation action required?

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A. When we learned of the tax sale of the storage tank parcel, our first reaction was to reason with Mr. Sabry. When that was unsuccessful, we filed a legal action to reverse the tax sale. Subsequently, however, our attempt to finance with CoBank and then Wells Fargo fell through, and our need to obtain financing for capital improvements had to be our primary objective. It became evident that the proceeding to reverse the tax sale would be drawn out and result in an unacceptable delay in obtaining a loan. The best course of action was to withdraw the law suit and initiate a condemnation, an action that SunTrust would accept -- and made it a requirement of the loan.

Q. Why should the legal fees be included in the cost of providing service?

A. The tax sale was beyond our control. Upon managing DIUC, we notified Beaufort County of the new address, and we received regular property tax bill from Beaufort County at that address. For an unknown reason, Beaufort County sent a tax bill for the storage tank parcel of land to the wrong address without our knowledge, as well as notices of a delinquency and a tax sale. It even posted a notice of the tax sale at the wrong property, and our operators never observed any notice at the storage tank site which they visit daily. The legal fees were, therefore, unavoidable and included in the cost of land.

Q. Why should GA's fees related to capital improvements be included in the cost of providing service?

A. GA's management agreement contain a provision under which work performed in connection with capital improvements is not part of the routine day-to-day management of DIUC and, therefore, would be billed at 10% of the first $50,000 of improvements and 8% of capital costs over $50,000. The work involves establishing the improvements that are needed or desirable, establish priorities in terms of their impact on service and available funding cost, solicit and obtain contractors' proposals, select contractors, schedule and coordinate work with DIUC's routine operations, and supervise the construction work.

Q. Did ORS provide any reason for eliminating GA's fees related to capital improvements?

A. Not that I could find.

Q. Why should GA's fees related to capital improvement be included in rate base as part of the cost of the improvements to utility plant is service?

A. GA's capital fees are not only part of an arms-length management agreement, they are necessary and the cost is reasonable. It is obvious that capital improvements cannot be made without the work I describe above. The 10% and mostly 8% of the construction costs are significantly less that the 15% to 20% typically allowed for administration and supervision of construction work."

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Hearing Transcript at 204-206.

ORS and Intervenors have not provided any evidence to refute the testimony in the record regarding these cots. The evidence supports only one conclusion -- these costs were incurred by DIUC in the course of managing its property and securing the improvements necessary for providing safe and adequate service to its customers. As such, the Order on Rehearing must allow recovery of these expenses. See Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff, 392 S.C. 96, 107 n.8, 708 S.E.2d 755, 761 (2011) citing Bluefield Waterworks & Improvement Co. v. Public Service Comm'n of W. Va., 262 U.S. 679, 690, 43 S. Ct. 675, 67 L. Ed. 1176 (1923) (explaining that where the rates charged by a public utility company "are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service . . . their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment").

The Commission should revise the Order on Rehearing. The reliable, probative evidence in the record does not provide a basis to support adoption of the ORS adjustment of $699,361 to plant in service. ORS failed to properly identify the items it sought to exclude, ORS failed to refute the ample testimony that DIUC employed proper NARUC principles in estimating certain costs, and ORS did not provide any supported reason why properly incurred capital costs and legal costs associated with plant in service should not be recovered. The complete amount of Utility Plant in Service of $3,949,956 for water and $4,189,304 for sewer, or a total of $8,139,260, as requested by the Application, should be included in the allowance for Utility Plant in Service.[1]

[1] DIUC's appeal to the Supreme Court included this issue which is among the "multiple" adjustments in the ORS/POA Settlement Agreement that the Court found were unsupported by any evidence presented to the Commission.

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2. ACCUMULATED DEPRECIATION AND DEPRECIATION EXPENSE

DIUC witness Gary White's direct rehearing testimony presented DIUC's rate analysis and supporting schedules in Exhibit GCW-R1, which includes proposed accumulated depreciation in the amount of $429,396 for water and $348,458 for sewer, and depreciation expense of $42,120 for water and $ 53,420 for sewer, net of the annual amortization of CIAC. Mr. White's prefiled rehearing rebuttal testimony addressed ORS witness Sullivan's depreciation amounts for both accumulated depreciation and depreciation expense, pointing out several inconsistencies in the ORS testimony. *See* Rehearing Transcript at 126 to 130. In that testimony, Mr. White observed that Mr. Sullivan's depreciation schedules are in conflict with DIUC's book figures, there are no known and measurable changes after December 31, 2014, and his roll forwards are not consistent with ORS's position in the 2011 rate case as to plant in service, accumulated depreciation and average service lives. Id. Mr. White also provided a detailed roll forward of depreciation expense and accumulated depreciation in Exhibit GCW-R2.

In his surrebuttal testimony, Mr. Sullivan states that he focused on the issues from the Supreme Court decision and given the limited time in this rehearing process, he did not undertake further reviews of DIUC's books and records, the ORS position in the 2011 rate case, or the positions reflected in Ms. Gearheart's work in this docket. Rehearing Transcript at 459. So, Mr. Sullivan's testimony does not constitute substantial evidence for rejecting Mr. White's depreciation recommendations. ORS has provided nothing to contradict Mr. White's analysis. Further, Mr. White provided Exhibit GCW-R2 (Rehearing Exhibit 3) and specifically testified that "DIUC's calculation of accumulated depreciation has been consistent; it reflects proper regulatory accounting; and it makes the appropriate known and measurable adjustments." Rehearing Transcript at 130.

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The Commission should reconsider its Order and accept the detailed depreciation analysis provided by Mr. White.

3. RATE CASE EXPENSE

The Order on Rehearing's allowance of only $272,382 for rate case expense is not supported by the reliable, probative, and substantial evidence on the whole record. As is explained in the following discussion, the rate case expense adopted by the Order improperly and summarily excludes $542,978 of Guastella Associates ("GA") billings, based solely upon ORS's last-minute attempts to manufacture a multitude of brand new complaints about the invoices submitted by DIUC to document the costs for services provided by GA to DIUC in furtherance of this rate proceeding which has involved over three years of litigation and appeals.

A. The Order on Rehearing improperly applied the Supreme Court's decision and erroneously relied upon the initial ORS recommendation as to rate case expense

The Order on Rehearing's discussion of DIUC's need to collect the expense incurred through the multiple rate proceedings and appeal in this matter begins with the following erroneous assertion:

> Rate case expenses were not specifically mentioned in South Carolina Supreme Court Decision No. 27729, however, in keeping with the Court's Opinion, DIUC introduced new evidence that altered its original Rate Case expense request. As a result, this issue was litigated at the rehearing.

Order on Rehearing at 36, FN#33.

The issue of DIUC's entitlement to recover its rate case expense was not litigated at rehearing simply because DIUC introduced new evidence. Instead, the Supreme Court's decision specifically instructed the Commission to address rate case expense, holding:

> [T]he Settlement Agreement [adopted by the Commission] did not resolve any issues between the parties, but rather was merely an agreement between the POAs and ORS not to object to one another's pre-filed testimony, and to accept ORS's recommendations and adjustments should the Commission adopt them.

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> Furthermore, **the Settlement Agreement contained multiple adjustments which were entirely unsupported by the evidence presented to the Commission.** Therefore, we hold that Commission erred in approving and adopting the Settlement Agreement and DIUC is entitled to a new hearing in which the parties may present any additional evidence. While **we are reversing and remanding for a new hearing as to all issues**, in order **to provide guidance to the Commission on remand, we address three allegations of error raised by DIUC in this appeal**.

Daufuskie Island Util. Co., Inc. v. S.C. Off. of Reg. Staff, 420 S.C. 305, 316, 803 S.E.2d 280, 286 (2017) (emphasis added).

As Mr. Guastella explained in his rehearing testimony, it is DIUC's position that in reversing Commission Order 2015-846 in its entirety, the Supreme Court found that there was no evidence to support any of the adjustments reflected in the ORS/POA Settlement Agreement as adopted by the Commission. *See* Rehearing Transcript at 66 and Applicant's Proposal for Procedure Following Remand and Expedited Hearing, Docket Entry 272433. The Commission should have considered the rate case expense issues on remand based on the Supreme Court's ruling that the previous rate case expense adjustment was "entirely unsupported by the evidence presented to the Commission [at the original hearing]." *Daufuskie Island Util. Co., Inc. v. S.C. Off. of Reg. Staff*, 420 S.C. 305, 316, 803 S.E.2d 280, 286 (2017).

By failing to properly apply the Supreme Court's findings as to rate case expense, the Commission did not require ORS to provide support for its previous position that adjustment of rate case expenses in the original proceeding down to only $97,500, of which $75,000 was allocated for the current rate case and $22,500 for the unamortized balance related to the last rate case. The Supreme Court found ORS's estimated amount of $97,500 amount to be wholly unsupported and the Commission errs in disregarding this ruling. Further, the Order on Rehearing compounds this issue when it begins its rate case expense analysis by stating in Footnote 34 on page 36 of the Order that the $75,000 figure was "arrived at during the ORS and POAs." That is

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not accurate. The $75,000 was provided by ORS witness Gearheart and is what Ms. Gearherat determined should be "allowed" for "GA's preparation of the Application, developing rate models, calculating test year data, filing other rate case documents and legal expenses." Hearing Transcript at 495. Ms. Gearheart and ORS did not support that amount with any specific evidence. The

When challenged on appeal, ORS took the position that it did not have to support its recommendation with any facts:

> S.C. Code Ann § 58-4-50(A)(l) requires nothing further than a recommendation. Inherent in ORS's recommendation is its expertise and experience as the sole regulatory agency in South Carolina with the duty of examining utilities along with its knowledge of the case. [...] ORS recommended rate case expenses which it deemed reasonable and in the public interest.

Final Brief of Respondent South Carolina Office of Regulatory Staff, Appellate Case No. 2016-000652 at 19. Notably, in the original hearing ORS never raised issues about the GA invoices submitted by DIUC in support of its rate case expense. In fact, it is not ORS's position that it has provided any evidence in this case that the bills are insufficient – ORS simply states it "cannot recommend them in an amount to be covered." Rehearing Transcript at 510 (Ms. Hipp testifying "Whether or not ORS is penalizing them, ORS cannot verify these and, as such, cannot recommend them in the amount to be recovered.")

The Supreme Court ruled this ORS analysis from the original testimony and the ORS-POA Settlement Agreement was unsupported and the Commission erred in relying upon it as the basis of its rate case expense adjustment in Order 2015-846. Because no further evidence on the $75,000 amount was provided by ORS at rehearing, the Commission's reliance on that amount in the Order on Rehearing likewise creates a ruling based upon unsupported evidence.

B. DIUC was not afforded its lawful right to rebut the alleged evidence presented by ORS in opposition to DIUC's request to include GA rate case expenses in its rates.

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The Order on Rehearing adopts the ORS position that DIUC's costs for work performed by GA should be ***completely*** disregarded because of the invoices from GA. The primary support for this testimony came from ORS witness Dawn Hipp who testified at rehearing that the GA invoices provided for rate case expense:

> ... contain mathematical errors; do not contain sufficient detail to describe the work performed, the specific dates and hours of work, employee name, and business purpose; contain expenses such as air fare, lodging, and meals for which no detail or receipt was provided; and, do not appear to be paid by DIUC.

Rehearing Transcript at 476.

However, prior to the filing of ORS surrebuttal rehearing testimony, there was never any testimony in this case about ORS concerns or complaints as to the format of GA invoices or that it was discussed with DIUC. *See* Rehearing Transcript at 500 (Ms. Hipp testifying ORS complaints about the GA invoices were not raised in testimony in this case until she did so to refute DIUC's assertion that ORS has unfairly raised this issue so late in the case at rehearing).

The late timing of this new reason to exclude $542,978 of rate case expense was improper and unfair. DIUC did not have ample time to respond to or address the complaints raised by ORS. As the Supreme Court has explained, "Consistent with its obligation to provide Utility an opportunity to achieve a reasonable return, the PSC was obligated to accord Utility a meaningful opportunity to rebut the evidence presented in opposition to its proposed rates." *Utilities Services of S.C., Inc. v. S.C. Off. of Reg. Staff*, 392 S.C. 96, 107, 708 S.E.2d 755, 761 (2011) citing 26 S.C.Code Ann. Regs. 103–845(C).

Disallowing the $542,978 also rewards ORS for not previously raising the issue or providing DIUC a fair opportunity to respond in the usual manner allowed by ORS. Specifically, ORS admits it did not allow DIUC to provide additional information about the rejected $542,978 but that ORS usually engages an applicant to allow additional information to be provided in

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response to ORS questions about verification of charges or invoices. Ms. Hipp explained how DIUC was treated differently which resulted in the exclusion of every single rate case expense invoice from GA:

> In the case of this rehearing, the invoices that we received came to us, and we had such a short time period in order to examine them and make decisions, to meet the deadlines that the Applicant had asked for, that there wasn't that give-and-take. But in a normal rate case, we do have the luxury of having several months to go back and forth with the company, to make sure we thoroughly understand the expenditures for which they're seeking recovery.

Rehearing Transcript at 520.

By adopting the ORS position in its Order on Rehearing, the Commission denied DIUC ample opportunity to respond as well as an opportunity to respond in the manner that ORS usually allows; as such, DIUC was not able to rebut the alleged evidence presented by ORS in opposition to its proposed rates.

While DIUC appreciates that the Order on Rehearing permits DIUC an opportunity to support the $542,978 of requested rate case expenses in a future rate proceeding, not allowing DIUC to recover any GA charges in this case, not even a modest amount that has been clearly supported by evidence, is contrary to the basic standards of cost recovery and rate setting principles. Furthermore, deferral improperly requires DIUC to bear the burden of carrying these costs beyond a reasonable period of time resulting in a punitive impact on DIUC.

C. The Order on Rehearing improperly excludes $542,978 of Guastella Associates billings from rate case expense.

Before addressing the specifics of the ORS position regarding rate case expenses and the Order's adoption of the same, it is important to pause and acknowledge just how much work has been required for DIUC to push through these proceedings which began over three years ago. First, in the original proceeding DIUC was required to respond to discovery and to comply with

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information requests equal to those required of large utilities, which resulted in disproportionate expenses for a small utility like DIUC and significant amounts of time from GA personnel to conduct these activities. *See* Hearing Transcript at 218. Additionally, after a full hearing on its application, DIUC was forced to incur the additional high costs associated with a complicated request for reconsideration and a lengthy appeal to the South Carolina Supreme Court. Following remand, DIUC requested a very limited proceeding, but the POAs and ORS disagreed so DIUC was again required to rely upon the expert assistance of GA personnel to participate in broad discovery, prepare testimony, and then litigate a full rehearing. Denying DIUC any recovery now for the GA rate case expenses incurred through this multi-year proceeding is unjustifiably punitive. Even if the Commission is inclined to defer some costs for a later rate case or for additional paperwork or for more detailed information, there is ample evidence in this record justifying recovery of a significant amount of GA's rate case charges.

The Order's adoption of the ORS position has resulted in an extreme ruling that unnecessarily punishes DIUC. ORS is certainly aware, as is the Commission, that GA provided DIUC with services including answering a significant number of discovery responses (all of which were verified for DIUC in this case by GA employee John Guastella), preparing prefiled testimony by GA employees Guastella and White, traveling to the original hearing to provide live testimony by GA employees Guastella and White, preparing prefiled rehearing testimony by GA employees Guastella and White, preparation for rehearing live testimony by GA employees Guastella and White, and attendance at the rehearing by both Mr. Guastella and Mr. White.

ORS witness Dawn Hipp testified that there were five criteria employed by ORS to ensure the DIUC invoices and supporting documentation:

1) The invoice is mathematically correct;
2) The invoice is for a valid business purpose;

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3) The expense was incurred during the period under review;

4) The invoice was properly recorded on the books and records of the Company; and

5) The invoice was paid by the Company.

Rehearing Transcript at 474.[2]

With respect to the mathematically correct invoices error, Ms. Hipp refers to GA invoice #133 (Rehearing Exhibit 10) that lists a rate for Principal as $35 instead of the rate of $345 to $375 that appears on other invoices. That invoice, the only one with a mathematical error, is dated 7/10/2014 and in the amount of $1,612.50. Indeed, the $35 rate should have been $345, but this clerical error resulted in a charge that was actually less than it should have been.

In response to a question by Commissioner Nelson regarding whether GA bills had been paid and whether that was the main issue, Ms. Hipp testified "... that is one of the issues. I wouldn't consider it main. They are all weighted the same." Rehearing Transcript at 532-533. That means that ORS considers all five of these criteria equally. It is beyond any reasonable ratemaking standard in which to establish the cost of providing service that clerical billing errors, in this case on one bill, would be 20% of ORS's reason to recommend eliminating $542,978 of charges incurred by DIUC.

With respect to a valid business purpose, GA charges to DIUC for rate case work certainly meet that standard. In this context, Ms. Hipp testified that because GA's management of DIUC presents challenges in verifying where the work performed by GA under that management agreement ends and where the work performed to support the rate case and appeal begins, ORS concluded that ORS cannot verify that DIUC's characterization of the efforts GA undertook to "...complete discovery, try the case, and then file an appeal..." is accurate. Rehearing Transcript

[2] Also, the Commission must reconsider this analysis in light of DIUC's assertion that ORS for the first time raised these issues just days before the hearing on remand, more than three years after the initiation of this rate proceeding.

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at 484. However, to identify the different tasks covered under each role that GA provides for DIUC, ORS merely needed to read the detailed scope of services GA is required to perform, as set forth in its management agreement with DIUC and compare them to the detailed descriptions of work performed for the rate case as set forth in Ms. Hipp's own exhibit under the column entitled "DIUC Invoice Descriptions." *See* Rehearing Exhibit 10.

With respect to whether the rate case expenses were incurred during the period under review, there is simply no question that the rate case expenses for GA services were incurred during the period under review. Exhibit JFG-R3 (Hearing Exhibit 1) specifically itemizes GA's monthly billings for the periods from June 2014 through September 2017, including dates, and the actual dated invoices were also provided.

With respect to recording invoices on DIUC's books and records, long before the rehearing DIUC provided ORS with copies of DIUC's trial balances for 5 years, general ledger, tax returns and trial balances tied to rate application schedules. ORS also performed an audit and requested similar information which DIUC supplied in response to ORS Information Requests 1.13, 1.14, 1.17 and 1.20. Finally, there was no testimony that the GA billings were not properly recorded on DIUC's books.

With respect to payment of invoices, the allowance of costs incurred by a utility does not depend on whether a bill has been paid or reflected on the books as an account payable; if a reasonable cost is incurred then it qualifies for rate setting purposes. As Mr. Guastella testified, the owners have never taken a dividend and significant amounts owed by DIUC to GA have remained as accounts payable because the DIUC accounting priority has always been to use available cash for providing service to the customers. *See* Rehearing Transcript at 78 (Mr. Guastella testifying, "not only has there never been a dividend paid to any owner since the

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inception of the DIUC (formerly Haig Point Utility Company), but the existing owners have had to repeatedly infuse significant amounts of capital into DIUC to pay for operational costs during the appeal and before."). Finally, a requirement of payment of invoices is not a standard for "known and measurable" or any other rate setting standard.

In addition to these five criteria, Ms. Hipp also made certain assertions that, upon reconsideration, clearly do not support the conclusions asserted. With respect to the detail shown in GA invoices, Mr. Guastella testified that GA's invoices for rate case work have been the same for other clients, including Kiawah Island Utilities, Inc., and that only in this rehearing did ORS raise the question of the detail reflected in GA's invoices, never in the primary case or any other case. Rehearing Transcript at 88. In response, Ms. Hipp testified that ORS received five (5) invoices prior to its cutoff date of August 11, 2015, for review of the application materials. She further testified that ORS hosted a conference on August 24, 2015, during which time the GA invoices were discussed with DIUC representatives as part of the ORS explanation for its first reduction of rate case expenses to an allowance of only $75,000. Ms. Hipp provided no documentation in support of her response and the assertion is not logical. If ORS had, in fact, indicated in August of 2015 that its allowance of rate case expenses depended on the detail it now claims is necessary, there would be no reason for DIUC not to provide extensive details by revising past bills and including similar content on all future bills. The fact of the matter is, however, that GA's bills provide enough detail to establish the reasonableness of the charges for rate case work.[3]

Ms. Hipp does not deny that ORS reviewed and approved GA's bills to Kiawah Island Utility, Inc. in its rate cases. Instead, she claims that such a comparison is not warranted because,

[3] GA's extensive work is also highlighted in the legal bills that document in this rate proceeding that DIUC's attorneys communicated with GA on 423 occasions for some 139 hours attributable to those occasions.

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as she asserts for the first time, the GA-DIUC relationship is not an "arms-length transaction" thereby requiring "a careful review by ORS." Rehearing Transcript at 487. Not only are these criticism brand new at the final hour of rehearing in this matter, the claims are conjecture. GA is not an affiliate of DIUC or its stockholder and owners. GA's services are provided to DIUC in accordance with a management agreement that includes the provision of rate case consulting services separate from the management scope of work. In fact, in response to ORS Audit Request 1-14, DIUC provided over 150 emails to the president of DIUC and its owners, addressing all aspects of DIUC's operations, including the filing of the rate application, as well as financial statements, tax returns, PSC and court decisions, and other major matters. It is illogical to think that the president and owners of DIUC are somehow unaware of the rate case expenses or that these communications can simply be disregarded. DIUC and its owners are in constant communication with GA personnel; the suggestion that somehow GA is or might be inappropriately approving or making payments to itself borders on slander.

Following are responses to the other complaints raised by ORS in Rehearing Exhibit 10 with regard to GA invoices. The critiques do not advance the analysis of what is included in the billed rate work and whether it was performed. However, the issues raised and responses do demonstrate the extent to which ORS has gone to make excuses for disallowing $542,978 of GA billings:

- No contractor name – All bills are on Guastella Associates, LLC letterhead.
- No start date – As shown in Exhibit JFG-R3, GA bills are rendered monthly, showing the period ending on the last day of the month so the start date would be the first of the month.
- The name of the employee not listed – Each of the invoices from GA include time entries identified by the title of the personnel billing the time. A few early invoices refer to: "Principal" and to "Director-Financial/Accounting" while the later invoices identify the billers as "President" and "Vice President–

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Financial/Accounting." *See* Rehearing Exhibit DMH-1. These titles are sufficient to identify Mr. Guastella and Mr. White, both of whom have testified before this Commission and provided their job descriptions and titles to this Commission. *See* Hearing Transcript at 134 (John Guastella testifying he is President of Guastella Associates) and Hearing Transcript at 119, 123 (Mr. White testifying "I am Vice President and the Director of Accounting with Guastella Associates, LLC a firm that provides utility consulting services primarily for municipal and investor-owned water and wastewater utilities."). Both gentlemen have appeared before this Commission twice in this case to provide expert testimony on behalf of the Applicant. The name and title of each GA staff person was also provided in response to ORS discovery request ORS 1.2.

- No specific dates and times listed for each employee – The specific dates worked by each employee are not shown. GA bills do, however, list the number of hours worked and hourly rates by each employee. It should be kept in mind that DIUC is the regulated utility, not GA. If DIUC's officer and owners accept GA's billing because they know the work product and effort made by GA, just as all of GA's other clients have over the years, then ORS's disallowance of all $542,978 of GA charges fails to recognize the actual cost of the rate setting process.

- ORS cannot verify if rates charged by GA to DIUC for rate case expenses are accurate – This is simply not true. ORS could have verified the rates charged by GA by simply referring to DIUC's books for the entries of the GA charges. Another way would be to ask for GA's typical schedule of hourly rates that it charges all of its clients. Given the extensive discovery exchanged long before ORS raised this issue, it is unfair for ORS to suddenly claim it was without opportunity or information regarding verification.

ORS also raised questions about GA's documentation for travel costs. Ms. Hipp's begins this line of analysis by citing to some unidentified rate case(s) where "ORS's review of travel expenses has found situations where regulated utilities incurred lavish expenditures related to employee travel (i.e. private jets, $50 alcoholic drinks) and included those lavish expenditures in a rate application." Rehearing Transcript at 488. There are only a few GA bills for travel expenses and they total $5,634, including the $4,532 for the cost of three GA employees to appear in Columbia for the first rate hearing. Knowing the date of the hearing and the GA personnel in attendance, it seems logical that ORS professionals could evaluate the reasonableness of those travel expenses as reflected on the invoices billed to DIUC. There is no cause to believe that

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$5,634 in total travel costs over a three-year rate case in any way involve the kind of extravagances ORS witness Hipp purports to prevent. There is no reason to doubt these travel expenses.

As previously noted, ORS has required DIUC to supply many discovery responses and has had more than ample time to request additional information. It is not fair to delay DIUC's ability to recoup its costs because ORS waited to surprise DIUC with this "gotcha" position at rehearing. Additionally, ORS admits it did not allow DIUC to provide additional information about the rejected $542,978 but that ORS usually engages an applicant to allow additional information to be provided in response to ORS questions about verification of charges or invoices. Ms. Hipp explained how DIUC was treated differently, which resulted in the exclusion of every single rate case expense invoice from GA:

> In the case of this rehearing, the invoices that we received came to us, and we had such a short time period in order to examine them and make decisions, to meet the deadlines that the Applicant had asked for, that there wasn't that give-and-take. But in a normal rate case, we do have the luxury of having several months to go back and forth with the company, to make sure we thoroughly understand the expenditures for which they're seeking recovery.

Rehearing Transcript at 520.

The ORS criticisms of the invoices in no way negate the work performed by GA. There is no testimony in the record that the extensive rate case work was not performed by GA or that it was unnecessary. Changing invoices to include names of employees instead of titles or correcting a single clerical error on a bill from $35 to $345 or recording a cost as a payable instead of a current payments, does not change the validity of or the quantity of work demonstrated by the GA billings submitted as rate case expenses. The reliable, probative, and substantial evidence demonstrates the significant amount of work performed by GA for DIUC in these rate proceedings and the Commission should allow DIUC to recover the costs for at least one-half of the rate case work performed by GA.

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CONCLUSION

The Rate Application that initiated this proceeding requested a 108.9% increase over the rates authorized pursuant to the last petition for rate adjustment. *See* Rehearing Transcript at 80. After appeal and remand to the Commission, DIUC provided testimony that the "current economic realities following remand" require DIUC obtain "a 125.7% increase over the rates authorized pursuant to the last petition for rate adjustment." *Id.* at 79. However, to keep the final rates within the Application's original 108.9% increase, DIUC proposed to leave outstanding that portion of its rate case expenses beyond those that could be included within a 108.9% increase. *See* DIUC's Proposed Order, Docket Entry 273556.

Following that same logic, DIUC hereby requests the Commission reconsider the Order on Rehearing and enter an amended order including the $699,361 of utility plant in service and revising the depreciation as set forth herein. The Schedule attached hereto as *Exhibit 1* should form the basis of an amended order. As demonstrated by the Schedule, the resulting revenue requirement would be $2,243,072.

The Order on Rehearing allowed $272,382 for rate case expense incurred through September 30, 2017. DIUC requests the Commission reconsider and increase the allowed rate case expense so that DIUC can recover $269,356 for GA fees incurred through September 30, 2017. Using a 3-year amortization and limiting the total rate increase to the original 108.9%, the Commission should allow $541,738 for total rate case expenses over three years collected annually at $180,579. *See Exhibit 1.* That would leave outstanding about one-half of the $541,738 of GA fees invoiced through September 30, 2017, or $273,662.

DIUC would support the Commission not ruling on or offering any decision on those outstanding pre-September 30, 2017, GA costs or their documentation at this time. The $273,662

would be carried over to the next rate proceeding during which ORS should engage in its usual and customary "back and forth with the company, to make sure [ORS] thoroughly understand[s] the expenditures for which [DIUC is] seeking recovery." *See* Rehearing Transcript at 520. At that time DIUC would also present its additional post-September 30, 2017, actual rate case expense for the conclusion of this docket to enable an accurate accounting of what additional costs should be considered in the rate case.

Respectfully submitted,

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February 20, 2018

Charleston, South Carolina

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Daufuskie Island Utility Company, Inc.
Water and Wastewater Systems
Combined Operating Statement

	Company	Revised ORS	Amended Order Post-Reconsideration		
	Pro Forma Proposed Rates	Pro Forma Proposed Rates	Pro Forma Present Rates	Adjustments	Pro Forma Proposed Rates
Operating Revenue:					
Residential	$710,786	$514,330	$312,153	$379,306	$691,459
Commercial	287,589	241,135	146,277	141,717	287,994
Irrigation	213,238	201,180	99,193	104,573	203,766
Availability Billing	992,880	933,626	485,761	509,678	995,439
Misc. Other Revenue	63,229	46,623	30,197	34,217	64,414
Interdepartmental Sales	0	0	0	0	0
Billing Adjustments	0	1,498	0	0	0
Total Revenues	2,267,722	1,938,392	1,073,581	1,169,490	2,243,072
Operating Expense:					
Wages	164,752	176,590	176,590	0	176,590
Benefits	10,686	6,200	6,200	0	6,200
Director's Fees	16,500	16,500	16,500	0	16,500
Sludge Disposal	0	0	0	0	0
Power	166,718	130,181	130,181	0	130,181
Chemicals	9,510	9,020	9,020	0	9,020
Supplies & Maintenance	28,543	27,116	27,116	0	27,116
Outside Services-Mgmt	171,364	132,211	171,365	0	171,365
Outside Services-Engineering	8,013	10,137	10,137	0	10,137
Outside Services-Accounting	2,762	2,761	2,761	0	2,761
Outside Services-Legal	23,178	23,178	23,178	0	23,178
Outside Services-Testing	92,289	92,288	92,288	0	92,288
Outside Services-Other	38,622	38,621	38,621	0	38,621
Other Operating Expenses	0	0	0	0	0
Transportation	2,756	2,450	2,450	0	2,450
Bad Debt	30,852	190,127	105,383	114,761	220,144
Insurance	48,322	38,913	38,913	0	38,913
Regulatory Commission Expense	15,636	15,636	15,636	0	15,636
Other A&G Expenses	36,436	36,438	36,438	0	36,438
Accepted ORS Adjustment	0	(46,033)	(46,033)	0	(46,033)
Total O&M Expense	866,939	902,335	856,744	114,761	971,506
Depreciation	95,266	82,560	89,923	0	89,923
Amortization of Rate Case Exp	140,221	54,477	180,579	0	180,579
Amortization of Deferred Property Tax	65,855	65,855	65,855	0	65,855
Revenue Taxes	14,320	16,592	9,196	10,019	19,215
Property Taxes	192,301	192,301	192,301	0	192,301
Payroll Taxes	13,732	13,212	13,212	0	13,212
State and Federal Income Taxes	260,495	174,109	0	203,439	203,439
Total Operating Expenses	1,649,129	1,501,441	1,407,812	328,219	1,736,030
Net Operating Income	$618,593	$436,951	($334,230)		$507,041
Rate Base	$7,085,475	$5,867,632	$6,798,680		$6,798,680
Rate of Return	8.73%	7.45%	-4.92%		7.46%
Revenue Increase	108.9%	80.6%			108.9%
Interest Expense	$180,680	$142,783			$165,208
Operating Margin	19.3%	15.2%			15.2%

Notes:
Restored Rate Base (UPIS & A/D at YE 2014 booked levels).
Restored Management Fees.
Limit Rate Case amortization allowance not to exceed 108.9% revenue increase.
Working Capital adjusted to reflect PSC's O&M expenses.
Depreciation expense adjusted to reflect YE 2014 depreciable assets.
Bad debt reflects 9.82% of revenue.

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Docket No. 2014-346-WS

Daufuskie Island Utility Company, Inc.
Revenue Impact Analysis
Test Year Revenue - Existing Rates

WATER

Customer	Classification	Consumption	Usage Charge	Units	Base Charge	Revenue
Haig Point-Residential	3/4" Meter			1,061	$62.09	$65,877
	0 to 22,500 gals.	8,360,179	$2 76			$23,074
	Over 22,500 gals.	3,192,728	$2.76			$8,812
Haig Point-Irrigation				727		
	0 to 18,000 gals.	8,367,838	$2 76			$23,095
	18,001 to 60,000 gals.	9,829,270	$3.09			$30,372
	Over 60,000 gals.	10,049,342	$3.50			$35,173
Melrose-Residential	3/4" Meter			452	$80.72	$36,485
	0 to 22,500 gals.	4,105,940	$0.00			$0
	Over 22,500 gals.	2,177,808	$2.44			$5,314
Melrose-Irrigation				100		
	0 to 18,000 gals.	1,368,330	$1.66			$2,271
	18,001 to 60,000 gals.	2,002,230	$1 66			$3,324
	Over 60,000 gals.	2,986,298	$1.66			$4,957
Haig Point-Commercial	Metered			106	$86.93	$9,215
	0 to 22,500 gals	2,413,190	$2.76			$6,660
	Over 22,500 gals.	2,132,690	$2.76			$5,886
Melrose-Commercial	Metered			329	$136.60	$44,941
	0 to 22,500 gals	1,752,659	$0 00			$0
	Over 22,500 gals.	2,544,703	$2.44			$6,209
	Water Service Total	**61,283,205**		**2,775**		**$311,667**

SEWER

Customer	Classification	Consumption	Usage Charge	Units	Base Charge	Revenue
Haig Point-Residential	3/4" Meter			1,061	$110.38	$117,113
	0 to 22,500 gals	8,360,179	$1.32			$11,035
	Over 22,500 gals.	3,192,728	$1 32			$4,214
Melrose-Residential	3/4" Meter			448	$80.72	$36,163
	0 to 22,500 gals	3,926,008	$0 00			$0
	Over 22,500 gals.	2,296,390	$1.77			$4,065
Haig Point-Commercial	Metered			102	$178.21	$18,177
	0 to 22,500 gals.	2,362,530	$1.32			$3,119
	Over 22,500 gals.	2,132,690	$1.32			$2,815
Melrose-Commercial	Metered			329	$136.60	$44,941
	0 to 22,500 gals	1,559,487	$0.00			$0
	Over 22,500 gals.	2,436,565	$1.77			$4,313
	Water Service Total	**26,266,577**		**1,940**		**$245,955**

REVENUE SUMMARY:

Total Residential Water and Sewer Service Revenues				$312,153
Total Commercial Water and Sewer Service Revenues				$146,277
Total Irrigation Service Revenues				$99,193
		Total Water and Sewer Service Revenues		**$557,623**
Availability Billing-Water	Haig Point	1,917	$31.04	$59,504
	Melrose	1,617	$76.36	$123,474
	Bloody Point	368	$76.36	$28,100
Availability Billing-Sewer	Haig Point	1,917	$55.19	$105,799
	Melrose	1,617	$85.08	$137,574
	Bloody Point	368	$85.08	$31,309
		Total Water and Sewer Availability Revenues		**$485,761**
Misc. Other Revenue	Other			
	Return Check Fees			
	Late Fees-Metered Sales			
	Late Fees-Availability			
		Total Misc. Other Revenue		**$30,197**
		Total Operating Revenue		**$1,073,581**

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Docket No. 2014-346-WS

Daufuskie Island Utility Company, Inc.
Revenue Impact Analysis
Test Year Revenue - Proposed Rates

WATER

Customer	Classification	Consumption	Usage Charge	Units	Base Charge	Revenue	Increase Amt.	Increase %
Haig Point-Residential	3/4" Meter			1,061	$155.83	$165,336	$99,458	151.0%
	0 to 22,500 gals.	8,360,179	$4.46			$37,286	$14,212	61 6%
	Over 22,500 gals.	3,192,728	$4.46			$14,240	$5,428	61 6%
Haig Point-Irrigation				727			$0	N/A
	0 to 18,000 gals.	8,367,838	$4.91			$41,086	$17,991	77.9%
	18,001 to 60,000 gals.	9,829,270	$5.80			$57,010	$26,637	87 7%
	Over 60,000 gals.	10,049,342	$6.70			$67,331	$32,158	91 4%
Melrose-Residential	3/4" Meter			452	$155.83	$70,435	$33,950	93.1%
	0 to 22,500 gals.	4,105,940	$4.46			$18,312	$18,312	N/A
	Over 22,500 gals.	2,177,808	$4.46			$9,713	$4,399	82.8%
Melrose-Irrigation				100			$0	N/A
	0 to 18,000 gals.	1,368,330	$4.91			$6,719	$4,447	195.8%
	18,001 to 60,000 gals.	2,002,230	$5.80			$11,613	$8,289	249.4%
	Over 60,000 gals.	2,986,298	$6.70			$20,008	$15,051	303.6%
Haig Point-Commercial	Metered			106	$218.16	$23,125	$13,910	151.0%
	0 to 22,500 gals.	2,413,190	$4.46			$10,763	$4,102	61.6%
	Over 22,500 gals.	2,132,690	$4.46			$9,512	$3,626	61.6%
Melrose-Commercial	Metered			329	$218.16	$71,775	$26,833	59 7%
	0 to 22,500 gals.	1,752,659	$4.46			$7,817	$7,817	N/A
	Over 22,500 gals.	2,544,703	$4.46			$11,349	$5,140	82.8%
	Water Service Total	**61,283,205**		**2,775**		**$653,429**	**$341,762**	**109.7%**

SEWER

Customer	Classification	Consumption	Usage Charge	Units	Base Charge	Revenue	Increase Amt.	Increase %
Haig Point-Residential	3/4" Meter			1,061	$221.58	$235,096	$117,983	100.7%
	0 to 22,500 gals.	8,360,179	$2.35			$19,646	$8,611	78.0%
	Over 22,500 gals.	3,192,728	$2.35			$7,503	$3,289	78.0%
Melrose-Residential	3/4" Meter			448	$221.58	$99,268	$63,105	174.5%
	0 to 22,500 gals.	3,926,008	$2.35			$9,226	$9,226	N/A
	Over 22,500 gals.	2,296,390	$2.35			$5,397	$1,332	32.8%
Haig Point-Commercial	Metered			102	$310.21	$31,641	$13,464	74.1%
	0 to 22,500 gals.	2,362,530	$2.35			$5,552	$2,433	78.0%
	Over 22,500 gals.	2,132,690	$2.35			$5,012	$2,197	78.0%
Melrose-Commercial	Metered			329	$310.21	$102,059	$57,118	127.1%
	0 to 22,500 gals.	1,559,487	$2.35			$3,665	$3,665	N/A
	Over 22,500 gals.	2,436,565	$2.35			$5,726	$1,413	32.8%
	Water Service Total	**26,266,577**		**1,940**		**$529,791**	**$283,836**	**115.4%**

REVENUE SUMMARY:	Total Residential Water and Sewer Service Revenues				$691,458	$379,305	121.5%
	Total Commercial Water and Sewer Service Revenues				$287,995	$141,719	96.9%
	Total Irrigation Service Revenues				$203,766	$104,573	105.4%
			Total Water and Sewer Service Revenues		**$1,183,220**	**$625,597**	**112.2%**
	Availability Billing-Water	Haig Point	1,917	$112.19	$215,068	$155,565	261 4%
		Melrose	1,617	$112.19	$181,411	$57,937	46.9%
		Bloody Point	368	$112.19	$41,286	$13,185	46.9%
	Availability Billing-Sewer	Haig Point	1,917	$142.92	$273,978	$168,178	159.0%
		Melrose	1,617	$142.92	$231,102	$93,527	68.0%
		Bloody Point	368	$142.92	$52,595	$21,285	68.0%
			Total Water and Sewer Availability Revenues		**$995,439**	**$509,678**	**104.9%**
			Total Misc. Other Revenue		**$64,414**	**$34,217**	**113.3%**
			Total Operating Revenue		**$2,243,073**	**$1,169,492**	**108.9%**

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STATE OF SOUTH CAROLINA
In the Supreme Court

APPEAL FROM THE PUBLIC SERVICE COMMISSION

Docket No. 2014-346-WS

Daufuskie Island Utility Company, Inc.,

Appellant,

v.

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

Respondents.

NOTICE OF APPEAL

Daufuskie Island Utility Company, Inc. appeals the Decisions and Orders of the Public Service Commission dated January 31, 2018 (Order No. 2018-68) and May 18, 2018, (Order No. 2018-346). Copies of the Orders are attached and are more specifically identified as follows:

- Order No. 2018-68 Commission Order on Rehearing, and
- Order No. 2018-346 Commission Order Denying Reconsideration.

Because the Orders set a public utility rate under Title 58 of the South Carolina Code of Laws, this Appeal is filed in the South Carolina Supreme Court pursuant to Rule 203(d)(2), SCACR. Appellant received written notice of entry of the Order Denying Applicant's Petition for Reconsideration and/or Rehearing on May 18, 2018.

June 13, 2018

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OWNER'S ASSOCIATION, INC., and
BLOODY POINT PROPERTY OWNER'S ASSOCIATION

BEFORE THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

COLUMBIA, SOUTH CAROLINA

HEARING #17-11494 DECEMBER 6, 2017 10:30 A.M.

DOCKET NO. 2014-346-WS:
DAUFUSKIE ISLAND UTILITY COMPANY, INC. – Application for Approval of an Increase for Water and Sewer Rates, Terms, and Conditions

Rehearing on Remand of the Supreme Court of South Carolina

TRANSCRIPT OF TESTIMONY AND PROCEEDINGS **VOLUME 1 OF 2**

HEARING BEFORE: Swain E. WHITFIELD, CHAIRMAN; Comer H. 'Randy' RANDALL, VICE CHAIRMAN; and COMMISSIONERS John E. 'Butch' HOWARD, Elliott F. ELAM, Jr., Elizabeth B. 'Lib' FLEMING, Robert T. 'Bob' BOCKMAN, and G. O'Neal HAMILTON

ADVISOR TO COMMISSION: F. David Butler, Esq.
SENIOR COUNSEL

STAFF PRESENT: Jocelyn G. Boyd, Chief Clerk/Administrator; Joseph Melchers, General Counsel; James Spearman, Ph.D., Executive Assistant to Commissioners; William O. Richardson, Douglas K. Pratt, Thomas Ellison, and John Powers, Technical Advisory Staff; Jo Elizabeth M. Wheat, CVR-CM/M-GNSC, Court Reporter; and Calvin Woods and William O. Richardson, Hearing Room Assistants

APPEARANCES:

G. TRENHOLM WALKER, ESQUIRE, and ***THOMAS P. GRESSETTE, JR., ESQUIRE,*** representing DAUFUSKIE ISLAND UTILITY COMPANY, INC., **APPLICANT**

APPEARANCES *[Cont'g]*:

JOHN F. BEACH, ESQUIRE, and ***JOHN J. PRINGLE, ESQUIRE,*** representing HAIG POINT CLUB & COMMUNITY ASSOCIATION, MELROSE PROPERTY OWNERS ASSOCIATION, and BLOODY POINT PROPERTY OWNERS' ASSOCIATION, **INTERVENORS**

JEFFREY M. NELSON, ESQUIRE, and ***ANDREW M. BATEMAN, ESQUIRE,*** representing **THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF**

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P R O C E E D I N G S

CHAIRMAN WHITFIELD: Please be seated. I'll call this hearing to order and ask our attorney, Mr. Butler, to read the docket.

MR. BUTLER: Thank you, Mr. Chairman, other members of the Commission.

This is Docket No. 2014-346-WS. This is the second hearing on Daufuskie Island Utility Company, to be heard *de novo* on remand from the South Carolina Supreme Court.

Pursuant to the Standing Hearing Officer's Directive, the matter is to be heard beginning on Wednesday, December 6, 2017, at 10:30, in the offices of the Commission at 101 Executive Center Drive in Columbia, South Carolina.

Mr. Chairman and other members of the Commission, the docket is in order. And, Mr. Chairman, if you don't mind, if I may make one further announcement, just for general interest to everyone, I think, that will be here, Ms. Wheat informs me that we do have copies of the transcript and materials from the last hearing two years ago, available up front here. If anyone needs to reference those, they will be available.

Thank you, Mr. Chairman.

CHAIRMAN WHITFIELD: Thank you, Mr. Butler.

I'll now call on our attorneys in this proceeding to make their appearances. For the company?

MR. GRESSETTE: Good morning, Commissioners. My name is Tom Gressette. I'm here on behalf of Daufuskie Island Utility Company.

MR. WALKER: Trenholm Walker, also here on behalf of Daufuskie Island Utility Company.

CHAIRMAN WHITFIELD: Mr. Walker, Mr. Gressette, welcome.

MR. WALKER: Thank you, sir.

MR. BEACH: Good morning, Mr. Chairman and Commissioners. My name is John Beach and I'm here on behalf of the property owners' associations on Daufuskie Island.

CHAIRMAN WHITFIELD: Welcome, Mr. Beach.

MR. PRINGLE: Jack Pringle, Mr. Chairman and Commissioners.

CHAIRMAN WHITFIELD: Welcome, Mr. Pringle.

And ORS.

MR. BATEMAN: Good morning, Mr. Chairman and Commissioners. Andrew Bateman here, on behalf of ORS, along with Jeff Nelson.

CHAIRMAN WHITFIELD: I understand Ms. Fox is

not going to participate, representing Beach Field Properties. She's listed as an Intervenor but is not participating.

MR. BUTLER: That is correct, Mr. Chairman. We have a letter accordingly.

CHAIRMAN WHITFIELD: Thank you, Mr. Butler.

At this time, I'm going to ask the parties if there any preliminary matters that need to come before the Commission at this time.

MR. GRESSETTE: None from the Applicant.

MR. PRINGLE: None from the Intervenors.

MR. NELSON: None from ORS, Mr. Chairman.

CHAIRMAN WHITFIELD: All right. Thank you. That also includes if any of you would like to make opening statements. Do any of the parties wish to make opening statements at this time?

MR. GRESSETTE: Yes, for the Applicant, Your Honor.

CHAIRMAN WHITFIELD: Please go ahead, and we will proceed with everyone's opening statement.

MR. GRESSETTE: Good morning, Commissioners. Again, my name is Tom Gressette; I'm with the law firm of Walker, Gressette, Freeman & Linton, down in Charleston. I'm here with my partner, Trenholm Walker, on behalf of the Applicant, Daufuskie

Island Utility Company, Incorporated.

Today, I'll likely say "DIUC" a lot; that means Daufuskie Island Utility Company.

Here with us today are Mr. John Guastella and Mr. Gary White. Both of these gentlemen are employed by Guastella Associates, which is the manager of DIUC.

About a year ago, I stood in front of the Supreme Court and said, "We are here today because what you do," Supreme Court, "will determine whether this utility survives." And as the Commission knows, the issues in that case were, in the Applicant's eyes, the result of adjustments proposed to the Commission in the previous case by ORS and the Intervenors in a settlement agreement that did not recognize the actual, known expenses that this utility incurs in operating.

When we went to the Supreme Court, we talked about five adjustments, and we said, "We have to have enough money to pay our taxes. This agreement didn't allow us to do it. We need your help." We said, "Our plant-in-service includes all the property that is used and useful. The settlement agreement didn't account for that, and we need your help." We discussed bad debt and the fact that the

only evidence in the record supported our position, but not the position that ORS and Intervenors had reverted to at the hearing. And, finally, we said, "The utility has incurred management fees pursuant to a legal contract, and we need some help."

The Supreme Court listened to arguments and said, in essence, "There are three adjustments that we are sending this case back to address. Those are related to utility plant-in-service, the utility's taxes, and the bad-debt expense." The Supreme Court also said that the way that the case was presented to the Commission shouldn't be repeated again when we came down, and that the Commission should hear new facts about what had transpired since the original Application. And, so, the utility today has come to the hearing prepared to talk to you about the positions of the parties and the facts that have occurred since the original Application.

The Intervenors and ORS have taken positions which they will, of course, describe to you. In my summary, I would say that ORS has done the very minimum required by the Order. Our reading of the Order is that the Supreme Court said, "Look, there are a lot of problems with the way ORS and

Intervenors handled this. You need to go fix it and give the Commission better evidence." In response, ORS and the Intervenors have said, "Mm, I don't know, they only talked about those three specific ones, so that is all we are doing." It's not enough. If the Commission accepts the extreme positions asserted again in this rehearing by ORS and the Intervenors, we will be right back in the same place, and two years from now we'll likely be back talking about whether or not this utility had enough revenue to meet its known and actual costs.

Now, a lot of these issues were briefed, put in the testimony earlier, and before the Commission, and so it's not our plan today to repeat that. What I would like to do is highlight the new adjustments that are at issue, and then we will propose testimony that very briefly summarizes those and makes the witnesses available for any questions you might have.

The five adjustments are: rate-case expenses, utility plant-in-service, management fees, bad debts, and depreciation expense and accumulated depreciation.

The utility plant-in-service number has been increased to address the elevated tank and a pump

on that property. So, went to the Supreme Court on ORS's proposal, but there's still utility plant-in-service that's missing that makes a significant difference.

Rate-case expenses: The utility, in pursuing the original case, reconsideration, rehearing, appeals, coming back to rehearing, has asserted total rate-case expenses of $794,000. ORS has reviewed that amount and proposed about 275. Those are actual known, documented costs.

Management fees were discussed in the previous hearing, not specifically ruled on by the Supreme Court. Our position remains the same, based on the evidence that was originally submitted. You are going to hear new reasons for why the management fees should not be what the utility requests, and that is because, coming back on rehearing with the initial testimony from ORS and then its surrebuttal testimony, the bar keeps getting moved. The reasons keep getting added. These are not the reasons you heard last time. Our position is that, if those reasons existed before, they would've told you, and that there is something fundamentally unfair about moving the target once the case has been filed or once the case is back on rehearing.

Bad debts: Bad debts are a percentage that are calculated, as you know, based on actual debts that aren't collectible. Since the time of the original Application, we had new, real data about what has not been collected, and so we're going to present that to you by way of update.

Finally, depreciation expense and accumulated depreciation: These calculations, which Mr. White is going to discuss, as proposed by ORS, do not properly balance things like reducing retired plant with the appropriate adjustments that should be made to balance the accounting. And we will explain those to you.

Those are the adjustments that are at issue. Again, our focus is making sure that we provide the Commission the reasonable, factual explanation of why the Applicant's position on those adjustments is accurate and reflected in the testimony and records before the Commission. The Intervenors' are a little bit different. Intervenors have a proposal that involves multiple scenarios of how the Commission might recalculate the entire rate base, which we assert is essentially rewriting history. In other words, they came back after remand and said, "Oh, we need some more discovery.

There's some other documents out there. We want to beef up our argument. Now we have some more." And those arguments are that "The way you did your accounting all along, the way that ORS accepted your accounting all along, is just not right and we need the Commission to undo that. And if you'll undo that, then the utility can go back and get some taxes changed and do some other things based on that, and then lower rates make sense." We submit that all of that is not only hypothetical but not possible and not accurate under proper ratemaking.

Then there's another analysis that Intervenors present. If you didn't like that one, they've got another one, which is: Daufuskie Island Utility built too much plant. And when the developer built all that plant, it shouldn't have done that much and now people are getting charged too much for plant." By that, I mean pipes, that aren't being used. They can fancy it up all they want, but that's the argument.

If we don't look at the real facts, what is reasonable, in response to the Application that has been put forward, we will find ourselves back in this situation. These are large adjustments with

tremendous impact on the utility, and so it's our hope that by the end of the hearing the Commission will see that positions being presented other than those of the Applicant are, in fact, extreme and will result in not only damage to the utility but ongoing expense related to these rate proceedings if we don't get it all straightened out.

We are here to help. If there are any questions as we proceed, please let us know and we are happy to respond. Thank you.

CHAIRMAN WHITFIELD: Thank you, Mr. Gressette. Now, Intervenors?

MR. BEACH: Thank you.

CHAIRMAN WHITFIELD: Mr. Beach?

MR. BEACH: Thank you, so much. I have –

CHAIRMAN WHITFIELD: Can you come to a microphone, Mr. Beach?

MR. BEACH: I can do that, and I'm wondering if it makes more sense for me to come over here. I'm going to be displaying three documents on this screen, and maybe being here is the best place for me. I don't know.

CHAIRMAN WHITFIELD: Mr. Richardson, let's make sure that microphone is on.

MR. BEACH: Okay, on now. Very good.

[Document distributed]

[Reference: Attached "CEL-R2"]

MR. BEACH: Mr. Chairman and Commissioners, thank you for allowing us to be here today and hearing us. I'm going to try and spend a few minutes giving you some background, and also to try and focus us in on the issues that the property owners' association witnesses are bringing to the Commission.

The three main points the POA experts will address relate to a single issue, and that is: What is the utility's appropriate and correct rate base?

A very, very, very large portion of the rates that the utility is requesting in this rate case are return on rate base. There are costs, of course, that are to be recovered for operating, but there's a very, very, large component that relates to the rate base and the return on rate base. That's why this is important.

In the 1980s, International Paper, the developer of Haig Point, constructed a water and sewer system, parts of which were big enough to serve the entire development of Haig Point if it were fully built out. That was a decision the developer made. The developer then donated the

systems to the utility that it created, Haig Point Utility Company, now renamed Daufuskie Island Utility Company, Inc. Same company from the beginning until now.

The Commission set HPUC's water and sewer rates for the first time in 1985. The rates covered the utility's operating costs, only. It did not include rate elements to recover the utility's capital investments or to pay a return on capital assets. These rates and this rate structure was in place for 18 years.

The utility hired Mr. Guastella to help them with the rate case they filed in 2005. In preparation for the 2005 rate case, the utility conducted a 2004 study, concluding the developer, IP, had spent approximately $4.3 million constructing that original water and sewer system, or plant, that we're discussing. When I say the word "plant," I'm talking in terms of the entire system; I don't just mean the treatment plant. I'm talking "plant" in terms of utility accounting.

Now, as part of that study, you can see the utility created this trial balance sheet that we're looking at right here [indicating]. And it's important to focus on this, because this is a

hugely important document and it really is the genesis of one of the biggest flaws and one of the reasons why the rate base that is being asserted by the utility in this case is vastly overstated. If you look at the first highlighted under "Property, plant & equipment," you can see that there's a $4.3 million estimated system cost that was added as an asset. And if you look down at Note 2, you can see in Note 2 that explains that that was added as a result of the Thomas & Hutton study that we've been talking about.

If you look then again down at "Paid in capital," you can see where – and that went from zero to $4.6 million, roughly, and you can look down at Note 8, which explains that that is again to make that – that's the counterbalancing entry that the utility made when putting that property, plant, and equipment on its books.

Now, Mr. Loy and Mr. Lanier are going to explain to you that NARUC rules actually require this donated plant to be added not to paid-in-capital but to contributions-in-aid-of-construction. Mr. Loy's testimony includes historic documents demonstrating in several different ways that this plant was donated by the

utility in exchange for no consideration. But the easiest way to see that is by looking at this trial balance sheet. You can see that under the column that is headed "6/30/04" – I'm sorry – "Total Year Ended 6/30/04," that property, plant, and equipment is at zero. In the adjustment, that's the amount that has been calculated. Likewise, if you look down at "Paid in capital," that column, the "before" column, if you will, the column as of June 30, 2004, was also zero.

This document, this historic document of the utility's, proves that for roughly the 18 years following 1985, the utility was carrying these assets at zero value, and the reason they were is because the utility had donated them – I'm sorry – the developer had donated them to the utility for no consideration.

[Reference: Attached "CEL-R1, Schedule A-1"]

Now, if you look at the next document I've given you, it is Schedule A-1. And, again, these two documents are exhibits to Mr. Loy's testimony, so his testimony explains these, as well, in much greater detail than this. But, now, this is the balance sheet that the utility submitted to the

Commission in its 2005 rate Application. And you can see, again, where under the assets there's plant-in-service for $4.339 million. That was put there as a result of the 2004 study, and that was not an error. There's no problem with putting that in there. The utility accounting mistake was in offsetting it by pretending that it was paid in capital. In other words, that the utility had actually paid for that capital, which it didn't, because it was donated. The NARUC rules, and also other authorities, required that to actually put it into contributions-in-aid-of-construction, which you can see is about three lines above the paid-in-capital line.

Why does the utility's seemingly innocuous decision to record this as plant-in- – as paid-in-capital, as opposed to contribution in service, or contribution-in-aid-of-construction matter to us today? Well, the reason it matters is because those same utility accounting authorities that require donated plant to be recorded as contributions-in-aid-of-construction also require contributions-in-aid-of-construction to be subtracted from plant-in-service, in calculating rate base. You'll see that in all of the documents

that are filed with this Commission in this case that relate to rate base. Contributions-in-aid-of-construction are subtracted from plant-in-service to determine rate base.

The same rule does not apply to paid-in-capital because, in theory, the utility has actually paid for the capital that's reflected in paid-in-capital. Paid-in-capital is not subtracted from rate base, which is almost certainly why the utility put it there, instead of where it should have been as a contribution-in-aid-of-construction. The whole purpose of this study and the exercise we have here was to create a rate base for the utility's 2005 rate case.

Because the utility didn't pay for this original plant – that is, it's not the utility's investment – the utility is prohibited from earning a return off of this plant or recovering the original cost of the plant through depreciation expense. Those are the rules that apply here. Now, the utility carried this accounting error forward to the rate case it filed in 2011, and now to the present rate case.

Now, Mr. Loy will explain this incorrect 2004 accounting entry causes the utility's claimed rate

base to be significantly overstated today, which, in turn, improperly inflates the utility's revenue requirements in the resulting rates. And Mr. Loy and Mr. Lanier will explain how those adjustments, the necessary adjustments to correct this, flow through to the utility's rate requirement.

Now, the 2005 and 2011 rate cases both established rates through settlements, not fully litigated hearings. Both settlement agreements entered into by this utility, the property owners' associations, and ORS, included provisions guaranteeing that ORS and the POAs would have the ability to challenge, in the future, any of the utility's financial assertions, including its assertion of rate base. These settlement provisions ensured that the rates established through those settlements did not set a precedent regarding the utility's rate base. Neither the property owners' associations nor ORS would have entered into the settlements without these negotiated safeguards. And those settlement agreements were approved by this Public Service Commission when it set the rates, again, based on the settlement agreements in 2005 and 2011 – or 2012, is ultimately when those rates were set.

Again, the POAs and ORS would not have entered into these settlements without that negotiated provision, because, otherwise, they would be here today with the utility arguing that those rate-base numbers that they put on the piece of paper back then are a precedent and that this Commission is now powerless to do anything to change that. That's why those guarantees were in there. And it's a little surprising to me to hear the utility company now arguing that those safeguards don't mean what we all know they say. Mr. Loy and Mr. Lanier explain in their testimony how removing this donated plant from the asserted rate base by re-characterizing it as contributions-in-aid-of-construction affects DIUC's revenue requirements and its resulting rates.

If the Commission decides not to accept the POAs' proposal to remove DIUC's donated plant from rate base, and the utility is vehemently arguing that you should reject that idea, our experts explain to you why you should, nevertheless, adjust the utility's rate base to reflect actual system usage. ORS first established this idea in the 2005 rate case for this very utility, the idea of a plant utilization adjustment. ORS Witness Sharon

Scott proposed this approach in her direct testimony, which was Exhibit SGS-11 in that docket. It's an exhibit to Mr. Loy's testimony, his direct testimony, for this rehearing. And you need to know that the Commission didn't reject the ORS proposal on applying a plant utilization factor to rate base back then. Back then, the utility was proposing that the Commission set rates based on something called a Complete System Methodology. And Complete System Methodology is an idea that was created by Mr. Guastella. As far as we know, it's never been used before, or since, in any other rate case here in South Carolina. But, nevertheless, she offered this as an alternative. And what Ms. Scott said is, "If the Commission were not looking at this in a complete system but a more traditional approach," which is what we're here today for, "we recommend that you apply these plant utilization adjustments to reflect the fact that, at that time, only about 40 percent of the Haig Point development was actually built out."

Well, Mr. Loy's testimony will show you, and, actually, the testimony of the utility will show you, that there's been little or no – there's been no material growth to this development since 2005.

The evidence shows that. They're still stuck at around 40 percent, or 42 or 44 percent, or maybe 39, depending on whether you're talking about water or sewer. Something in that range is where this development is basically stuck, and has been since 2004. Because it has been stuck since that time, it's unfair to set rates that charge the ratepayers for a return on the entire overbuilt system. If the developer, International Paper, gambled in overbuilding the system initially, instead of designing it in phases, which we've all seen many developers do, the ratepayers should not be burdened with that bad development gamble, and the utility should not benefit from it. Mr. Guastella is, himself, asking the Commission to actually apply the same system utilization factors that Mr. Loy uses to calculate depreciation expense in this case.

[Reference: Attached "S-C.3"]

If you look at the next of the three documents that were handed up to you, this is Schedule S-C.3 from Daufuskie Island Utility Company's current Application. And this is – based on this, you can see, if you look in the "Pro Forma Utilization" – this is for sewer and there's another one for water

– you can see that Mr. Guastella himself applies a 35.47 percent utilization factor to each one of these components of the utility's plant, net plant, which means that he's decreasing something to 35 percent which is, according to him, how much of the sewer system is being used, as a result, in the test year, here, today. Again, 35 percent.

Mr. Loy explains – now, and he is actually – Mr. Guastella is actually proposing this, or I should say the utility is proposing this, to decrease depreciation of the plant. Now, Mr. Loy will explain why – and this is depreciation expense; you can see that. Mr. Loy explains in detail why the utility's use of this approach in isolation, just for depreciation expense, violates NARUC rules on depreciation, causing the utility's plant to be overstated today, which, again, improperly increases the rate base. If you think about it, if the depreciation expense is lowered or, in our opinion, understated, then it means that what's left is a bigger number, and Mr. Loy explains why that violates the NARUC rules. But for the purposes of analyzing what percentage of the plant is properly considered as rate base – in other words, in applying this to the actual value

on the books of the plant – Mr. Loy has taken Mr. Guastella's own system-utilization factors and directly applied them to those same components of the plant. The result reflects a rate base that is calculated on the universally accepted used-and-useful concept, which is correct from a utility ratemaking perspective and avoids burdening the utility's ratepayers with the developer's losing gamble.

So, what's good for the goose, here, is good for the gander. You can't argue that utilization factors should be applied here in a way that hurts the ratepayers, which is what Mr. Guastella has done, and then say that it's not appropriate to also apply that same theory in a way that helps the ratepayers by applying it to the actual value of the plant that they're proposing to include in their rate base.

We sincerely appreciate your attention today and, if it should happen to be, tomorrow morning. And I encourage you to ask our witnesses any questions you may have, during their time on the stand. Thank you.

CHAIRMAN WHITFIELD: Thank you, Mr. Beach.

Office of Regulatory Staff, Mr. Nelson?

MR. NELSON: Mr. Chairman, ORS is going to waive making an opening statement. We would like to reserve the right, at the conclusion of the evidentiary portion of the hearing, to make a closing statement, however.

CHAIRMAN WHITFIELD: So noted, Mr. Nelson.

At this time, if there are no further preliminary matters, I'm going to turn it over to the company to present your case.

MR. GRESSETTE: Thank you, sir. We would begin with a panel of two witnesses: Mr. Guastella and Mr. White.

CHAIRMAN WHITFIELD: Come forward, Mr. Guastella and Mr. White.

[Witnesses affirmed]

THEREUPON came,

J O H N F . G U A S T E L L A ,

G A R Y C . W H I T E ,

called as witnesses on behalf of the Applicant, Daufuskie Island Utility Company, who, having been first duly affirmed, were examined and testified as follows:

MR. GRESSETTE: Commissioners, we will begin with Mr. Guastella's statement, followed by Mr. White's. Mr. Guastella's testimony addresses the majority of what I explained in opening, so he will

begin.

DIRECT EXAMINATION

BY MR. GRESSETTE:

Q Mr. Guastella, for purposes of the record, could you state your name and your business address?

A [GUASTELLA] John F. Guastella, 725 Highway A1A, Jupiter, Florida.

Q And where are you employed, Mr. Guastella?

A [GUASTELLA] At Guastella Associates.

Q And what does Guastella Associates do?

A [GUASTELLA] It's a consulting firm that provides rate management and valuation services, primarily to water and wastewater utilities.

Q And how long have you been in that line of work?

A [GUASTELLA] As a consultant, since 1978. As a regulator, since 1962.

Q And do you have personal knowledge of the operation of Daufuskie Island Utility Company?

A [GUASTELLA] Yes.

Q How do you have personal knowledge of the operation of DIUC?

A [GUASTELLA] Guastella Associates was employed under an agreement to manage the utility at the time the utility was acquired by CK Materials from International Paper.

Q Is Guastella Associates still employed by DIUC?

A [GUASTELLA] Yes. Under a management agreement and also for other consulting services.
Q Did you testify in the original hearing in this case, in 2015?
A [GUASTELLA] Yes.
Q And have you submitted additional prefiled testimony for the rehearing portion of the case?
A [GUASTELLA] I have.
Q And can you identify the components of that prefiled testimony?
A [GUASTELLA] In the rehearing?
Q Yes, sir.
A [GUASTELLA] Yes. My prefiled testimony was designed to establish, again, the cost of providing service, because that's what the utility needs to cover in its revenues. We must cover the cost of providing service and also – in terms of operating costs and a reasonable return on investment – to maintain financial viability and attract capital. Otherwise, we won't be able to provide safe and adequate service to the customers.

So the primary purpose of the rehearing was to, again, establish the cost of providing service and, in particular, addressing the issues that the utility raised in its appeal to the Supreme Court. Those issues included the investment in utility facilities, rate-case

expenses, bad debts, management fees, and property taxes. And I addressed those issues that were presented to the Supreme Court for that rehearing.

Q And does that rehearing testimony include prefiled rehearing testimony, prefiled rebuttal rehearing testimony, and exhibits?

A [GUASTELLA] It does.

Q And have you had an opportunity to review that entire collection of testimony and exhibits?

A [GUASTELLA] I have.

Q Do you wish to make any changes to that prefiled testimony –

A [GUASTELLA] No.

Q – or exhibits?

A [GUASTELLA] No.

MR. GRESSETTE: Mr. Chairman, at this time, I would move that the prefiled testimony of Mr. Guastella, along with his exhibits, be read into the record as if given orally from the stand.

CHAIRMAN WHITFIELD: Mr. Guastella's prefiled direct testimony will be entered into the record as if given orally from the stand, along with exhibits.

MR. GRESSETTE: And that would also include, Mr. Chairman, the rebuttal rehearing testimony, as

well?

CHAIRMAN WHITFIELD: The rebuttal rehearing testimony, as well. All of that, I can make his Hearing Exhibit No. 1, if –

MR. GRESSETTE: That would be fine with Applicant.

CHAIRMAN WHITFIELD: Okay, that's exhibits JFG-R1 through -R4, and JFG-R5 and -6.

[WHEREUPON, Hearing Exhibit No. 1 was marked and received in evidence.]

[See pgs 64-80 ~ Prefiled rehrg. direct]

[See pgs 82-103 ~ Prefiled rehrg. rebuttal]

MR. GRESSETTE: Yes, sir. Thank you, sir.

BY MR. GRESSETTE:

Q Mr. Guastella, you identified five adjustments or areas of concern that you wanted to focus on in your testimony. As you heard me indicate in my opening, our goal is to succinctly summarize the utility's position on those issues and to make sure that you're available, should the Commissioners have any questions. Can you summarize the utility's position as to the adjustment for utility plant-in-service?

A Yes. The utility plant-in-service figure and adjustment in the original case was approximately a million six downward adjustment to utility plant. Of that amount,

approximately $924,000 represents the cost of the storage tank and related well and facilities. There's another portion which has not been addressed in rehearing because it was addressed fully in what I call the primary case, the original case, where I provided testimony as to the reasonableness of those.

In my reading of the Supreme Court's decision, the Supreme Court recognized that the adjustments in the settlement agreement between ORS and the property owners' association had multiple adjustments, all of which were entirely unsupported by evidence presented to the Commission. The Supreme Court addressed three specific adjustments and gave specific adjustments – they did not give specific adjustments or propose specific adjustments to the Commission, but they recognized that the evidence – there was no evidence lacking with respect to all of the multiple adjustments made in the POA/ORS agreement.

I believe the cost of the storage tank and facilities were addressed by ORS, and I do not disagree with making that adjustment to restore to plant that $924,000. I believe that's the number. It's a combination of the cost of the tank and wells. And I believe, also, what should be restored to plant is the balance of the million six.

Q And is the testimony you've previously submitted in the record, in this matter, sufficient to express the company's opinion as to those remaining costs, in addition to the elevated tank and well, that should be included within the utility plant-in-service?
A [GUASTELLA] Yes.
Q The next adjustment that we have discussed is rate-case expenses. Would you mind summarizing for the Commission – or perhaps another way to phrase that would be to begin with, have you reviewed the ORS position as to rate-case expense?
A [GUASTELLA] Yes.
Q And can you describe for the Commission your understanding of ORS's position as to rate-case expenses?
A [GUASTELLA] Yes. The ORS's rate-case expenses include, in the primary case, $75,000 that was a number that ORS proposed in the 2012 rate case, and they added $22,500 for an unamortized balance of rate-case expenses. I do not know, of the $75,000 proposed, which was a figure taken from the previous case, what portion of that is legal and what portion of that is consulting fees.

ORS's testimony in this case adds approximately $177,000 to the $97,500, describing the $177,000 as legal expenses and then the cost of undertaking the

bonds to assure refunds and a letter of credit also to ensure refunds. If we subtract approximately $60,000 from $177,000, that represents the bonding cost and the letter of credit. There's about $110,000 left that ORS describes as legal fees. ORS then excludes all of Guastella Associates' billings since the beginning of preparing the rate filing, through to September where we submitted a schedule with all the bills and the bills. It does not include any costs beyond the September, and I believe, if I'm correct, subject to updating what the actual cost of the billings have been for October and November and until now, and projected to the end, I had projected approximately $120,000 worth of legal and consulting costs to go through the rest of this rehearing process. But, basically, they excluded every bill that I submitted to the utility since the preparation of the rate filing, through September of this year. So no costs for consulting fees.

Q To back up just for a moment, so that the Commission is clear, what was the total rate-case expense sought by the Applicant in this case?

A [GUASTELLA] Originally, we requested $191,000 in our original rate filing, indicating, however, that the actual cost was going to be $380,000. And recognizing that this was a small company, it was Guastella

Associates' recommendation to the owners of the company that, "Let's mitigate the rate impact on the customers, so let's ask for $191,000," which was similar to what we had previously asked for, and for other utilities – another utility in South Carolina that I also testified for. So that was our judgment; instead of asking for the full amount, let's ask for approximately half of what it was actually going to cost.

It turned out that instead of costing $380,000 for the primary case, it cost $450,000 for the primary case. However, now that we've been through the entire process of appeals and rehearing, our costs have increased substantially, because we're basically going through a whole new round of discovery, a whole new testimony, a new review of testimony, and hearings. We estimate that, to complete the case, it's going to be approximately close to $800,000 – $794,000 was the schedule – which includes actual costs through September for legal and consulting, and the costs to – since September 30th, for October, November, and for whatever it's going to be to complete the case now in December. We estimated some costs. And at this point, we're asking for recovery, because, over the years, at my suggestion or recommendation to the owners, whenever there was a shortfall of cash, I would tell the owners,

"You're not going to get dividends, you're not going to get directors' fees, you're going to have to put money into the utility to survive." I have a schedule that shows the effect – and, "I am not going to pay Guastella Associates' management fees until there's enough cash flow to do that." For all the past rate-case expenses, 2012, for which there wasn't enough cash flow to pay Guastella Associates, the customers are not going to pick that up. Any of the retroactive costs are not going to be picked up by the customers; they're going to be picked up by the stockholders, the owners of the utility. Fortunately, I've got the owners convinced that, eventually, this utility's going to be successful and get adequate rate relief. But I can't ask them – and I added it up to about a million dollars' worth of subsidization, in effect, just to keep the customers' service adequate and reasonable. If we had not obtained additional money, delayed payments, we would not have been able to cover power costs and employee costs and regulatory costs and operation and maintenance. The customers would not have had service. So that was the goal, and the owners and I agreed that that was the goal that we had to meet. Priority is serving the customers. Even though it cost, essentially, delaying or not earning any return, ever, for the stockholders, that was

the goal. And then we go through a rate case that has become very, very expensive. So at this point, I made a decision that we're no longer just going to give up any of those costs. We need to cover the costs and this utility needs to function and go forward.

I don't want to stray too much and give too long an answer. I know you're in a hurry. But I do – I would encourage a review of, I believe it's Hearing Exhibit 7 in the primary case, where, after the 2012 rate decision by the Commission, we had to provide the Commission with a capital-improvements report after we obtained financing to show what we did with the financing. And I prepared a very detailed report. I'm not going to go into the details. I really recommend you take a look at the report, because I start off the report by saying I've regulated 450 customers, I've consulted for 600-700 small utilities; I've never seen any single utility have all of the problems that this utility has had. This utility had to survive the CoastalStates Bank foreclosure. We had to survive a loss of 25 percent of revenues from the day that the new owners acquired it from International Paper. We had to survive property tax bills that were retroactive and save – and in doing that, save the customers a bunch of money. We saved a whole bunch of money in constructing a failed lagoon

liner at the system. There have been so many different problems that this small utility has faced, and the biggest problem this small utility has faced is now this rate case. This rate case has gotten way beyond. We were in three years of rate case for a company that has 1100 customers. And they have – I must say, they have me, equivalent to other top consultants that small companies don't usually have. If this utility didn't have somebody to run it and know how the ratemaking was, this utility wouldn't be existing, aside from the fact, if I may throw in, that when Melrose Utility Company abandoned its system, we began to operate it at no charges so that the customers of Melrose, which were not our customers, would continue to have service. So we've done some, what I call, miracles for small utilities. So we're at the point now where we have to go forward now and recover all our costs.

Sorry for the long answer.

Q That's all right. And are the costs that you propose to seek as rate-case expenses actual costs to the utility?

A [GUASTELLA] They are actual costs to the utility. Every utility that has management – and many of them hire me because they need expertise for ratesetting purposes. So I treat it in the management agreement that I was going to do the day-to-day operations, which are

detailed in the management agreement, which, indeed, we performed above and beyond what anything I expected when I entered into the management agreement in 2008. But then rate-case expenses are a different thing; that's not covered by the typical cost of the management agreement.

But all the costs and all of our charges, we keep track of our hours, and each month we set forth the hours, a summary of the work we did, the position of the employee in Guastella Associates who performed the work, and provide invoices that reflect our actual costs and our actual time to undertake this process. Guastella Associates' time represented by that is over 2000 hours for a rate case. I think ORS allows something – if the $75,000 they're allowing is about half the –

MR. NELSON: Mr. Chairman, I don't mean to interrupt, but I think we're going well beyond the prefiled direct testimony in this case, so if Mr. Guastella could just please stick to the prefiled testimony.

CHAIRMAN WHITFIELD: Yes, if you would –

WITNESS GUASTELLA: It includes all our costs and time.

BY MR. GRESSETTE:

Q There are a couple of what I will call minor adjustments

addressed in some ORS testimony about copying costs. They're generally referred to in your prefiled as Adjustments 1, 3, and 4, and also – those are regarding copying and legal costs; and Adjustment 2 for unrelated legal costs. Is the utility all right with those adjustments, as proposed by ORS?

A [GUASTELLA] Yes.

Q Am I correct that those address costs that were awarded by the Supreme Court and had been previously submitted for rate-case expenses?

A [GUASTELLA] Yes, I believe that's what happened.

Q And there were a few entries on some of our law firm's bills that didn't quite belong to the rate case, and so that's the $1470 that was removed?

A [GUASTELLA] Fourteen hundred and seventy dollars [$1470], yes.

Q All right. What period of time does the utility request that it's rate-case expenses be amortized?

A [GUASTELLA] We request an amortization period of five years.

Q Was that the ORS –

A [GUASTELLA] I'm sorry. Three years. Three years. I was just corrected.

Q So Daufuskie requests an amortization period of three years for its rate-case expenses, and can you explain to

the Commission why that is important versus the amount requested by other parties?

A [GUASTELLA] Yes. As I indicated, this case has been going on now for almost three or three and a half years. If we're going to continue, we expect that three years be an adequate period, because the last case was in 2012; we filed this case in 2015, which is a three-year period. We clearly, because of the delay, we have major capital improvements that need to be made, that DHEC is waiting for us to make. So we are going to be – assuming successful in obtaining rate relief that will enable us to attract more capital – needing to make capital improvements, and we're probably going to have to file for another rate increase probably in two years, but certainly no more than three years. So three years is the interval between rate cases that I believe is reasonable.

And then there's another reason: The recovery over three years recovers the actual costs of the rate-case expense, but no carrying costs. So, for example, if you borrow a thousand dollars and you promise to pay the thousand dollars back in three years, without interest, there's a time value of money that's not included in the rate filing. It was my understanding that that's one of the policies of ORS. So, in our primary case, and in

the rehearing, we're not seeking the average unamortized balances in rate base, but certainly it should be recognized that although we're asking for a three-year recovery of the actual costs, there is a time value of money that is not being recovered by the owners of the utility that will eventually pay for the cost.

Q Thank you, sir. Turning now to management fees –

A [GUASTELLA] Yes.

Q – can you summarize the utility's request for management fees and the response by ORS?

A [GUASTELLA] Yes. Management fees are based on a management agreement between the utility, its owners, and Guastella Associates. Back when it was first entered into, it included a flat fee for monthly charges, plus an inflationary increase of 3½ percent per year. And then there are other provisions that did not refer to management services but other types of services, such as rate-case expense.

The level that we sought in the case was approximately $171,000, which represented our estimate of the – I believe it was the 2014, possibly 2015, level of the actual management fees. And we still are asking for that level. We haven't adjusted that level for the two years that have passed, by the time these rates go into effect. ORS included $132,000 instead of 171. I

believe the $132,000 in management fees was the 2011 level, and it's recommended that there be no adjustment beyond the 2011 level to get us to the 2015, and we haven't asked for more for the subsequent years, but those are our actual charges for management services.

Q Do you understand why ORS asserts that the 2011 management fees' amount is all that DIUC should recover now, in 2017?

A [GUASTELLA] Well, it appears that the primary reason is that the management services have not changed since the 2011 number, which ORS recommended in the 2012 rate case. Management fees or any charges would change over time, regardless of changes of services under the management agreement, which are extensive. It turns out that the services provided when we entered into the management agreement never contemplated the circumstances and occurrences that happened since that agreement, and continue to happen since the last rate case. So our services have drastically changed beyond anything expected. So even if there's no consideration that fees don't stay stagnant forever, there are cost-of-living increases built into most charges for most utilities. Our rates change periodically as well – Guastella Associates' billing rates. And that's a flat charge. A flat charge not only includes our employees'

changes in our billing hourly rates, but we maintain offices, equipment, computers, services, a whole range of services provided from everything to keeping books and records, and accounting, and billing, and operation of the utility system. And we are then available to respond to every request of banks, DHEC, and others. So the management fees have increased substantially. So even if there's no recognition that costs increase for inflation over time, certainly it's not accurate to say that our services have not changed since the 2011 level.

Q And do those requested management fees cover the costs you just described, or, better phrased, do the management fees requested include recovery of costs for the technology and other office equipment and things that you just described?

A [GUASTELLA] They do. They include all of our costs.

Q And are those types of expenses greater now than they were in 2011 –

A [GUASTELLA] Yes.

Q – for Daufuskie Island Utility?

A [GUASTELLA] Yes. All of Guastella Associates and the billings to all my other clients have changed over time for changes in hourly rates. It's just typical of how consultants function and move forward from year to year.

Q There is a lot of testimony from the initial hearing

about the elevated tank site and how that came to be subject to question by ORS as plant-in-service, and then there was also some discussion about the condemnation matter that was pending regarding the elevated tank site. How would you characterize ORS's position with regard to those two events and your management?

A [GUASTELLA] Well, I believe ORS's testimony indicates that Guastella Associates should have anticipated the property tax bills, and if it had anticipated property tax bills, then there wouldn't have been the tax sale of the tank site parcel.

The utility receives tax bills for a number of parcels. The total had been about $10,000 a year. When Guastella Associates began managing the utility, we notified Beaufort County of the change of address, where to send the bills, and taxes. So as Beaufort County sends us bills, we pay the bills.

We never got a bill for the tank site, despite sending them notices of where to send the bills. They never posted the notice of the tax sale at the correct property and they never sent the notice of the tax sale to the address that we provided to Beaufort County. So there was a tax sale of the site. Beyond our control.

Q Did the Supreme Court Opinion address either of those issues?

A [GUASTELLA] I believe, in oral argument – and I cited in my testimony, because I went through and I've reviewed that oral argument from their video portal many, many times. I believe it was Justice Ahearn[sic] said, "Well, clearly, it was not the utility's fault that there was a tax sale. They never received the bill," something to that effect. And, indeed, that's correct, and I think the Court recognized that was not the utility's fault. I get the impression from reading ORS witnesses' testimony that they nonetheless fault the utility. So it's just beyond our control. We don't get bills, we don't go looking for more bills than we get.

Q Would you summarize for the Commission the utility's position as to bad debts?

A [GUASTELLA] Yes. I believe that issue was addressed in pretty much detail by the Court and I'm not going to expand on it. Indeed, the Court gave specific direction to include the $108,000 that ORS had recommended in the primary case.

Q So for just purposes of summary, what amount did Daufuskie assert as bad-debt expense in its original Application?

A In our original Application, we requested approximately $30,000, as a conservative estimate. And that was, again, to try to mitigate the rate impact, same as we

tried to mitigate the rate impact by not charging full costs of the rate case that we anticipated.

Q Did ORS propose a different number than $30,000 in the original case, for bad debts?

A [GUASTELLA] Yes.

Q What number did they propose?

A [GUASTELLA] Well, they found that the book number was $105,000, and then ORS proposed $108,000. When ORS proposed the $108,000, I went back and looked at what our actual bad debts were subsequent to the information we had in the test year, and we found that, once again, the bad debts continued to be over $100,000. So having looked at the $100,000 per books, and then subsequent books, $100,000, and then ORS coming out with $108,000, I accepted, of course, that ORS proposal for $108,000.

Q And in executing the settlement agreement, what position did ORS take with respect to bad debts?

A [GUASTELLA] ORS then adjusted its recommendation to reduce the bad debts back to what the utility had filed for, approximately $30,000.

Q And what is your understanding of the Supreme Court's instruction with regard to bad debts?

A [GUASTELLA] Well, not specifically with respect – well, the instruction was to use the $108,000, I believe. But the Supreme Court also said that they recognize that

these remands take time, and over the course of time for remands – and indeed here we are, three years' worth of rate case – there are changing economic circumstances that should be taken into account. The changed economic circumstances, the $108,000 is based on what our revenues were – approximately a million dollars – but now with the rate increase that we're anticipating, the bad debts are going to be somewhere in the $200,000 range, not the $100,000 range. And, indeed, in response to discovery – I believe it was from Intervenors' discovery – we provided all of the bad debts. We updated the bad debts, and we updated the difference between what was billed and collected under the 108 percent increase which was in, subject to refund, and the difference is close to $200,000. So I've updated the bad debts to reflect the approximately $200,000.

Q And is that update on bad debts based on the actual bad debts that have occurred under the higher rates that have been in place for about the last year?

A [GUASTELLA] Yes.

Q So that number is no longer an estimate.

A [GUASTELLA] Well, it's still an estimate because we estimated what the rates are going to be. If the rates are going to change, the proportion of the bad debts in relation to the level of revenues is going to depend on

the results of the rate case, the filing, the results of the rate case.

Q Mr. Guastella, can you briefly summarize the issue in this rehearing, as it relates to depreciation expense and accumulated depreciation?

A [GUASTELLA] Yes. Mr. White is going to get into the details, but basically what we did is we took a look – Mr. White made an analysis of all the plant-in-service and all the depreciation that's been accumulated, and found some adjustments that were needed in relation to ORS's case. And I'll let Mr. White get into the detail.

Q Certainly. Moving on to the position of the Intervenors in this case, before I ask you to generally summarize, I'd like to ask you if you saw the documents that Mr. Beach put up on the projector earlier, during his opening argument.

A [GUASTELLA] I did, yes.

Q Do any of those documents reflect a violation of NARUC rules?

A [GUASTELLA] No.

Q Why is that?

A [GUASTELLA] The NARUC System of Accounts says that, if you have contributions-in-aid-of-construction, it's a reduction to rate base. It doesn't say you have to have contributions-in-aid-of-construction. There's no

requirement that says how you should establish contributions-in-aid-of-construction. So if there aren't any, then NARUC doesn't require that you have some. So there's no violation of NARUC in terms of the actual degree of whether or not Daufuskie Island Utility has contributions-in-aid-of-construction. So there's no violation there of how we reflected the actual cost of the utility and the actual financial structuring of the utility, based on what typically happens with newly formed, developer-related utilities, which I can get into a little bit.

Q Well, if you would, just explain to the Commission the basis of your testimony regarding the accounting for Daufuskie Island Utility Company that is related to what you just described as a newly formed utility company – developer-formed utility company?

A [GUASTELLA] I will try my best to keep it brief. But I've regulated over 400 developer-related utilities and I have consulted for over 600 developer-related utilities. Every single developer-related utility, when they create a new development that does not have utility facilities available, have to construct their own water and wastewater utility facilities to serve that newly formed development.

The utility corporation is a paper corporation.

When you start out, it has no customers, no revenues, no ability to finance. So the developer constructs the utility facilities; it operates the utility at its own cost, because the utility initially has no revenues coming in, and for a number of years not enough revenues to even cover operating expenses, let alone to construct utility facilities. The utility cannot pay for anything, and it's not anticipated that the utility would pay for anything, because the utility was created as an investment by the developer with which to provide utility service. And what typically happens is, at some point in time, years after the development develops at whatever pace the real estate developer develops, then they reach the point where the structuring of the utility is, I'll call it, ripe for establishing. And the way it's established is all of the construction costs and the utility assets that had to be paid for by the developer, because the utility was a paper corporation and no revenues, no ability to finance it, and those facilities are turned over to the utility and they're turned over as an investment by the developer in the form of equity investment in the utility. It doesn't ask the utility to pay for the utility facilities. The utility couldn't then, and it couldn't now.

And the way the utility was financed – every single developer, every newly formed utility, 1000 or more that I've been familiar with and worked for and have helped establish – function in the same way. You see nothing on the utility's books for a period of years. At some point, it becomes time for – there's enough customer growth, there could be enough revenues to function and cover operating expenses, earn a return on investment, but the investment was made by the utility in the form of equity. It was not made in the form of a donation to the utility, and there was no expectation that a utility was going to pay for utility facilities. They couldn't. Never happens that way.

So the whole description that was presented earlier by Mr. Pringle[sic] is not the way utilities are formed and could not be the way utilities are formed, and there is no requirement the developer has to contribute those utility facilities – not in NARUC and not in GAAP and not anyplace else.

This type of forming utilities is exactly what happens, and I might add, if you have a brand-new small utility with a real estate development, and you don't establish the utility assets and the funding of utility assets through equity investment, that utility can't move forward. If all of this was considered

contributed, we never would've gotten a loan from the bank. The loan we now have from the bank would no longer exist, because they'd probably foreclose. We never could have obtained financing to add plant that we needed to the plant, to serve the customers in the future. It would be the end of this utility, and I don't know what happens at that point in time. But I do know that it's not the way to establish just and reasonable rates to maintain financial viability and attract capital.

Q Mr. Guastella, if the Commission were to accept the proposals that the Intervenors assert in this case, as generally described by Mr. Beach and as represented in the testimony, what would happen to the utility?

A [GUASTELLA] Well, as I think I just mentioned – and I will repeat it – there would not be enough cash to cover the existing debt service. Not even a small fraction of the existing debt service. The cash flow to this utility would be negative, to the magnitude of over $4-$500,000 annually. You just don't survive, and you don't continue to provide service to the customer because all the capital improvements that we need to make –

MR. BEACH: I hate to interrupt Mr. Guastella right –

CHAIRMAN WHITFIELD: Mr. Beach?

MR. BEACH: – now, but I'm going to have to object. He's going past the prefiled testimony in this testimony right now.

CHAIRMAN WHITFIELD: Mr. Gressette?

MR. GRESSETTE: I think the prefiled testimony talks about the impact of the Intervenors' position. I can rephrase the question a little bit, if that would be all right.

CHAIRMAN WHITFIELD: Let's rephrase the question, if you would, sir.

BY MR. GRESSETTE:

Q Mr. Guastella, does your prefiled testimony discuss the impact on the ability of the utility to obtain financing if the books were adjusted as proposed by the Intervenors?

A [GUASTELLA] Yes, I believe it does. I don't think I could – I'd have to take it out and review it, to tell you exactly where.

And that was addressing the imputation of contribution, which I think is correct, and there were some other adjustments, as well, that are proposed by the Intervenors, that I haven't yet addressed.

Q Okay, and would you like to explain those to the Commission?

A [GUASTELLA] Yes. I believe the first one was imputed contributions-in-aid-of-construction, whether or not they exist. And if that's not acceptable to the Commission, then try what's called a used-and-useful adjustment. It is not true that the plant was constructed and is not used and useful. The plant was constructed to sell real estate –

MR. BEACH: Mr. Chairman, again, I'm going to ask that –

CHAIRMAN WHITFIELD: Mr. Beach, if you could come to a mic, or maybe turn yours on right there, so we can – so everybody can hear you.

MR. BEACH: [Indicating.] Is that on?

CHAIRMAN WHITFIELD: Yes, sir.

MR. BEACH: Okay. Mr. Chairman, in response to the testimony on this point that was given by Mr. Loy and Mr. Lanier, their direct testimony in this phase of the proceeding, Mr. Guastella filed rebuttal testimony. His rebuttal testimony does not include any of the things that he's talking about right now, and he could have chosen to include those in that testimony if he decided to. But this is not an opportunity for Mr. Guastella to add to his testimony or give additional testimony, because, if it were, then he should have given it

in his rebuttal, which would have given us an opportunity to address it in our surrebuttal. And that's the reason for the ruling we're asking, for that ruling to be recognized. Thank you.

CHAIRMAN WHITFIELD: Mr. Gressette?

MR. GRESSETTE: Thank you, sir. In this unique circumstance, we have the testimony that's being prefiled with regards to this hearing, and then we also have, for purposes of the Commission's review and reliance, the record as it existed previously, which includes all of the prefiled testimony and hearing testimony on this subject. I would think it appropriate for the witness to summarize any of that earlier testimony for the same reason that, if, when we came back before this Commission, the Intervenors were allowed to pursue discovery because they wanted new information to supplement that record, and because all the parties are relying on that record, it seems appropriate just for him to summarize it for the Commission today.

MR. BEACH: Mr. Chairman?

CHAIRMAN WHITFIELD: Yes, sir.

MR. BEACH: In response to that, we fully agree that – even though it would take quite a bit

of time, we do think that the previous testimony is part of the record. The problem is, that testimony does not include what Mr. Guastella is testifying on right now, or getting ready to testify. It is surplusage that he is adding in response to the direct testimony of Mr. Loy and Mr. Lanier in this phase of the proceeding. And it did not – is not in the prior testimony.

MR. GRESSETTE: Mr. Commissioner, I am happy, rather than the witness to summarize, for him to rely on exactly what is in the testimony previously, as to this matter. I disagree with Mr. Beach, but the transcript will reflect what is included.

CHAIRMAN WHITFIELD: If we could move forward with you doing that, that would be appreciated.

Also, during the preliminary matters, I kind of anticipated that someone would move that the transcript of the 2015 hearing be entered into the record. No one did so. Is there a desire to do so now?

MR. GRESSETTE: Yes, Your Honor. So moved by the Applicant.

CHAIRMAN WHITFIELD: And I think that Ms. Wheat acknowledged that she had copies up here, as

well. So we will move that into the record, the transcript of the 2015 hearing, as Hearing Exhibit No. 2.

[WHEREUPON, Hearing Exhibit No. 2 was marked and received in evidence.]

MR. GRESSETTE: Thank you, sir.

CHAIRMAN WHITFIELD: And if you would continue, Mr. Gressette, as you've agreed to – we are going to push on just a few more minutes, and we are going to take a break shortly for lunch, and our court reporter is – you okay to go a little further now?

COURT REPORTER: A little further.

CHAIRMAN WHITFIELD: Okay. We're going to go just a few more minutes, and we'll break for lunch. So if we don't get to Mr. White, we will get him afterwards. So, continue, please, Mr. Gressette.

MR. GRESSETTE: Yes, sir. I believe we can finish with Mr. Guastella in just a moment and then get Mr. White quickly for you.

BY MR. GRESSETTE:

Q With regard to the surrebuttal testimony that you filed for this rehearing, Mr. Guastella, did you address certain matters raised by the witnesses of the Intervenors?

A [GUASTELLA] The rebuttal testimony.
Q Yes, sir. And can you summarize the positions asserted, for the Commission?
A [GUASTELLA] Yes.
Q I have the testimony, if it would help.
A [GUASTELLA] It would help, if you would.

MR. GRESSETTE: If I may, Your Honor?

CHAIRMAN WHITFIELD: Yes.

BY MR. GRESSETTE:

Q [Indicating.]
A [Indicating.] Yes. In my rebuttal testimony, I cover the fact that the 2004 rate case had testimony by a ORS witness that the balance sheet reflected the books and records of the utility. I reflected the fact that the sale of the utility from Haig Point – from – the sale of Haig Point Utility, now Daufuskie Island Utility, purchased by CK Materials from International Paper, included the balance sheets and the cost of plant as part of the Application for the Commission's approval. So the cost of plant and the structuring of the paid-in-capital was part of that exhibit. I include that the 2012 case included no adjustments for contributions, other than what was booked on the utility by ORS. The 2012 financing by SunTrust Bank couldn't have been possible if the utility had no rate base or if the rate

base had the levels of contributions or used-and-useful adjustments proposed by Intervenors. There couldn't have been a financing. And I think there doesn't have to be a statement by SunTrust; I think it's fairly obvious that, if you don't have an investment equal to the –

MR. BEACH: Mr. Chairman.

WITNESS GUASTELLA: – $3,250,000 –

MR. BEACH: I'm sorry. I'm going to have to –

CHAIRMAN WHITFIELD: Mr. Beach?

MR. BEACH: – object again, because Mr. Guastella is again adding to the testimony that he is supposedly summarizing right here. I'm looking at the testimony, as he speaks.

CHAIRMAN WHITFIELD: Mr. Guastella, if you would stick to your testimony, we need to do that.

WITNESS GUASTELLA: Yes, Your Honor.

I specifically show that the SunTrust Bank relied on the balances provided by the company. ORS testimony and exhibits do not agree with the Intervenors' position regarding the testimony in this case. There is no evidence that the purchaser paid other than the market value. The purchases of lots and homes, I indicate there's no evidence that they paid anything but the value of the real

estate, and they got what they paid for. They paid for real estate; they got real estate. They did not pay for contributions-in-aid-of-construction towards utility facilities. And I summarize that in some of the issues that I addressed in rebuttal.

MR. GRESSETTE: [Indicating.]

WITNESS GUASTELLA: [Indicating.] And I – my testimony related to the booked cost of the utility plant-in-service and the booked cost of the equity investment. It did not address whether or not there should be any rate base. There could not be any rate base adjustments; that was not part of my rebuttal testimony.

BY MR. GRESSETTE:

Q Mr. Guastella, with regard to the impact of the previous rate order on the utility, did you prepare any documents that were [indicating] –

A [GUASTELLA] [Indicating.]

Q – submitted with your testimony?

A [GUASTELLA] We did not – I prepared documents, but I don't believe I prepared and submitted the Schedule A.

Q I hand you what is marked as JFG-R2, which is the second exhibit to your prefiled rehearing testimony for this proceeding [indicating].

A [Indicating.]

Q Can you identify that for me, and the Commission?
A [GUASTELLA] This is the impact of the Commission's Order, if they accept ORS's or the POAs' settlement in that previous case.

MR. GRESSETTE: May I use the overhead?

CHAIRMAN WHITFIELD: Yes.

MR. GRESSETTE: I think we're almost done.

CHAIRMAN WHITFIELD: Mr. Gressette, if you – I think if Mr. Woods can cut that mic on for you, if you would stay at that podium near a mic, that would be helpful.

MR. BEACH: What testimony is this an exhibit to, Tom?

MR. GRESSETTE: This is JFG-R2 to the prefiled rehearing testimony of Mr. Guastella. This is also the attachment that was submitted with the Motion for Reconsideration.

[Reference: Guastella Rehearing Exhibit JFG-R2, Attachment A]

BY MR. GRESSETTE:

Q Mr. Guastella, this is a little hard for me, so I'm going to start at the top. Can you –

CHAIRMAN WHITFIELD: Mr. Gressette, if you could make sure that mic is on, or maybe we can get you a Lavaliere or something.

MR. GRESSETTE: I'll make sure I stay close to this one, sir.

BY MR. GRESSETTE:

Q Mr. Guastella, can you explain that document to the Commission?

A [GUASTELLA] Yes. This is a document prepared to see what the impact of the ORS/POA settlement would be, had it been accepted.

Q And can you just generally describe that analysis –

A [GUASTELLA] Yes.

Q – For the Commission?

A [GUASTELLA] Yes. We start with the revenues proposed by the settlement agreement, and then we show the expenses that we anticipate, showing the net income and then the interest expense. And if you move down the page, we then show what the debt service would be, and then what the SunTrust Bank requirements would be. We found that the debt service coverage – and if you look in the box, it's a 1.5; that's a mistake. It should be 1.2 for the coverage. But even if it were 1.2, the result would be a 1.03 coverage, which does not meet the SunTrust requirement. And the EBITDA ratio is much greater than the 6. So, but the two requirements of the SunTrust Bank loan would not be met, would not have been met, with the settlement agreement and the rates that were

allowed in the primary case.

Q If the entries at the top of Attachment A were changed to reflect new numbers that, let's say, the Commission entered pursuant to a decision in this case, would this mathematical analysis be applicable to determining the same thing for those proposed rates?

A [GUASTELLA] Yes.

[PURSUANT TO PREVIOUS INSTRUCTION, THE PREFILED REHEARING DIRECT TESTIMONY OF JOHN F. GUASTELLA FOLLOWS AT PGS 64-80]

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DAUFUSKIE ISLAND UTILITY COMPANY, INC.

DOCKET NO. 2014-346-W/S

Testimony of John F. Guastella

On

REHEARING

Before the South Carolina Public Service Commission

Rehearing Testimony Prepared: October 18, 2017

Rehearing Date: TBD

Q. Please state your name and business address.

A. John F. Guastella, 725 N. Highway A1A, Suite B103, Jupiter, Florida 33477.

Q. Did you submit direct and rebuttal testimony in the primary case?

A. Yes, I provided direct testimony, rebuttal testimony, and exhibits in the primary case. I also testified before the Commission at the hearing on October 28, 2015.

Q. Do you adopt all of your testimony and the exhibits in their entirety in the primary case as if repeated and submitted herewith?

A. Yes.

Q. Have you reviewed South Carolina Supreme Court Opinion No. 27729, reversing and remanding Commission Order No. 2015-846?

A. Yes.

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Q. What is the purpose of your testimony?

A. The purpose of my testimony has not changed from my testimony in the primary case, which is to demonstrate DIUC's cost of providing adequate water and wastewater service. In the original proceeding, DIUC accepted 19 adjustments to its Application in response to the positions asserted by ORS. However, there were five major ORS adjustments that DIUC could not accept because those five adjustments were not based on the evidence and therefore would deny DIUC enough revenue to cover its known, unavoidable operating expense and prevent DIUC from earning a reasonable return on its actual net investment rate base. This rehearing provides the Commission an opportunity to reconsider the ample and reliable evidence of DIUC's reasonable cost of providing service. If the Commission enters an order based upon that evidence and accepts DIUC's position on these five adjustments, the Commission will have established rates for DIUC that provide enough revenue to cover its known, unavoidable operating expenses thereby allowing DIUC to earn a reasonable return on its actual net investment rate base.

Q. Would you briefly summarize the issues DIUC presented to the Supreme Court in its appeal of Order 2015-846?

A. DIUC's appeal of Order 2015-846 addressed the validity of the Commission's acceptance of the ORS-Intervenors Settlement Agreement and the Order's adoption of the five major ORS adjustments. In its appeal, DIUC explained to the

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Supreme Court why DIUC could not accept those five adjustments and demonstrated that the adjustments were not based on the evidence and therefore would deny DIUC the ability to earn a reasonable return on its actual net investment rate base.

Q. Can you identify the five adjustments DIUC discussed in its appeal?

A. Yes. DIUC appealed Order 2015-846's adjustments to utility plant in service, property taxes, bad debts, rate case expenses, and management fees.

Q. What is your understanding of the overall impact of the Supreme Court's reversal and remand of Order 2015-846?

A. The Supreme Court found that the ORS-Intervenors Settlement Agreement should not have been approved by the Commission. The Court found there was no evidence to support Order 2015-846's inclusion of the five major adjustments proposed by ORS then provided what the Court referred to as "guidance to the Commission on remand" regarding three of those five major adjustments. Specifically, the Court addressed utility plant in service as to the elevated storage tank and related facilities, property taxes, and bad debts.

Q. Is there specific language in the Supreme Court's order and other factors that you rely on for that understanding?

A. Yes. Page 8 of the Supreme Court's Opinion states:

> "...the Settlement Agreement did not resolve *any* issues between the parties, but rather was merely an agreement between the POAs and ORS not to object to one another's pre-filed testimony, and to accept ORS's recommendations and adjustments should the Commission adopt them.

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> Furthermore, the Settlement Agreement contained multiple adjustments which were entirely unsupported by the evidence presented to the Commission. Therefore, we hold that Commission erred in approving and adopting the Settlement Agreement and DIUC is entitled to a new hearing in which the parties may present any additional evidence. While we are reversing and remanding for a new hearing as to all issues, in order to provide guidance to the Commission on remand, we address three allegations of error raised by DIUC in this appeal."

Accordingly, in addition to the three specific directions by the Supreme Court regarding the issues of elevated storage tank and related facilities, property taxes, and bad debts, the Supreme Court's Order rejected Order 2015-846's adjustments to management fees, rate case expenses, and the portions of utility plant in service that are not related to the elevated storage tank and related facilities.

Q. What are the issues and/or adjustments will you address in this testimony?

A. As previously stated, I adopt all of my testimony and exhibits in their entirety from the primary case and rely upon the testimony and exhibits of The Hon. Maria Walls, Gary C. White, and Eric Johanson as reflected in the transcript and exhibits of record in this proceeding as if repeated and submitted herewith. With respect to the Supreme Court's specific directions, DIUC's position is that:

1. No further testimony is necessary at this time to support DIUC's position regarding rate base treatment of the elevated storage tank and related facilities. The Application's inclusion of the elevated storage tank and related facilities within utility plant in service is in accord with the Supreme Court's guidance and should be accepted.

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2. No further testimony is necessary at this time to support DIUC's position regarding property taxes. The Application's original request for property taxes is in accord with the Supreme Court's guidance and should be accepted.

3. No further testimony is necessary at this time to support DIUC's position as to the appropriate allowance for bad debts. The amount for bad debts sought by DIUC is based upon the allowance endorsed by the Supreme Court, with consequential recalculation based upon increased overall revenue, and should be accepted.

These adjustments are shown in the "Schedules in Support of Rate Increase Rehearing" submitted in conjunction with the Prefiled Rehearing Testimony of Gary C. White and marked as Exhibit GCW-R1.

Q. Does this complete your summary of DIUC's position as to the three major adjustments upon which the Supreme Court offered specific direction to the Commission on remand?

A. Yes.

Q. Do you intend to offer testimony as to DIUC's position on the remaining issues DIUC raised on appeal regarding Order 2015-846?

A. Yes. I will discuss the costs of utility plant in service that are not related to the elevated storage tank facilities, management fees, and rate case expenses.

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Q. What are your comments regarding the costs of utility plant in service that are not related to the elevated storage tank facilities?

A. The total ORS adjustment to plant in service adopted by Order 2015-846 was $1,624,696, but the components of that total were not specified by ORS or the Order. The largest portion apparently related to the elevated storage tank, which the Supreme Court has now, in agreement with DIUC, ruled should be included in DIUC's plant in service. My incorporated rebuttal testimony in the primary case also addresses the reasons why ORS's other adjustments to utility plant in service did not adequately identify the specific items of utility plant and did not provide any basis as to why the costs were not reasonable. Addressing the ORS adjustment's inclusion of items other than the elevated storage tank and related facilities, I testified in detail in rebuttal explaining why all of the costs, account by account, were reasonable and should be included in rate base. My rebuttal testimony was not refuted and supports DIUC's position as to why the Commission should not accept any downward adjustment as to utility plant in service not related to the elevated storage tank facilities.

Q. What comments do you have regarding the ORS adjustment for management fees?

A. This is another adjustment by ORS that my rebuttal testimony thoroughly demonstrated was unreasonable. My extensive rebuttal testimony and related exhibits demonstrating the reasonableness of the management fees were not refuted, and not even addressed by Order 2015-846. Accordingly, the record

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amply supports DIUC's position as to why the Commission should not accept any downward adjustment to the management fees requested by the Application.

Q. What does DIUC propose regarding rate case expenses?

A. The Supreme Court's decision in this matter states, "Rate cases are heavily dependent upon factors which are subject to change during the pendency of an appeal, thus it serves no purpose to bind parties to evidence presented at the hearing which may no longer be indicative of the current economic realities on remand." In accordance with that ruling, I submit herewith additional evidence related to DIUC's rate case expenses because this evidence adequately reflects the current economic realities facing DIUC. DIUC proposes the Commission incorporate that evidence into its forthcoming order.

Q. Can you begin by summarizing the evidence DIUC presents as to its rate case expenses?

Rate case expenses are a necessary cost of operating any utility, but it is essential to note that the cost of a rate case has significant financial impact on a small utility like DIUC. As I testified in the primary case, the rate case procedures and discovery required of DIUC in this matter were equal to those for a large utility. The parties participated in exhaustive discovery prior to the hearing. DIUC was required to respond to in excess of 150 discovery requests (exclusive of multiple subparts), review the direct testimonies of nine witnesses, prepare rebuttal testimony and surrebuttal testimony, and prepare for the hearing on the

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Application. A larger utility with larger revenue and more staffing would be better equipped to absorb the high costs of extensive discovery and other proceedings, but DIUC cannot. As with the other adjustments, DIUC relies upon and incorporates its previous filings and testimony. At the time of the hearing I estimated that the actual rate case expenses to date were about $380,000. However, DIUC's Application included only $191,200 in an effort to mitigate the impact on ratepayers. ORS responded by proposing an even further adjustment that allowed only $97,500 for rate case expenses. As shown in detail through DIUC's evidence, particularly my unrefuted rebuttal testimony, the rate case expenses incurred were actual, unavoidable, and reasonable in the circumstances.

Q. Did DIUC incur additional rate case expenses after the hearing during which you testified as to the $380,000 expended as of that time?

A. Yes.

Q. Can you explain what happened?

A. Yes. Order 2015-846 allowed a rate increase of approximately 43%. If that ruling was accepted without challenge, DIUC would have had no earnings and would have been in default on its debt – essentially bankrupt.

Q. How would DIUC have been in default?

A. DIUC's loan documents for the SunTrust Bank financing approved by this Commission in Docket No. 2012-397-WS, Order No. 2013-605, include

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covenants that put DIUC in default if it does not maintain a minimum debt service coverage and minimum EBITDA (i.e., Earnings Before Interest, Taxes, Depreciation, and Amortization) ratio. The lack of income allowed by the Order would have put DIUC in default on its $2,500,000 term loan and would have precluded DIUC's ability to repay its $500,000 line of credit. It would have also indefinitely prevented DIUC from attracting additional capital for system improvements that are necessary to meet DHEC requirements. For inclusion in the record, I have attached as Exhibit JFG-1R a copy of the Loan Documents as previously produced to the parties in this case.

Q. What happened next?

A. We had no choice but to file a motion for reconsideration to ask the Commission to correct the Order. That motion was filed on December 21, 2015, and captioned as DIUC's Petition for Reconsideration and/or Rehearing.

Q. Did you prepare any schedules in conjunction with DIUC's Petition for Reconsideration and/or Rehearing?

A. Yes. I prepared a schedule demonstrating the impact of the Commission's Order on DIUC's operations and how SunTrust would test DIUC's booked cost of operations pursuant to the Loan Documents we had previously produced to ORS and the Intervenors. The Schedule was entitled "Impact of Commission's Order Accepting ORS/POA Settlement" and a copy was filed with DIUC's Petition for

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Reconsideration and/or Rehearing as Attachment A. For inclusion in the record, I have attached as Exhibit JFG-2R a copy of the Schedule.

Q. Can you explain what the Schedule (Exhibit JFG-2R) illustrates?

A. Yes. The Schedule shows the $1,536,375 of combined water and sewer revenues allowed by Order 2015-846 then subtracts the actual cost of operations DIUC will incur and book. The operating expenses of $1,355,363 listed in the Schedule are those DIUC included in its Proposed Order because SunTrust uses these actual costs and booked figures to perform its tests of Debt Service Coverage and the EBITDA ratio. In other words, when SunTrust analyzes DIUC's books to determine if DIUC is in compliance with the terms of its loan, SunTrust will review the books DIUC presented to the Commission that reflect the Utility's actual expenses and bad debts. SunTrust does not consider reductions or analysis of adjustments like those asserted by ORS or Intervenors in response to a rate application; instead, SunTrust looks at cash flow to test DIUC's compliance with the terms of the SunTrust loan.

Q. Can you further explain the Schedule (Exhibit JFG-2R) with some specific examples?

A. Yes. DIUC's ongoing property taxes are used by SunTrust at the levels that must be accrued in order for DIUC to make its monthly and annual tax payments. However, the Order included ORS's alternatively calculated property tax expense allowance which was considerably less than the actual known and measurable

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property taxes that DIUC pays. In addition to covering its actual monthly installment payments under the property tax Settlement Agreement with Beaufort County, SunTrust requires DIUC properly accrue amounts sufficient to satisfy S.C. Department of Revenue assessments and Beaufort County property tax rates. These amounts were not allowed by the Order. Also, SunTrust considers DIUC's obligation to pay management fees according to the GA management contract without regard to the reduction that the ORS-Intervenors Settlement Agreement proposed. Management costs, then, are booked in accordance with the agreement and costs actually incurred. Finally, the bad debt expense used by SunTrust is the booked amount.

Q. Does the Schedule (Exhibit JFG-2R) show anything else?

A. Yes. The Schedule shows the cash flow allowed by Order 2015-846 and demonstrates the calculation which will form the basis of SunTrust's decision as to whether DIUC is in compliance with its loans. Specifically, the Schedule shows the following calculation:

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

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Q. Is anything else considered by SunTrust in determining whether DIUC is in compliance with its loan?

A. Yes. SunTrust will include depreciation and debt service. So, using depreciation of $93,089 and deducting debt service from Net Operating Income, the Schedule demonstrates cash flow under Order 2015-846 would be a negative $4,024. This is a disastrous result.

Q. Why is that a disastrous result?

A. Pursuant to the SunTrust loan, DIUC must maintain certain ratios of coverage for debt and EBITDA. These are included on the Schedule and as shown, if DIUC collects only the approved rates under Order 21015-846, then there will be no money for equity return and DIUC will fail SunTrust's tests for debt service coverage and the EBITDA ratio. Accordingly, under the rates approved by the Order, DIUC will be in default on the SunTrust financing, DIUC will not be able to obtain refinancing to pay off its $500,000 line of credit, and it will not be able to attract capital to make further capital improvements necessary to provide adequate service and comply with DHEC requirements. The SunTrust refinancing is essential to the survival of the Utility.

Q. Did the Commission grant the Petition for Reconsideration and/or Rehearing?

A. No. The Petition was denied, so the Utility had no choice but to pursue an appeal.

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Q. What impact did the appeal have on rate case expenses for DIUC?

A. DIUC's appeal of Order 2015-846 added another layer of significant rate case expense, which continues to grow as the current rehearing process proceeds. In order to survive, DIUC had to put appropriate rates in effect pending appeal. This required DIUC to obtain bonds, which first had to be presented to and approved by the Commission. The bonds later had to be renewed and an additional bond obtained. These efforts cost the Utility significant and unavoidable legal and consulting charges in addition to the cost of bonds. At this point, the cost of actual rate case expenses as of September 30, 2017, including projections to complete the rehearing process for legal and consulting services totals $794,201.17, plus the $60,781.56 DIUC incurred for the bonds and an associated letter of credit.

Q. Have you prepared a schedule showing by month the legal and consulting charges, bond costs, and projected future costs from the initial work to prepare and file for the rate increase through anticipated completion of this rehearing process?

A. Yes. Attached hereto as Exhibit JFG-3R is a schedule of monthly charges incurred by DIUC to prepare and pursue this rate case, plus the cost of the bonds. The schedule includes projected future costs to completes the anticipated rehearing process, assuming there are no further appeals.

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Q. What are the rate case expenses DIUC proposes for inclusion in the revenue requirement?

A. DIUC requests that the total rate case expenses for legal and consulting in the amount of $794,210, plus the $60,782 of bond costs, be recovered and amortized over 3 years. This total rate case expense adequately reflects the current economic realities facing DIUC.

Q. Why are you proposing a 3 year amortization period?

A. The Application was filed in June of 2015 and depending on the schedule of the rehearing, final rates will not be billed until January or March of 2018. That is nearly three years after the initial filing. The Commission does not allow unamortized rate case expenses in rate base. Applying a 3 year amortization, on average the recovery of these significant rates case expenses will spread over approximately 5 years. Applying a 5 year amortization would extend the period to 7 years, which is fundamentally unfair to the Utility. Even under a 3 year amortization, which in this instance will actually spread the recovery over a 5 year period, DIUC's owners will have to absorb significant carrying costs, effectively reducing recovery of the full amount of the expense and, therefore, in effect denying the a reasonable opportunity to earn the fully allowed rate of return on equity. The length of this case and appeal combined with the time it will take to recover the expenses indicate a 3 year amortization is the just result.

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Q. Why is DIUC seeking to recover the total amount of the rate case expenses, as opposed to absorbing a portion as previously discussed?

A. First, DIUC's total rate case expenses has reached a magnitude that is far too disproportionate to its revenues. Second, recovery of the expenses will be spread over time by amortization which does not account for the carrying costs or time value of money. It is no longer reasonable to expect DIUC to simply absorb costs of a lengthy proceeding that has mushroomed due to no fault of the Utility. It is also important to note that DIUC's only source of obtaining outside financing, SunTrust Bank, has not been willing to refinance the existing loans and provide needed funds for capital improvements until the final rates are approved in a reasonable amount. SunTrust requires periodic financial statements and has been aware that the Commission's rate order allowing only a 43% rate increase would have placed DIUC in default on the existing loans, and the uncertainty of the outcome of DUIC's appeal of Order 2015-846 has created a risk and hesitation for it to provide financing. In fact, as demonstrated in the email from SunTrrst Vice President Carol Coppola attached hereto as Exhibit JFG-4R, SunTrust will offer no additional credit until this rate case is resolved. As I have testified at length in this matter, DIUC desperately needs additional financing for delayed capital improvements. Finally, not only has there never been a dividend paid to any owner since the inception of the DIUC (formerly Haig Point Utility Company), but the existing owners have had to repeatedly infuse significant amounts of capital into DIUC to pay for operational costs during the appeal and before. In addition, the owners are responsible to pay for accounts payable for consulting

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services that were not paid on a current basis because the priority use of all cash flow has always been to provide adequate service to DIUC's customers. In sum, the Utility's owners cannot reasonably be expected to absorb any further costs and a new rate order reflecting the actual, known rate case is expenses is appropriate.

Q. Have you directed Mr. Gary White to prepare the same format of schedules as was filed with DIUC's original Application containing the positions you explain above?

A. Yes, at my direction and supervision, Mr. White has prepared an exhibit entitled "Schedules in Support of Rate Increase Rehearing." I would note that in my rebuttal testimony in the primary case, DIUC accepted 19 adjustments made by ORS. These schedules reflect those adjustments as well as the positions I have discussed herein regarding the Supreme Court's findings.

Q. What is the result of your analysis as reflected in this exhibit?

A. Taking into account the Supreme Court's decision and reflecting current economic realities following remand as the Utility awaits rehearing, the revenue requirement is $2,423,049, which is a 125.7% increase over the rates authorized pursuant to the last petition for rate adjustment.

Q. How does that compare to the amount originally sought by the Application in this case?

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A. The Application included a revenue requirement of $2,267,721, which is a 108.9% increase over the rates authorized pursuant to the last petition for rate adjustment. The current economic realities facing DIUC indicate a revenue requirement $155,328 greater than the amount included in the Application ($2,423,048 less the originally proposed revenue requirement of $2,267,721).

Q. How does DIUC propose to address that difference?

A. Rather than include the total rate case expenses for legal and consulting in the amount of $794,210, plus the $60,782 of bond costs, DIUC requests the Commission enter an order granting the Application's originally proposed revenue requirement of $2,267,721, resulting in a 108.9% increase, and deferring the $155,328 difference for future rate recognition.

Q. Does this complete your testimony at this time?

A. Yes.

[PURSUANT TO PREVIOUS INSTRUCTION, THE
PREFILED REHEARING REBUTTAL TESTIMONY
OF JOHN F. GUASTELLA FOLLOWS AT PGS 82-103]

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DAUFUSKIE ISLAND UTILITY COMPANY, INC.

DOCKET NO. 2014-346-W/S

Rehearing Rebuttal Testimony of John F. Guastella

Before the South Carolina Public Service Commission

Testimony Prepared: November 29, 2017

Hearing Date: December 6, 2017

Q. Please state your name and business address.

A. John F. Guastella, 725 N. Highway A1A, Suite B103, Jupiter, Florida 33477.

Q. Did you previously submit direct and rebuttal testimony in the "primary" proceeding in this case?

A. Yes. I provided direct testimony, rebuttal testimony, and exhibits in the primary case. I also testified before the Commission at the hearing on October 28, 2015. I have more recently provided prefiled testimony for consideration of the current proceeding following.

Q. Have you reviewed the direct testimonies on rehearing submitted on behalf of the Office of Regulatory Staff ("ORS"), and the Haig Point Club and Community Association, Inc., Melrose Property Owner's Association, Inc., and Bloody Point Property Owner's Association ("Intervenors")?

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A. Yes. I reviewed the testimonies of ORS's witnesses Dawn M. Hipp, Daniel F. Sullivan, and Dr. Douglas H. Carlisle as well as Intervenors' witnesses Lynn M. Lanier and Charles Loy.

Q. What is the focus of your rebuttal testimony?

A. My direct testimony in the primary phase and now more recently in the rehearing phase of this rate case provide evidence of DIUC's costs of providing service and the rates necessary to recoup those costs. This rebuttal testimony focusses on whether the adjustments proposed by ORS's and Intervenors' witnesses are supported by evidence demonstrating the actual cost of providing service, discusses whether the adjustments are based upon recognized rate setting principles and methodology, and addresses whether ORS's and Intervenors' testimony and exhibits are consistent with South Carolina Supreme Court Opinion No. 27729, reversing and remanding Commission Order No. 2015-846.

Q. How have you organized our testimony?

A. I will first address the positions of ORS then I will address those of the Intervenors.

Q. Are there any adjustments proposed by ORS that you would accept for rate setting purposes in the context of this rehearing?

A. Yes, the ORS's adjustment to include the cost of the elevated storage tank and related facilities and property taxes, as directed by the Supreme Court, are appropriate.

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Q. What are the adjustments by ORS with which you disagree?

A. I disagree with the following ORS adjustments:

1. Elimination of various costs in utility plant accounts that are not related to the elevated storage tank and facilities.
2. Rate case expenses.
3. Management fees.
4. Bad Debts.
5. Depreciation Expense and Accumulated Depreciation, which will be addressed by Gary White in his rebuttal testimony.

Q. Will you be referring to and relying upon other testimony in support of your positions?

A. Yes. Throughout this rebuttal testimony I will refer to the testimony I have previously provided so as to avoid the need to repeat the same. I understand that the other parties have agreed this is acceptable and that they will proceed in a like manner. I would also note that in testimony I provided earlier in this rehearing phase I adopted all my previous testimony for the Commission's consideration as if it had been restated for rehearing.

Q. Would you explain the reasons why you disagree with ORS's proposed adjustments to eliminate various costs in utility plant accounts that are not related to the elevated storage tank and facilities?

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A. These are the same adjustment ORS proposed in its primary case. I addressed the proposed adjustments in my first rebuttal testimony and, therefore, I will not repeat the same here. I would also note that these adjustments were included in the Settlement Agreement between ORS and the Intervenors, which the Supreme Court rejected.

Q. Have you reviewed ORS's position as to rate case expenses?

A. Yes. I reviewed the testimony and exhibits of ORS witnesses Hipp and Sullivan and studied the ORS discovery responses and other documents provided by ORS. DIUC seeks total rate case expenses of $794,210 ($674,210 actually incurred through September 2017, plus $120,000 projected to complete the rehearing phase) to be amortized over three years. ORS proposes DIUC only be allowed to recover $275,382 to be amortized over 5 years.

Q. What is included in the $275,382 that ORS proposes for DIUC's rate case expenses?

A. Mr. Sullivan's testimony, Adjustment 6(a) on page 9, indicates that the $275,382 includes $97,500 as taken from Audit Exhibit ICG-4 provided by ORS witness Ivana Gearheart in the primary case. He next includes $177,882 for additional legal costs, bond premiums, and letter of credit fees associated with the appeal. The ORS allowance, then, is $97,500 + $177,882 equaling the total ORS proposed allowance $275,882.

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Q. Ms. Hipp proposed certain adjustments to address the fees and copying costs that the Supreme Court awarded DIUC after DIUC filed its rehearing testimony. Are those adjustments acceptable to DIUC?

A. DIUC can accept Adjustments 1, 2, 3, and 4 as discussed on pages 5 and 6 of Ms. Hipp's testimony. Adjustments 1, 3, and 4 address the copying costs and legal fees awarded to DIUC by the Supreme Court and remove them from rate case expenses. Adjustment 2 removes $1,470 of unrelated legal costs. However, DIUC cannot accept ORS's proposed total rate case costs of $275,882 because that amount fails to include any allowance for rate case expenses incurred after September 30, 2017. DIUC has estimated those costs at $120,000. That $275,882 amount also improperly excludes other rate case expense.

Q. What is DIUC's position with regard to the other rate case expenses excluded by ORS?

A. Guastella Associates LLC ("GA") provides management, valuation and rate consulting services to water and wastewater utilities around the country, and is the contract manager of DIUC. Beyond the small percentage of GA fees included in the $97,500 of rate case expenses proposed by ORS from the beginning of this case, ORS has allowed no recovery for the cost of Guastella Associates' work over the past two years on this rate case. Those costs as sought herein total $542,978 and are made up of GA's monthly charges all the way back to when GA undertook the very first preparations of the rate application. The excluded amount refuses any recovery by DIUC for payment to GA for its work to complete discovery, try the

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rate case, then file an appeal and work to get this matter back before the Commission for rehearing.

Q. Do you have any information about ORS's position on why GA should not be paid these amounts?

A. Yes. Ms. Hipp's testimony provides only four bullet points that the witness asserts "in general" describe the GA invoices demonstrating its costs:

- **ORS bullet point "Contain mathematical errors."** That is all it says – "contain mathematical errors." Ms. Hipp does not identify any specific bill(s) that contain a mathematical error.
- **ORS bullet point "Do not contain sufficient detail to describe the work performed, the specific dates and hours worked, employee name, and business purpose."** GA has worked for about 600 different utilities over the 55 years of Mr. Guastella's work in the industry. Throughout that time GA's monthly billing descriptions have been the same; these descriptions have been used for DIUC as well as all other GA clients and no regulatory agency has ever raised any question about the amount of detail included in the invoices. Having provided these invoices to over two dozen regulatory agencies in the hundreds of rate cases in which GA has provided consulting services, I was shocked to see this testimony by Ms. Hipp. GA's invoices provide (and always have) a summary description of the specific work performed, the hours worked by the title of the individual performing the work and the hourly rates and amounts for each, along with the total amount

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of the bill. These invoices are routinely provided to and accepted by regulatory agencies.

For example, in response to discovery in the primary case, copies of GA's billings were provided to ORS, and ORS did not express any concern about their format or the information provided. ORS never asserted any complaint or criticism about the content of the invoices. After DIUC provided copies of GA bills to ORS via discovery in this rehearing phase, there was no follow up request for more detail or any concern raised about the need for more detail. Instead, without any notice ORS suddenly declared GA's invoicing insufficient.

There has never been a reason for GA to think the detail of its bills was a problem, not for previous billings to DIUC and not for previous billings for similar rate case work GA provided to Kiawah Island Utility as recently as the 2011 rate application by Kiawah Island Utility. In that case GA's bills were in the exact same format as these invoices for DIUC, and no issue was raised by ORS in that case.

- **ORS bullet point "Contain expenses such as air fare, lodging, and meals for which no detail or receipt was provided."** Once again, GA bills to DIUC are in the same format as those for all other GA clients. The travel expenses are typically detailed by date(s) of travel, whether for air fare, ground transportation, and room and board. I cannot remember a client who has ever demanded our travel invoices. Any time we travel for clients, they know the reason for the travel; in fact, we rarely travel except

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for hearings or major case events. And again, ORS has never before asked for GA travel documents in addition to invoices for billings to DIUC or to Kiawah Island Utility when GA performed rate consulting services for that utility.

It is also important to note that there are only a couple of GA bills that reflect travel expenses totaling some $5,634, including the $4,532 for the cost of three GA employees to appear in Columbia for the rate hearing. Knowing the date of the hearing and the GA personnel in attendance, it seems logical that ORS professionals could evaluate the reasonableness of those travel expenses as reflected on the invoices billed to DIUC. As previously noted, ORS has required DIUC to supply many, many discovery responses. ORS could have simply requested additional information, rather than waiting to surprise DIUC with this "gotcha" position at rehearing.

- **ORS bullet "Do not appear to be paid by DIUC."** Ever since 2008 when DIUC was acquired from Haig Point, Inc. there have been repeated occurrences that created major cash flow shortages in response to which the owners and GA have made it a priority to use available cash to provide service to the customers, with charges by GA accrued instead of being paid on a current basis. Delayed payments that create accounts payable do not mean that costs are not incurred and/or the costs are not allowable for rate setting purposes.

In summary, until this rehearing ORS has not complained about GA bills either. As previously discussed the $97,500 was found to be unsupported by the

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Supreme Court, but assuming that some portion of that amount represents legal fees and another portion GA charges, ORS's current recommended allowance for GA charges is only a small portion of the $97,500. By eliminating all $542,978 of GA billings, ORS essentially would have the Commission believe that DIUC should not recover through the rates any charges for the work GA performed.

Q. Can you summarize the work performed by GA in conjunction with this rate case?

A. Yes, I will provide an enumerated list of GA's work for DIUC's rate case:

1. Preparing the original rate analysis and rate application.
2. Responding to over 150 discovery requests with multiple parts and the need to research and prepare voluminous responses.
3. Assisting in preparing discovery to ORS and to Intervenors to attempt to identify data and information relevant to the rate case issues.
4. Examining the testimony and exhibits of ORS and Intervenors witnesses, and prepare rebuttal testimony and exhibits.
5. Review the ORS/POA Settlement and participate in the rate hearing.
6. Assist in the preparation of a proposed Commission rate order and reply to ORS's and Intervenors' proposed rate order.
7. Review the Commission's rate decision and order.
8. Assist in preparing a request to the Commission for reconsideration.
9. Assist in preparing the appeal to the Supreme Court.

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10. Work with SunTrust Bank to negotiate refinancing the defaulted line of credit, preparing financial projections to assure SunTrust of DIUC success in the appeal.
11. Preparing financial statements and working with agents to obtain a bond.
12. Assist in preparing for oral argument.
13. Preparing statements for possible settlement in an attempt to avoid a costly rehearing process.
14. Prepare direct rehearing testimony and exhibits.
15. Review and prepare responses to discovery by ORS and Intervenors.
16. Review and prepare discovery of ORS and Intervenors witnesses.
17. Prepare rebuttal testimony and exhibits.
18. For all of the above, prepare and review correspondence and participate in calls with attorneys and DIUC president and owners, SunTrust officers and bond representatives.

The above work represents over 2,000 hours of GA time, not counting October, November, and December 2017 billings. I estimate that about one-third of GA work and charges to DIUC are subsequent to the Commission's original rate order. DIUC did not want to incur these costs but it had no choice because the ORS/POA Settlement Agreement was not based on DIUC's known and actual costs of providing service.

Now, after forcing DIUC through a costly appeal, ORS seeks to deny DIUC the ability to cover its debt to GA for its work. ORS does not claim the work was not performed or needed. ORS does not claim GA is unqualified. Instead, ORS

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for the first time asserts that "in general" it finds the invoices lacking. DIUC sought the GA work and benefitted from it by surviving and succeeding in its appeal. The services were rendered effectively to DIUC and remittance is due.

Q. Do you agree with ORS's use of a 5 year amortization of the rate case expenses, instead of the 3 years proposed by DIUC?

A. No. Using a five-year amortization ignores the history of DIUC's rates. DIUC's last rate case was decided in July of 2012, three years before this rate application was submitted in June of 2015. DIUC will certainly need another rate filing within 3 years, or more likely two years, in order to cover the costs associated with utility plant additions that have been delayed because of an inability to obtain financing from SunTrust until this rate case is finally decided. Moreover, because the Commission has not allowed the average unamortized balances of rate case expenses in rate base, the carrying costs associated with the time value of money are not recoverable through the rates. An appropriate rate increase should have become effective in January of 2016, but the ORS-Intervenors' Settlement Agreement followed by appeal of the Commission Order 2015-846 delayed a final decision and rate increase to January 2018 at the earliest, assuming there is no need for another appeal. If DIUC is forced to apply a 5 year amortization of rate case expenses, the actual rate case expenses would not be fully recovered until January of 2023, which is 7 years after what would have been the effective date for new rates had the rate decision in 2015 been based on evidence and reflected DIUC's cost of providing service.

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Q. What other issues are implicated by the 5 year amortization of rate case expenses as asserted by ORS?

A. It will be a significant cost burden for the owners to incur a carrying cost of about $126,820 under a 3 year amortization period of DIUC's estimated $800,000 total rate case expenses, at a cost rate equal to an equity allowance of 9.29%. The approximate $800,000 represents the total actual rate case cost to be incurred by DIUC. If ORS's proposed allowance of $275,382 and 5 year amortization were to be accepted by the Commission, the unrecovered cost to DIUC would actually be about $1.1 million (about $500,000 of direct costs and $600,000 of carrying costs).

Q. Would that carrying cost impact the owner(s) of DIUC?

A. Yes. There has never been a dividend paid to DIUC's (and formerly Haig Point Utility Company's) owners since the creation of the utility in 1985, and charges by GA for management and other consulting services have been significantly delayed over the years because the priority has continuously been to first use available cash to provide service to the customers. The policies of retroactive rate making prevent customers from being responsible for past operating deficits as well as for delayed consulting charges which will be absorbed by the owners. DIUC's response to ORS's discovery request "ORS 1-2 Stockholder Infusion," attached as Exhibit JFG-R5, is a list of cash infusions by individual owners, direct payments by owners to vendors, open accounts payable to owners and open accounts payable to manager, the total of which is $1,128,267 representing use of cash to serve the customers when revenues from operations were insufficient.

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Q. Do you have any further comments on the ORS position to exclude GA's charges of $542,978 from rate case expenses and the lack of any allowance for rate case expenses incurred after September 30, 2017?

A. Yes. As stated in my rebuttal testimony in the primary case, the rate proceeding for this very small utility was as extensive --and possibly more extensive-- than cases for large utilities. Much of that was driven by the discovery requests made by ORS. After ruling in December 2015, it was then necessary that DIUC, for its very survival, undertake what turned out to be a successful but very costly appeal and now rehearing proceeding. ORS's proposed rate case expense allowance that eliminates virtually all of GA's charges ($542,978), including the entire amount being incurred to correct a Settlement Agreement entirely rejected by the Supreme Court, is beyond any reasonable regulatory standard of fairness and proper rate setting principles. Additionally, ORS's position against permitting recovery of any post-September 30, 2017, rate case costs is troubling. ORS is fully aware that following a full hearing another appeal is likely in this case. ORS is also aware that DIUC will incur more rate case costs; permitting ORS's attempt to deny DIUC the ability to recovery the costs necessary to complete this case arguably has an impact on DIUC's available litigation choices and that is unfair.

Q. Turning to ORS's proposal regarding GA's management fees, do you agree with Ms. Hipp's analysis and recommendation?

A. No. Ms. Hipp recommends DIUC only recover management fees of $132,211, which is the same amount ORS proposed in Docket No. 2011-229-WS, 6 years ago.

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Ms. Hipp takes the same position as taken by ORS witness Gearheart in the primary case, specifically that GA's services to DIUC did not increase in years following the 2011 rate filing. Quite simply, there is no evidence to support ORS's position. Not only did DIUC rebut that position in the primary case and in DIUC's appeal to the Supreme Court, the Supreme Court found that ORS's adjustments were entirely unsupported by any evidence it presented to the Commission.

Q. Does Ms. Hipp provide any other purported support the ORS adjustment to the management fees?

A. Ms. Hipp does further discuss the topic, but the additional reasons are either erroneous, contrary to the record, or without clear meaning.

Q. Please explain.

A. Let's take Ms. Hipp's statements one at a time.

Q. Please begin with the issue of "checks and balances," as Ms. Hipp construes them.

A. Certainly. Ms. Hipp first argues that the GA Management Agreement (Rehearing Exhibit DMH-4) lacks sufficient checks and balances to protect DIUC, its parent company, and its rate payers. That is simply not true. The GA Management Agreement has a specific provision, ARTICLE V. TERMINATION, under which the Clients may terminate the agreement. There is no greater check available to the

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Utility – it can terminate GA pursuant to the plain language of the GA Management Agreement.

Q. What other reason does Ms. Hipp offer for denying management fees pursuant to the GA Management Agreement with DIUC?

A. Ms. Hipp also circles back to try to revive the ORS position that GA is somehow responsible for the sale of the Elevated Tank Site and the failure of Beaufort County to asses utility property taxes. In doing so, ORS not only completely ignores my rebuttal testimony and evidence in the primary case in which I explained the details of how tax bills and notices were sent to the wrong address and sale was posted at the wrong site, she also ignores the discussion between ORS counsel Shannon Bowyer Hudson and Justice Kaye G. Hearn at oral argument on December 14, 2016, wherein Justice Hearn stated with respect to these issues,

> "How could it be right, though, with respect to the tax issues on the elevated water tank? I mean Maria Walls' testimony was very unequivocal that that was not conveyed, plus it was not the utility's fault that the property tax notice was sent to the wrong address."

Clearly, the Supreme Court read and understood the record and issues. ORS's position will not be tenable on appeal.

Q. What else does ORS assert as grounds for denying management fees pursuant to the GA Management Agreement with DIUC?

A. Ms. Hipp provides Rehearing Exhibit DMH-5 which attempts to compare DIUC's management fees per customer with the management fees per customer of Harbor Island Utility ("HIU") and Kiawah Island Utility ("KIU"). Before explaining why

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those comparisons are meaningless, it should be noted that those other utilities are not comparable just because they both provide water and wastewater service and are regulated by this Commission. HIU only has about one-tenth of the cost of DIUC's utility assets, it has no wells, no water treatment plant, and it is accessible by roadway-bridge. KIU has no source wells, no treatment plant, and only one wastewater plant, compared to DIUC's operation of 7 wells outfitted with water treatment and pumping as well as ongoing operation by DIUC of two wastewater treatment plants. KIU has about ten times more customers than DIUC over which to spread costs. Most importantly with regard to Rehearing Exhibit DMH-5, KIU's management fees are not just the $365,095 shown in Rehearing Exhibit DMH-5. That $365,095 amount is the amount affiliated corporations allocate to KIU, but day-to-day management of KIU is also provided by its direct, full-time employees. Those employee costs are not included in the amount Ms. Hipp is attempting to compare.

Relying on Exhibit DMH-5, Ms. Hipp testifies that the cost per customer per month is about $30 for management services for DIUC and about $7 per month for KIU, implying, of course, that the difference has some meaning. Even if the Commission were to ignore the fact that the $365,095 amount is significantly understated and the fact that KIU has about 10 times more customers over which to spread costs, Rehearing Exhibit DMH-5 shows that using ORS's 5 year old $132,211 proposed allowance, the cost per customer per month is about $25. The $5 difference between ORS's position at $25 and DIUC's at $30 is hardly a meaningful difference when all factors are considered. However, ORS makes no

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attempt to analyze the management services that GA has provided and ORS fails to consider the challenges GA has successfully met, as compared to any encountered by KIU or HIU. Ms. Hipp does not analyze or even discuss any of GA's accomplishments, nor did Ms. Gearheart. For just two examples, GA negotiated utility property tax savings of about $450,000 by negotiating with Beaufort County to rescind the 2010 and 2011 taxes and negotiated an instalment agree to pay 2012, 2013 2014 and 2015 property taxes over an 8 year period, without interest. GA also found a way to dispose of excavated soil under the failed lagoon liner at the wastewater treatment plant by constructing a helipad, saving an estimated $400,000 in capital costs, not counting the savings to the Island residents if the fire department would have had to construct the helipad itself. If we take the $450,000 of property tax saving and say roughly $60,000 in revenue requirement for the $400,000 of capital cost savings, spread that amount over 3 years ($170,000), calculate the monthly savings ($14,167) and divide by 462 customers, the savings is about $30 per month per customer. So, GA's management success for just these 2 items more than saved each customer the $5 per month difference per customer between ORS's proposed allowance and GA's requested management fees.

Q. Do you have any other comments regarding Ms. Hipp's criticism of GA's management fees?

A. Yes. I do not believe ORS has engaged in a fair analysis of the management fees issue. DIUC's direct and rebuttal testimony and exhibits in the primary case included a long list of the challenges met by GA management and significant

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accomplishments, particularly, Hearing Exhibit 7. ORS never even mentioned them in the primary case and not even in this rehearing. Instead, ORS witness Hipp now criticizes GA by stating that GA's management does not reflect the goals set by DIUC, which include "...operate the Company efficiently and manage its assets in order to minimize the rates charged to customers...." In addition to being wrong about stating that GA's failure was the cause of the sale of the Elevated Tank Site, Ms. Hipp nor anyone else testifying on behalf of ORS even mentions the following accomplishments and the resulting significant benefits to the customers provided by GA:

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

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

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

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

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

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

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

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

- Because cash flow is always first used to operate the water and sewer systems, **the owners of DIUC have never been paid a dividend** and **GA is owed thousands of dollars in accrued payments**. Mr. Guastella explained that the past due accounts payable to GA will eventually be paid by the owners and not the customers.

With regard to quality of GA's services, the record establishes GA's high level of performance and the increasing tasks and projects GA has mantled for DIUC year after year.

Q. Can you explain how GA has helped with the financial stability of DIUC in the past several years?

A. Yes. In addition, as previously stated, GA saved the customers some $450,000 related to property taxes and capital costs of $400,000 related to the disposal of earth at the helipad. It is important that the Commission realize ORS never refers to the infusion of cash and absorption of costs directly and indirectly by the owners and GA, which totals over $1.1 million and which was directed through GA's management. See Exhibit JFG-R5. Also, importantly, these amounts do not include the fact that no dividend has ever been paid; no equity return has been taken so that

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service to the customers would always be assured. It has been GA's management that has assured continued adequate service to DIUC's customers and has accomplished major cost savings. GA and the owners of DIUC that have acted at all times in the best interests of the customers.

Q. Do you disagree with the ORS position that the difference between the original application for a 108.9% rate increase and the updated revenue requirement should not be deferred?

A. Yes. The updated revenue requirement that exceeds the original 108.9% rate increase reflects costs that result from the time for the appeal and remand process, which the Supreme Court opined should be recognized. There is also a question of whether notice requirements would prevent the higher rate increase from being implemented without further notice and delay. Accordingly, such a deferral would make DIUC whole in terms of cost recovery and also delay a portion of the rate increase to the customers at this time.

Q. With respect to the testimonies of Intervenors' witnesses Charles Loy and Lynn M. Lanier, do these witnesses assert, as they did in the initial proceeding, that DIUC must impute CIAC in calculating rate base or, as an alternative, adjust utility plant as not used and useful?

A. Yes, both arguments are based on essentially the same inappropriate reasons as in their testimony in the primary case.

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Q. Have you previously addressed these issues in your rebuttal testimony in the primary case?

A. Yes. DIUC also addresses these issues in DIUC's Responses to Interrogatories of HPCCA, MPOA, and BPPOA dated October 27, 2017. A copy of the Responses is attached hereto as Exhibit JFG-R6 and incorporated into my testimony as if restates herein. These Responses also include information that supports DIUC's position as to bad debts. I would like the Commission to know I rely on the Responses for that issue as well.

Q. Do you have any other comments at this time regarding the issues raised by Messrs. Loy and Lanier?

A. Yes, the following is a quick summary of conclusive facts that are relevant to the Commission's understanding of why it should reject the Intervenors' request that DIUC impute CIAC in calculating rate base or, as an alternative, adjust utility plant as not used and useful. The facts are:

- In the 2004 rate case ORS established that the balance sheets accurately reflected the books and records.
- The Commission-approved application for the purchase of HPUC by CK Materials, included the balance sheet and cost of utility plant, and the approval was agreed to in a settlement signed by Attorney John F. Beach on behalf of the Intervenor, Haig Point Club and Community Association, Inc.

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- The 2011 DIUC rate application and related settlement did not include adjustments for additional CIAC.
- The Commission-approved 2012 financing with SunTrust Bank relied on the balance sheets as previously presented to the Commission.
- ORS's testimony and exhibits in this case do not agree with the Intervenors' position regarding the imputation of CIAC or adjustments to utility plant for non-used and useful assets.
- There is no evidence that the lot purchasers paid for anything other than the value of the real estate, and other than minor tap in fees no connection fees to fund utility plant assets.

Q. Do you have any other comments regarding Intervenors' witnesses?

A. Yes, I want to make two clarifying points for the benefit of the Commission. First, I want to reiterate that the debt service coverage under the SunTrust loan agreement is 1.2 times debt service, a test that could not be met with the original rate approval be the Commission. Second, the comparisons shown on Exhibit LNLR-7 are not valid because they do not make the necessary adjustments for the significant differences between an investor-owned utility such as DIUC and municipal utilities; as such, they are not relevant to the Commission's analysis in this case.

Q. Does that conclude your testimony at this time?

A. Yes.

MR. GRESSETTE: Mr. Chairman, that's all I have for this witness. I'm happy to proceed with Mr. White, or I'm happy to pause here. Whatever you prefer.

CHAIRMAN WHITFIELD: I think at this time we're going to break for lunch. And when we come back, I'm going to turn it over to Mr. Butler for a brief announcement before Mr. White gets started.

So we'll break now for lunch, and we'll come back at 1:15. I'd remind the parties that we do have a Commission Meeting today. We will have to stop for that at 2, or a little before 2. And we do have two Rule to Show Cause hearings after that.

So we'll see you back at 1:15.

[WHEREUPON, the witness stood aside.]

[WHEREUPON, a lunch recess was taken from 12:10 to 1:23 p.m.]

CHAIRMAN WHITFIELD: Please be seated. I'll call this hearing back to order.

THEREUPON came,

J O H N F . G U A S T E L L A ,

G A R Y C . W H I T E ,

recalled as witnesses on behalf of the Applicant, Daufuskie Island Utility Company, who, having been previously duly affirmed, were examined and testified further as follows:

CHAIRMAN WHITFIELD: And I had said I was going to have Mr. Butler ask Mr. White[sic] some things, but I believe that's been resolved.

MR. BUTLER: It's been resolved.

CHAIRMAN WHITFIELD: And I believe you were through with Mr. Guastella?

MR. GRESSETTE: Yes.

CHAIRMAN WHITFIELD: So, I will – I'm sorry, Mr. Gressette, do you have something else?

MR. GRESSETTE: I just have one more housekeeping matter with Mr. Guastella. With regard to his supplemental rehearing testimony, I just want to make sure we get it into the record, if that's all right, Commissioner.

CHAIRMAN WHITFIELD: Okay.

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CONTINUING DIRECT EXAMINATION

BY MR. GRESSETTE:

Q Mr. Guastella, just briefly, I want to take care of a housekeeping matter, if I could, with you. In addition to the testimony you referenced earlier that you prefiled in this case, did you also prepare supplemental rehearing testimony dated October 20th and revised October 26, 2017?

A [GUASTELLA] Yes.

Q Do you have any changes to make to that testimony?

A [GUASTELLA] No.

MR. GRESSETTE: At this time I would move the supplemental rehearing testimony prepared October 20th and revised October 26th into the record.

CHAIRMAN WHITFIELD: All right. Mr. Guastella's supplemental rehearing testimony, revised October 26th – I believe you said?

MR. GRESSETTE: Yes, sir.

CHAIRMAN WHITFIELD: – will be entered into the record as if given orally from the stand.

MR. GRESSETTE: Thank you, sir. I appreciate that.

[WHEREUPON, THE PREFILED REVISED REHEARING SUPPLEMENTAL TESTIMONY OF JOHN F. GUASTELLA FOLLOWS AT PGS 107-110]

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DAUFUSKIE ISLAND UTILITY COMPANY, INC.

DOCKET NO. 2014-346-W/S

Testimony of John F. Guastella

On

REHEARING

Before the South Carolina Public Service Commission

Supplemental Rehearing Testimony Prepared: October 20, 2017

Revised: October 26, 2017

Rehearing Date: December 5, 2017

Q. Please state your name and business address.

A. John F. Guastella, 725 N. Highway A1A, Suite B103, Jupiter, Florida 33477.

Q. What is your relationship to the Applicant in this matter, Daufuskie Island Utility Company, Inc.?

A. I am President of Guastella Associates, LLC which is the manager of Daufuskie Island Utility Company, Inc. ("DIUC"). Guastella Associates has been the manager of DIUC since July 9, 2008. I have served as the President of Guastella Associates throughout this period and I have been personally involved in the day-to-day operations as well as the management activities and decisions of DIUC.

Q. Did you submit direct and rebuttal testimony in association with the Application by DIUC that initiated the matter captioned as *In re: Application*

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of Daufuskie Island Utility Company, Incorporated for Approval of an Increase for Water and Sewer Rates, Terms and Conditions **and assigned South Carolina Public Service Commission Docket No. 2014-346-WS?**

A. Yes, I provided direct testimony, rebuttal testimony, and exhibits in the primary case then I testified before the Commission at the hearing on October 28, 2015. Recently, on October 18, 2017, I provided prefiled rehearing testimony with Exhibits JFGR-1 through JFGR-4.

Q. Did your October 18, 2017, rehearing testimony adopt all of your previous testimony and exhibits in their entirety as if repeated and submitted therewith?

A. Yes. I do adopt all of my testimony and exhibits in their entirety from the primary case and I also rely upon the testimony and exhibits of The Hon. Maria Walls, Gary C. White, and Eric Johanson as reflected in the transcript and exhibits of record in this matter, specifically the Transcript of Testimony and Proceedings of Hearing #15-11494 ("Transcript of Testimony and Proceedings").

Q. Do you now wish to supplement your October 18, 2017, prefiled rehearing testimony?

A. Yes.

Q. Why do you wish to supplement your October 18, 2017, prefiled rehearing testimony?

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A. My October 18, 2017, prefiled rehearing testimony describes, references, and relies upon the record of the October 28, 2015, hearing, which is set forth in the Transcript of Testimony and Proceedings of Hearing #15-11494. I also intend to use the Transcript of Testimony and Proceedings during the upcoming rehearing. Since I submitted my Supplemental Rehearing Testimony dated October 20, 2017, a Certified True Copy of the Transcript of Testimony and Proceedings with Hearing Exhibits has now been filed in the docket and the parties have agreed the same is authentic and admissible at any later hearings or other proceedings related to this Application. I intended to submit a copy of the Transcript as Exhibit JFGR-5 to my Supplemental Testimony. That is no longer necessary, as Order 2017-63-H confirms the parties may refer to and rely upon the Certified True Copy of the Transcript of Testimony and Proceedings with Hearing Exhibits which has now been filed in the docket. The portions of the Transcript of Testimony and Proceedings of Hearing #15-11494 I discussed in my Prefiled Rehearing Testimony dated October 20, 2017, are included within the Certified True Copy of the Transcript of Testimony and Proceedings with Hearing Exhibits which has now been filed in the docket.

Q. At rehearing of this matter will DIUC rely upon the testimony of witnesses as included in the Transcript of Testimony and Proceedings of Hearing #15-11494?

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A. Yes. DIUC will rely upon the upon the live hearing testimony of witnesses and the prefiled testimony and exhibits included in the Transcript of Testimony and Proceedings of Hearing #15-11494 with Hearing Exhibits.

Q. Does this complete your testimony at this time?

A. Yes.

MR. GRESSETTE: If the Commission is agreeable, I would like to move on to Mr. White.

CHAIRMAN WHITFIELD: Please.

BY MR. GRESSETTE:

Q Good afternoon, Mr. White.

A [WHITE] Good afternoon, Mr. Gressette.

Q Would you, for purposes of the record, state your full name, please?

A [WHITE] My name is Gary C. White.

CHAIRMAN WHITFIELD: Mr. White, would you pull that mic just a little bit closer, if you don't mind? We can hear you some, but just –

WITNESS WHITE: [Indicating.] Better?

CHAIRMAN WHITFIELD: I think so.

WITNESS WHITE: [Indicating.] Better yet?

CHAIRMAN WHITFIELD: Yes, sir.

BY MR. GRESSETTE:

Q What is your business address, Mr. White?

A [WHITE] My business address is the same as the Guastella business address in Jupiter, but I also have a satellite office in Summerfield, Florida.

Q And where are you employed?

A [WHITE] I'm employed by Guastella Associates.

Q And how long have you been employed with Guastella Associates?

A [WHITE] Twenty-six years.
Q And have you personal knowledge of the operations of Daufuskie Island Utility Company?
A [WHITE] Yes, I do.
Q And did you prepare and submit prefiled testimony, as well as offer live testimony in the 2015 hearing in this case?
A [WHITE] I have.
Q And have you recently submitted additional prefiled testimony in this case?
A [WHITE] Yes.
Q And can you, for purposes of the record, identify the components of that testimony?
A [WHITE] Yes.
Q All right. What are those?
A [WHITE] I filed what I consider the rehearing testimony, rehearing rebuttal testimony, and Exhibits GCW-R1 and GCW-R2.
Q And have you had an opportunity to thoroughly review that prefiled testimony, including exhibits?
A [WHITE] Yes.
Q If I were to ask you each of the questions contained in that testimony, would your answers be the same?
A [WHITE] Yes.
Q Do you wish to make any changes to that testimony at

this time?

A [WHITE] No.

MR. GRESSETTE: At this time, Mr. Commissioner, I would move the prefiled testimony of Mr. White, as described, be read into the record as if given orally from the stand, and that the exhibits attached thereto be hearing exhibits to the transcript.

CHAIRMAN WHITFIELD: Mr. White's prefiled testimony will be entered into the record as if given orally from the stand, and we will enter his exhibits as GCW-R1 and GCW-R2, as Hearing Exhibit No. 3.

[WHEREUPON, Hearing Exhibit No. 3 was marked and received in evidence.]

[See pgs 122-124 ~ Prefiled rehrg. direct]

[See pgs 126-130 ~ Prefiled rehrg. rebuttal]

MR. GRESSETTE: Thank you, sir.

BY MR. GRESSETTE:

Q Mr. White, would you please briefly summarize for the Commission the testimony you have prepared and submitted in this case?

A [WHITE] Sure. The rehearing testimony prepared the revenue requirement schedules reflecting the, roughly, 20 ORS adjustments in the primary case that we all

agreed upon, plus plant, property tax, bad debt, management fee, and rate-case expense adjustment that were guided by the Supreme Court, South Carolina Supreme Court decision, as we have interpreted it.

Q And does that testimony include any reference to the analysis supported in prefiled testimony by any of the other parties?

A [WHITE] I don't understand your question. Could you restate it? I'm sorry.

Q I'm sorry. Did your testimony have any analysis of the positions asserted by Intervenor witnesses or ORS witnesses in their rebuttal testimony in this case?

A [WHITE] Yes.

Q Would you briefly summarize those for the Commission?

A [WHITE] Sure. My rebuttal testimony basically addressed the entries that were made, and adjustments made, to accumulated appreciation and depreciation expense, and focused on Mr. Sullivan, of the ORS, his spreadsheets and work papers which he used to develop his accumulated depreciation balances and expenses.

I found several areas of concern and issues and errors within Mr. Sullivan's analysis. The major issue that I found was his lack of recognition of the use of — or, the treatment of retirement units, as far as depreciation is concerned. According to regulatory

accounting, when an asset is retired, you reduce the plant balance by the amount of the original cost of that asset and also reduce accumulated depreciation by the original cost of the asset. Mr. Sullivan failed to recognize that adjustment to accumulated depreciation.

Q And are there other instances that are fully covered in the prefiled testimony?

A [WHITE] Yes, there are other instances where there's inconsistencies when I look at the balances established in the 2011 test-year case. Ms. Stultz, who testified on behalf of the ORS, her balances at June 30, 2011, do not agree with the balances in Mr. Sullivan's analysis of the balances at that same date. So there are some – and some are the same, but there are inconsistencies in some of those balances.

The other thing that changed were the service lives. Some of the service lives – and, again, not all, but some of the service lives – have changed from what was recommended by ORS in the prior case, and these changes are made without explanation. So, you know, the company has been consistent with the depreciation rates and useful lives that we've used for depreciation over the past years.

MR. GRESSETTE: Mr. Commissioner, for a few final questions, may I put a document on the

projector?

CHAIRMAN WHITFIELD: Sure.

[Reference: Attached "Schedule S-C.3"]

BY MR. GRESSETTE:

Q Mr. White, have you seen the document that I have put up on the ELMO projector?

A [WHITE] I have. I prepared that document.

Q And does that document have an exhibit number?

A [WHITE] It certainly does. At the top, it says "Schedule S-C.3."

Q And is this the same document we looked at earlier when counsel for the Intervenors was giving opening statements?

A [WHITE] Yes.

Q All right. Can you explain to me, generally, and then with reference to this Schedule S-C.3, how a utilization factor is used?

A [WHITE] Sure.

MR. BEACH: Mr. Chairman?

CHAIRMAN WHITFIELD: Yes, sir, Mr. Beach.

MR. BEACH: I don't want to limit Mr. White or Mr. Gressette in –

CHAIRMAN WHITFIELD: I need to get you to a mic, if you can, Mr. Beach, or you can – you can just pick that one up.

MR. BEACH: [Indicating.]

CHAIRMAN WHITFIELD: There you go, now – if you can just pick it up, that'd be great.

MR. BEACH: [Indicating.] I truly do not want to limit Mr. Gressette or Mr. White in any way that would materially keep evidence that the Commission is interested in from coming into the record. On the other hand, I'm not sure that I know where what he just asked him appears in the testimony that he's summarizing.

Can you help me with that, Tom?

MR. GRESSETTE: Yes, sir. The exhibit is prepared using utilization factor, and so I'm asking him to explain the exhibit.

MR. BEACH: Right. And so, my question is, where does his explanation of this exhibit appear in the testimony that you have filed on his behalf? That's my question.

MR. GRESSETTE: He is explaining the exhibit that was filed as part of his testimony.

MR. BEACH: Wasn't this part of the Application that was filed, Mr. Gressette, and not a party's testimony?

MR. GRESSETTE: It may be. Is that what – it was submitted as an affidavit – as an attachment to

his rebuttal testimony.

MR. BEACH: To Mr. White's –

MR. GRESSETTE: White's.

MR. BEACH: – rebuttal testimony, okay. I just need to know where that is.

MR. GRESSETTE: Oh, I'm sorry. Yes, sir. This is part of, as I understand it, Mr. White's rebuttal exhibit.

MR. BEACH: Okay, that's fine. And in the body of his testimony, he explains that.

MR. GRESSETTE: He's going to explain it for you now.

MR. BEACH: Okay. And in doing that, he's going to be summarizing what is in his testimony.

MR. GRESSETTE: I – Mr. Commissioner, I don't – if Mr. Beach wants to cross-examine me. The witness wants to explain his testimony. His testimony includes reference to these schedules. He's simply going to explain to the Commission what the utilization factor means, as he used it in the exhibit. In the time that we've gone back and forth, he could've done that twice.

CHAIRMAN WHITFIELD: Mr. Gressette, this needs to be in his prefiled testimony, in order for you to – prefiled or rebuttal.

[Brief pause]

MR. GRESSETTE: Mr. Commissioner, the –

CHAIRMAN WHITFIELD: Yes.

MR. GRESSETTE: – reference in the testimony is in the initial rehearing testimony on page two: "Have you prepared scheduled that summarize your rate analysis based on the Supreme Court reversing and remanding the PSC Order in the primary case?"

"Yes. I prepared 'Schedules in Support of a Rate Increase Rehearing,' a copy of which is attached..." He then goes on to describe what he was doing in that exhibit.

I simply want him to explain a part of the exhibit which he incorporated into his testimony.

CHAIRMAN WHITFIELD: Mr. Gressette, I'm going to have to sustain Mr. Beach's objection. We need to stick to a summary of the direct testimony or rebuttal.

MR. GRESSETTE: For purposes of the record, may I proffer the testimony?

CHAIRMAN WHITFIELD: Yes.

MR. GRESSETTE: Okay.

[WHEREUPON, the following proffer was made:

BY MR. GRESSETTE:

Q Mr. White, when you use – in Exhibit GCW-R1, on page 45, "Utilization Factor Analysis," can you explain what utilization factor analysis was, as referenced in that exhibit?

A [WHITE] Yes.

Q Would you do that for me?

A [WHITE] The utilization percentage is based on the number of customers currently connected to the system, active connections, as a percentage of all potential connections for the system, and has the effect of decreasing the depreciation rate and depreciation expense charged to the current customers. Therefore, the current customers are only paying their fair share of depreciation expense.

Q And does your utilization, in the third column, of a Pro Forma Utilization indicate that the Daufuskie Island Utility Company plant, or any part of it, was underutilized?

A [WHITE] No, it's – that utilization factor is not a used-and-useful study that would determine the utilization of the plant facilities.

Q And for purposes of clarity, those numbers don't indicate how much of the system is used and useful, and used-and-useful is what is the basis of the rate analysis in this case, correct?

A [WHITE] That's correct.]

MR. GRESSETTE: That's all I have.

[PURSUANT TO PREVIOUS INSTRUCTION, THE PREFILED REHEARING DIRECT TESTIMONY OF GARY C. WHITE FOLLOWS AT PGS 122-124]

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DAUFUSKIE ISLAND UTILITY COMPANY, INC.

DOCKET NO. 2014-346-W/S

Testimony of Gary C. White

On

REHEARING

Before the South Carolina Public Service Commission

Rehearing Testimony Prepared: October 18, 2017

Rehearing Date: TBD

Q. Please state your name and business address.

A. Gary C. White, 17369 S.E. 111th Court, Summerfield, Florida.

Q. Did you prepare the schedules in support of the rate application submitted by DIUC in this case?

A. Yes.

Q. Did you submit direct and rebuttal testimony in the primary case?

A. Yes, I provided prefiled testimony and exhibits in the primary case. I also testified before the Commission at the hearing on October 28, 2015.

Q. Do you adopt and rely upon all of your testimony and the exhibits in their entirety in the primary case as if repeated and submitted herewith?

A. Yes.

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Q. Did you review the South Carolina Supreme Court's Opinion No. 27729 pertaining to the Public Service Commission Order No. 2015-846?

A. Yes.

Q. Have you prepared schedules that summarize your rate analysis based on the Supreme Court reversing and remanding the PSC Order in the primary case?

A. Yes, I prepared "Schedules in Support of a Rate Increase Rehearing," a copy of which is attached hereto as GCW-R1. I began by updating the schedules filed with the original application and to reflect the ORS adjustments accepted by DIUC as reflected in Mr. Guastella's rebuttal testimony in the primary case. No adjustments were necessary to reflect the positions Mr. Guastella describes in his rehearing testimony in order to reflect the Supreme Court's decision with respect to plant in service costs, utility property taxes for both annual utility property tax expense and the amortization of deferred property taxes under the installment plane with Beaufort County, and management fees.

Q. Briefly explain the updates that were necessary in connection with the Supreme Court's decision.

A. The bad debt expense was calculated to reflect an amount adjusted for the percentage of the revenue increase. In other words, the amount of bad debts or

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uncollectible revenues is proportionate to the total revenues. Rate case expense reflects a 3 year amortization of actual rate case costs as of September 30, 2017, plus the estimated cost to complete through the current rehearing process, as well as the 3 year amortization of the cost of bonds related to potential refunds to customers.

Q. Does this conclude your testimony?

A. Yes.

[PURSUANT TO PREVIOUS INSTRUCTION, THE PREFILED REHEARING REBUTTAL TESTIMONY OF GARY C. WHITE FOLLOWS AT PGS 126-130]

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DAUFUSKIE ISLAND UTILITY COMPANY, INC.

DOCKET NO. 2014-346-W/S

Rehearing Rebuttal Testimony of Gary C. White

Before the South Carolina Public Service Commission

Testimony Prepared: November 29, 2017

Hearing Date: December 6, 2017

Q. Please state your name and business address.

A. Gary White, 17369 S.E. 111th Court, Summerfield, Florida 34491.

Q. Did you submit direct testimony in this remand case?

A. Yes. I provided direct testimony, rebuttal testimony, and exhibits in the primary case. I also testified before the Commission at the hearing on October 28, 2015. I have more recently provided prefiled testimony for consideration of the current proceeding.

Q. Have you reviewed the direct testimonies submitted on behalf of the Office of Regulatory Staff ("ORS"), and the Haig Point Club and Community Association, Inc., Melrose Property Owner's Association, Inc. and Bloody Point Property Owner's Association ("Intervenors")?

A. Yes. I focused my attention on the testimony and exhibits of ORS witness Mr. Daniel Sullivan. I also did a cursory review of the testimonies of the other witnesses for ORS and Intervenors.

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Q. Please summarize the issues you will address in your rebuttal testimony?

A. My rebuttal testimony will speak to issues within the ORS's treatment of accumulated depreciation. My rebuttal testimony will supplement John Guastella's rebuttal testimony which will address the major issues in this case.

Q. Before addressing your specific issue, do you have any overall concerns with the adjustments proposed by Mr. Sullivan and ORS?

A. Yes. The calculations forming the basis of Mr. Sullivan's testimony appear to include errors and improper analysis.

Q. Can you provide some examples?

A. Yes. I will provide them in a list for ease of reference.

1. The Plant-in-Service balances shown by Mr. Sullivan are in conflict with the amounts shown on the Company's books and records.

2. ORS's discovery responses indicate Mr. Sullivan concluded that "Based on review of work papers and exhibits filed in this docket, it appears plant in service and depreciation expense were calculated as of December 31, 2014 and include no plant additions subsequent to December 31, 2014". That is not an accurate conclusion. The recently filed Exhibit GCW-R1 include Schedules W-B.2 and S-B.2 (Plant in Service); Schedules W-B.3 and S-B.3 (Accumulated Depreciation); and Schedules W-B.4 and S-B.4 (CIAC and CIAC Amortization) clearly reflect an additional pro forma 12/31/15 calculation.

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3. ORS continues to roll-forward conflicted account balances.

4. There are instances in ORS's work papers where beginning balances appear to be arbitrary. For example, Ms. Christina A. Stutz's (ORS) recommendation in the prior case included capitalized "Organization" costs of $41,185 which do not appear in ORS's current plant costs. In addition, Mr. Sullivan's plant and depreciation work paper appears to accept Ms. Stutz's recommended plant cost reductions, but her work paper fails to recognize:

a. Ms. Stutz's plant cost additions to water mains of $19,666 (CAS positive adjustment of $4,055 vs. DFS negative adjustment of $23,721);

b. Ms. Stutz's sewer pumping equipment of $15,936 (CAS positive adjustment of $15,936 vs. DFS adjustment of zero); and

c. Ms. Stutz's general plant of $4,800 (CAS positive adjustment of $2,400 water and $2,400 sewer vs. DFS adjustment of zero).

5. The ORS fails to acknowledge addition depreciation and CIAC amortization as a pro forma "known" change.

All of these omissions and adjustments have significant impacts on the depreciation related components of the revenue requirement and they render the ORS calculations from Mr. Sullivan unreliable.

Q. You mentioned your main focus is the accumulated depreciation issues you are addressing. Please state the problems you found within Mr. Sullivan's work papers and exhibits.

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A. One of the major issues with ORS's current adjustments is the absence of retirement units properly reducing accumulated depreciation. Mr. Sullivan's calculation of accumulated depreciation simply adds this year's depreciation expense to last year's balance which is incorrect. This methodology fails to include or consider the impacts of retirement units. Regulatory accounting requires that upon retirement of a plant asset the plant account is to be reduced by the original cost of that asset and accumulated depreciation is also reduced by the original cost of the asset, adjusted for any applicable salvage and/or removal costs.

Additionally, while ORS does reduce depreciation expense for retirement units, Mr. Sullivan's work paper incorrectly shows a 2011 and 2012 depreciation expense reductions recorded prior to the retirement of treatment equipment in the amount of $2,540.06 that was made in 2013.

Mr. Sullivan's calculations are further inconsistent with Ms. Stutz's calculations in the 2011 case. The balances rolled-forward by Mr. Sullivan do not tie to the plant and accumulated depreciation balances on Ms. Stutz's Audit Exhibit CAS-5 for the June 30, 2011 test-year in the prior rate case.

Mr. Sullivan also deviates from the service life assigned by ORS in the previous case by changing, without explanation or reason, some of the service lives from those recommended by ORS in the last rate case.

These omissions and adjustments have significant impacts on the depreciation related components of the revenue requirement and require the correction of Mr. Sullivan's calculations of accumulated depreciation and depreciation expense.

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Q. Do you have a recommendation regarding the accumulated depreciation component of rate base for this case?

A. Yes. DIUC has been consistent in methodology and service lives from its inception and its calculations are therefore more appropriate. I have provided the calculation of accumulated depreciation rolled-forward from 1987 in prior rate cases. A similar spreadsheet reflecting accumulated depreciation through the December 31, 2014 test-year is provided in Exhibit GCW-R2 that supports the accumulated depreciation as booked by DIUC as well as the balances reported in the Utility Annual Reports to the Public Service Commission.

As I have pointed out, the ORS calculation of accumulated depreciation is impacted by erroneous plant balances, regulatory accounting discrepancies, inconsistencies, and arbitrary choices and judgements.

DIUC's calculation of accumulated depreciation has been consistent; it reflects proper regulatory accounting; and it makes the appropriate known and measurable adjustments.

Q. Does this conclude your testimony?

A. Yes.

MR. GRESSETTE: Mr. Commissioner, thank you.

CHAIRMAN WHITFIELD: All right. Thank you, Mr. Gressette.

CHAIRMAN WHITFIELD: At this time, we're going to take questions of – any questions of both panelists, Mr. Guastella and Mr. White, from the Intervenors. Mr. Beach or Mr. Pringle?

MR. BEACH: Thank you, Mr. Chairman. I can go ahead and start. We'll be asking – I will be asking a few questions about this document that's being handed out, which is the management agreement between the utility and Guastella Associates. It was Hearing Exhibit No. 9 in the initial hearing in this matter, so I think it's still part of the record on which we are proceeding right now.

[Document distributed]

CHAIRMAN WHITFIELD: We have noted it as part of the record from the old case.

MR. BEACH: Okay. Thank you, Mr. Chairman.

CROSS EXAMINATION

BY MR. BEACH:

Q Mr. Guastella, the first series of questions that I have are for you. You are here today providing expert testimony to this Commission on behalf of Daufuskie Island Utility Company, are you not?

A [GUASTELLA] Yes.
Q And expert testimony is partly opinion testimony, isn't it?
A [GUASTELLA] Yes.
Q Okay. In fact, you've asked this Commission to base its return-on-equity decision on your – and I'm quoting from your direct testimony, from the 2015 hearing – "experience and judgment with respect to small water and sewer utilities, not on the typical Cost Of Capital Methodology." That was your testimony, was it not?
A [GUASTELLA] I'll accept it, subject to check.
Q So, in that testimony, you're asking this Commission to reject typical Cost Of Capital Methodologies and, instead, accept your experience and judgment. Isn't that correct?
A [GUASTELLA] I'm – in effect, I'm recommending that the Commission adopt my testimony with regard to rates of return on equity for small utilities, yes.
Q Okay. And as an expert, you're asking the Commission to consider your experience and judgment in making their decision on that, correct?
A [GUASTELLA] Specifically with respect to small utilities that do not finance, nor are they comparable to the group of large proxy companies with which those typical rate-of-return calculations are provided. There's no

comparison. And the impact on the rate of return on equity, because of the sensitivity of erosion of earnings for a small utility, is different, and I'm asking the Commission to recognize that. And, indeed, this case is a prime example of how this utility is hard-pressed to earn the allowed rate of return that would presumably allow for the rates of return given to the proxy groups of large utilities.

Q Would you agree with me that the credibility of an expert's testimony hinges on that testimony being objective and nonbiased?

MR. GRESSETTE: Objection, Mr. Commissioner.

CHAIRMAN WHITFIELD: Mr. Gressette?

MR. GRESSETTE: Thank you, Mr. Commissioner. The objection is that the questions are based upon the 2015 testimony. Mr. Beach just got through arguing that we should be limited only to what was discussed in the scope of prefiled rehearing testimony, even – I would say – further subject to what Mr. Guastella has testified about, live, here in the hearing. So I'm not sure that we can have it both ways.

CHAIRMAN WHITFIELD: Mr. Beach?

MR. BEACH: Mr. Chairman, I – if you heard me say that I was trying to restrict anyone's

testimony to simply the arc of this phase of the proceeding, that's not correct. I do believe that – and we've all, I think, agreed, in our discussions with Mr. Butler, that the testimony, in fact, sitting right there next to the court reporter from the previous hearing, is also part of the record in this case.

CHAIRMAN WHITFIELD: Go ahead, Mr. Gressette.

MR. GRESSETTE: Mr. Commissioner, I'm sorry. I just understood all of his objections to Mr. Guastella's testimony as being outside the scope of his prefiled testimony. We're limiting him to only what he had submitted in his prefiled testimony by way of summary. If he was not allowed to summarize anything from 2015, Mr. Beach shouldn't ask him or any other witness about 2015. That record stands as it is.

CHAIRMAN WHITFIELD: I'm going to overrule your objection at this time, Mr. Gressette.

Continue on, Mr. Beach.

MR. BEACH: Okay. And I –

MR. GRESSETTE: Thank you, sir.

MR. BEACH: – will try to – I am not going to try and dredge up what is in testimony in 2015 as a material part of my cross-examination.

BY MR. BEACH:

Q So, let me just ask again. Would you agree that the credibility of an expert's testimony hinges on that testimony being objective and unbiased?

A [GUASTELLA] Yes, I would agree to that.

Q Okay. Would you accept that, for an expert witness providing opinion testimony, to receive a direct monetary gain from the outcome he or she is advocating – do you believe that would be acceptable or unacceptable for expert testimony?

A [GUASTELLA] The compensation – and I can speak to my compensation. My compensation is based on the time devoted to a project, and my testimony reflects the cost of providing service, regardless of the wishes of the client.

Q All right. Well, let me ask it this way. Let me ask you a hypothetical. Let's say that you have a doctor who has given expert testimony on behalf of an injured patient in a medical malpractice case, and that that doctor is giving their opinion on whether the treating physician violated acceptable medical standards in performing surgery on that patient. With that hypothetical, would it be acceptable for that doctor-witness to be paid based on a percentage of whatever judgment the patient receives?

MR. GRESSETTE: Mr. Commissioner, we have an objection.

CHAIRMAN WHITFIELD: Yes, Mr. Gressette.

MR. GRESSETTE: The question is not relevant. The witness has not, in any way, asserted that he would be qualified to answer a hypothetical. The hypothetical is incomplete, lacking a factual basis. For those reasons, we would object to the question.

CHAIRMAN WHITFIELD: Mr. Beach?

MR. BEACH: I'll restate the question. In fact, I think I can boil this down a little bit better to something that Mr. Guastella can answer.

CHAIRMAN WHITFIELD: Please.

MR. BEACH: Okay.

BY MR. BEACH:

Q Mr. Guastella, if you were being paid, in part, based on a percentage of the rate increase that you're able to achieve for Daufuskie Island Utility Company, would that be an acceptable arrangement for the testimony of an expert witness?

A [GUASTELLA] Depends on the circumstances of the management agreement. I'm not being paid on the level of the rate increase; I'm being paid on the basis of the cost of providing service. So my testimony is going to

reflect the revenues, the expenses, and the return on investment that's consistent with ratesetting principles and guidelines by as far up as the Supreme Court. Regardless of what my compensation is, if I do a good job for the utility and the owners, then my compensation is not based on the percentage of the revenue increase, but I do have a percentage based on the net operating income of the utility, which does not increase the rates; it takes a share of what is being provided for through the rates based on the proper return on investment, without increasing the return on investment, but the shareholders are willing to share a part of the net operating income at a percentage of the net operating income, which does not change the basis for the rates, expenses, or return on investment. So the stockhold- – the utility ratepayers are not covering that.

Q So let's talk about that provision in the management agreement, if we can. I'd like for you to take a look – and I think Jack Pringle is getting ready to hand you one.

MR. PRINGLE: May I approach the witness?

CHAIRMAN WHITFIELD: Yeah.

MR. PRINGLE: [Indicating.]

WITNESS GUASTELLA: [Indicating.]

[Document distributed]

BY MR. BEACH:

Q And, Mr. Guastella, in particular – first of all, let me ask you, can you identify this document?

A [GUASTELLA] Yes, this appears to be a management agreement. I don't know for what year this is.

Q Okay. Well, take a look at it, and then maybe you can tell us for what year.

A [GUASTELLA] It was as of June 2015.

Q Okay. So, is this the management agreement that is currently in effect?

A [GUASTELLA] Yes. It's been revised in terms of payments of the management fee.

Q All right. The management fee, which is the one that is listed in Article III, Section 1, correct?

A [GUASTELLA] Yes.

Q Okay. So let's take a look on the next page, at Article III, Section 4 –

MR. BEACH: And I'm sorry, Mr. Chairman, but the pages are not numbered, so I think you just have to count as the first, second, third – this is the fourth page of the exhibit.

BY MR. BEACH:

Q Does Section 4 set out the incentive fee that you were just testifying about?

A [GUASTELLA] Yes, and that's paragraph four, I believe.
Q Paragraph four, entitled "Incentive Fee," correct?
A [GUASTELLA] Yes.
Q Okay. And just to be a little more precise, it's the third line down. In the middle it starts, "The incentive fee shall be (a) 20 percent of the total net utility operating income of the utility," and then it's got (b), which I'm going to ask you about in a minute. But right now, I'm asking you about (a), okay?
A [GUASTELLA] Sure.
Q Good. All right. So, if the rates approved – well, let me ask you this. Is there a difference between net operating income and net income?
A [GUASTELLA] Yes.
Q Okay. And while I'm going to get a piece of paper from my – well, actually, I think I don't need that. What is the difference?
A [GUASTELLA] Net utility operating income is the overall return on investment. Net income is after you subtract interest and any other below-the-line –
Q Okay.
A [GUASTELLA] – items.
Q And when you say "overall return," you're not talking about percentage; you're talking about the dollar income that is on the utility's books for that year, correct?

A [GUASTELLA] You said the net utility operating income, so I'm talking about dollar amounts, as opposed to overall rate of return.
Q Correct, okay. And then net income is that number minus the interest expense, correct?
A [GUASTELLA] Yes, less any or plus any other below-the-line adjustments.
Q Okay. Is it true that the higher the rates that are set by this Commission, as a result of this proceeding, the higher the utility's net income – net operating income – will be, all other things being equal?
A [GUASTELLA] Well, it depends on what the rate of return is on the overall rate base. I mean, the revenues can change, but if there's a constant return on rate base, then that wouldn't change.
Q But if the Commission approves higher rates or recognizes – put another way – recognizes a higher revenue requirement for the utility, that will result in a higher net operating income than if the Commission approves relatively lower rates.
A [GUASTELLA] Not necessarily. It depends on what overall rate of return is included in the revenue requirement.
Q Okay.
A [GUASTELLA] So if the rate of return on a fixed rate base is X percent, but the other components of the

revenue requirement produce a higher revenue requirement, then the return on investment doesn't change.

CHAIRMAN WHITFIELD: Mr. Beach, I think we're going to take this opportunity to recess for just a minute. We're going to have our Commission Meeting, and we do have two Rule to Show Cause cases immediately following that, and we'll resume the case immediately after that.

MR. BEACH: Okay. Thank you, Mr. Chairman. My understanding is that, under the South Carolina Rules, that witnesses are prohibited from discussing their testimony with attorneys, while they are sworn witnesses in a proceeding. Is that the way that we're recognizing things here?

CHAIRMAN WHITFIELD: Let me get Mr. Gressette's opinion.

MR. BEACH: Okay.

MR. GRESSETTE: That's fine, Your Honor.

CHAIRMAN WHITFIELD: Okay.

MR. BEACH: Thank you.

CHAIRMAN WHITFIELD: I think we all understand.

MR. BEACH: Okay. Thank you, Your Honor.

CHAIRMAN WHITFIELD: And we'll return after

our Commission Meeting and two Rule to Show Cause hearings.

[WHEREUPON, the witnesses stood aside.]

[WHEREUPON, the proceedings were in recess from 1:55 to 2:47 p.m.]

CHAIRMAN WHITFIELD: I'll call this hearing back to order.

THEREUPON came,

J O H N F . G U A S T E L L A ,

G A R Y C . W H I T E ,

recalled as witnesses on behalf of the Applicant, Daufuskie Island Utility Company, who, having been previously duly affirmed, were examined and testified further as follows:

CHAIRMAN WHITFIELD: And we will resume where we were with Mr. Beach crossing the company witnesses. So, Mr. Beach?

MR. BEACH: Thank you, Mr. Chairman.

CONTINUING CROSS EXAMINATION

BY MR. BEACH:

Q Mr. Guastella, let's see if I can shorten this a little bit and make it simpler by showing you – this is an exhibit that your counsel has already questioned the witness on. You recognize it?

A [GUASTELLA] Yes.

Q Okay. So you said to me that the difference between net operating income and net income is net operating income minus interest expense equals net income. Correct?

A [GUASTELLA] Yes, for this example.

Q Okay. And is that what we're looking at – when it says net operating income there, is that what Section 4

"Incentive Fee" is talking about in (a)?
A [GUASTELLA] If those would be the results of the rate increase.
Q Okay. So, in this example, the application of 4(a) to that would result in a 20 percent, or $36,000, per year payment going to Guastella Associates, correct?
A [GUASTELLA] No. The percentage incentive fee would depend on, once these rates go into effect, whether I could control costs and come close to achieving the allowed rate of return. So, once the rate of return is established by the Commission – and that's the Commission's decision, not mine, as to what level of rate of return that would be – if, then, I am able to operate the utility to come close to achieving that rate of return, that's what the incentive fee would be based on, not what the Commission allowed as a rate of return. Therefore, it's not depending on the Commission's decision; it's depending on what happens after the Commission's decision, if this utility could achieve the allowed rate of return.
Q Okay, but the mathematical analysis to actually calculate the net operating income is this that we're looking at right here, correct? Based on the revenues of the utility and the expenses of the utility, correct?
A [GUASTELLA] Based on the actual revenues and expenses,

and operating results, of the utility after any rate increase, and beyond –

Q Right.

A [GUASTELLA] – and what we could achieve in terms of net operating income, that's the basis for my 20 percent incentive.

Q Correct. And the higher the net operating income you're able to achieve, the higher that 20 percent incentive fee will be, correct?

A [GUASTELLA] Yes. For example, if – in this case there have been no dividends since the utility was created, but if, for example, I was able to save $450,000 in property taxes, that would increase the net operating income, and that would be an incentive fee for me to act as good as I can act, to cut costs for the operation of the utility, which ultimately affects the benefit of the customers. But then I get an incentive fee for that.

Q Okay. And, likewise, if you are able to increase income as a result of a rate case, that would increase the net operating income, as well, correct?

A [GUASTELLA] Well, I don't increase income as a result of a rate increase. I present to the Commission the full disclosure of what my agreement is, by the way. I present to the Commission the revenues, the expenses that I anticipate the company is going to expect when

the rates go into effect. I provide the Commission with a rate base and I make a recommendation as to rate of return. The Commission decides what the rate of return and what the ultimate allowable net operating income will be. It's up to me, then, after that increase, to try to achieve that allowable income.

Q Okay. And the higher income you can achieve to be approved by this Commission, the better chance you have of it achieving a higher net operating income when you are operating the utility, going forward, right?

A [GUASTELLA] But the basis for my recommendation is the rate of return that enables the utility to attract capital and maintain financial viability. It doesn't depend on whether or not I'm going to get an incentive fee.

Q Okay. Let's go to Section 3, which is the – well, actually, that's not where I want to look. Is there a provision in here that gives you a bonus, following the sale of the company?

A [GUASTELLA] Yes.

Q Okay. And where is that?

A [GUASTELLA] I believe that's also in 4, under the "Incentive Fee" heading.

Q Okay. And so that's 4(b). Is that correct?

A [GUASTELLA] Yes.

Q All right. And to be clear, one of Guastella Associates' express jobs under this management agreement is to maintain the utility's market value to posture it for possible sale condemnation. Is that correct?

A [GUASTELLA] Yes, it is.

Q Okay. So part of all of this management that you're doing, including this rate case, is to try and reach that goal, correct?

A [GUASTELLA] Well, yes. Under Uniform Standards of Professional Appraisal Practice, I can, on behalf of Daufuskie Island Utility, prepare a market value appraisal of the utility based on my opinion. If I note in that market value appraisal that I have a separate consulting service that I'm providing to the utility to help it sell, then it's consistent with the Uniform Standards of Professional Appraisal Practice for me to render an impartial market value determination but also serve as a consultant to the utility to help it sell the utility, as long as I note in the market value appraisal that there's a percentage fee. And that's acceptable, as part of the appraisal practice that I follow. So it's similar to what we're doing with the incentive fee for the net operating income. As long as you notify what your fees are based on, you can perform an independent analysis of the utility, whether it's for

appr- – for appraisal purposes, which outside parties have to rely on as an independent appraisal not influenced by the wishes of the client. But if you note that you also are providing consulting services for the client to help them sell the utility in which you would get a percentage of the sale price, that's perfectly acceptable.

Q Okay. And just to look specifically at that, on page two of the management agreement, Section 7, I'm going to read – it says, "All management decisions as to record-keeping, ratesetting, 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," correct?

A [GUASTELLA] Yes.

Q Okay. Now, so back to 4(b), roughly what rate base are you advocating the Commission adopt for combined operations in this proceeding?

A [GUASTELLA] I'll have to take a look at it.

Q Okay. And I am – you can – if you can give me within a half a million dollars, I'll be fine with that.

A [GUASTELLA] [Indicating.] Close to $7 million. It's $6,000,975.

Q Okay. So if Daufuskie Island Utility was sold or

condemned for that $7 million, what amount would Section 4(b) require to be paid to Guastella?

A [GUASTELLA] I don't believe the utility would be sold for original cost rate base, because the market value of the utility's based on reproduction cost new less depreciation plus going-concern value. So the rate base is not going to be the market value, and my recommendations to the client would first be to establish the market value based on the Uniform Standards of Professional Appraisal Practice, which for the most part in this country, are based on reproduction cost new less depreciation, not original cost less depreciation less any contributions. So the market value is going to be a much higher number than rate base, and then it's going to depend on the negotiation with whichever party is willing to negotiate the sale. If there were no negotiations and it were a condemnation, the condemnation would likely reflect reproduction cost new less depreciation. So the impact of the rate base on our rate case is not going to have an impact on a condemnation of the utility.

Q Okay. Let's just – just so that we can understand here, let's just say you are able to achieve a sale of $8 million, just to pick a number. I'm just asking you to do the math for us on 4(b) and tell me – and, again, I

want rough numbers, because I realize that the adjusted purchase price is a little more than $2 million. But wouldn't – and maybe a better way to do this is, would the math on that work like this: You take the $8 million, you subtract $2 million adjusted purchase price, and then you pay Guastella 8 percent of that first $3 million and 12 percent of the next $3 million, for a total of $600,000 paid under 4(b)? Is that – is my math correct?

A [GUASTELLA] For the purposes of the discussion, I'll accept it.

Q Okay. And the higher the sales price, the higher the bonus fee that would be earned by Guastella under 4(b), correct?

A [GUASTELLA] Yes.

Q Okay. Is the utility contemplating refinancing?

A [GUASTELLA] Yes.

Q Okay. And does part of your recommendation or testimony in this proceeding have something to do with the fact that that refinancing would be prudent for the utility?

A [GUASTELLA] Yes, the financing is necessary for the company to provide adequate service to the customers. There are certain improvements that we must be making – that we should be making, and we're only going to be able to make those improvements if the utility is able

to undertake a refinancing. The refinancing would likely have to be a refinancing of the existing $2,750,000 term loan plus a refinancing of what was a $500,000 line of credit, but was converted from the $500,000 line of credit to an installment payment for the $500,000 because of the last rate decision, the utility was not able to pay off the $500,000 and I was able to negotiate with SunTrust Bank and convince them that, if we pursue this further, we probably would get enough rate relief to enable the utility to continue to pay the debt service. So we're now in the process of doing that. Unfortunately, it's taking a long time. But once we do that, if the Commission allows adequate rate relief, we should be able to refinance. If the Commission – I have to add, I just have to – accepts ORS adjustments, we will not.

Q Okay. So if the rate relief – if you receive adequate rate relief, about how much would that refinancing be? And let me just jump in and say, would it be about $3 million?

A [GUASTELLA] No.

Q Okay. Can you give me a short answer as to how much it would be, roughly?

A [GUASTELLA] I'm hoping that it would be $3,750,000. That's what I'm hoping to get, and I've discussed that

with SunTrust –

Q Okay.

A [GUASTELLA] – Bank for the past two years.

Q So looking up above on this same page of your management agreement, under "Finance Fee," can you calculate to me if there's a $3,750,000 finance, or refinance, how much of a finance fee would the utility pay to Guastella Associates at closing?

A [GUASTELLA] Well, we've already incurred – "we," being Guastella Associates, spent three years trying to get financing. Hundreds and hundreds of hours dealing with three different banks the Commission is aware of and approved the loan with Wells Fargo. Before that, CoBank promised to give us a loan, but backed out. Then Wells Fargo backed out. Then we had to apply to the Commission again to change its approval for Wells Fargo to its approval of CoastalStates Bank. In the course of doing that, we had to completely reorganize the ownership of the utility to dissolve any connection with CK Materials or the officer of CK Materials.

I've been involved in three years of producing every possible record we could, and then generating all of the paperwork, incurring a small fortune of legal fees, to dissolve CK Materials, establish Daufuskie Island Utility Holding, Inc. I've got a stack this big

[indicating] from the attorneys of all the documents that had to be produced just to get financing for this utility. Massive effort. Those charges have been charged to the utility already, but not paid because I haven't had any money to pay for those. Those are not being passed on to the customers, by the way.

Q Correct. Okay. And just so we're clear, "Finance Fee" really gives Guastella a choice. It's either 2 percent of the principal amount of the loans, or Guastella's usual hourly rates for the actual time spent. Correct?

A [GUASTELLA] Correct.

Q And that's – the reason you've gone through that explanation just now is because you're way past the 2 percent number, and you're into actual time spent, correct?

A [GUASTELLA] That's correct.

Q Okay. So if and when that refinancing occurs, there's going to be a number that is – and I'm going to get the math wrong, here, but 2 percent of 3.7 is about $74,000, am I right?

A [GUASTELLA] Sounds about right.

Q Okay. But what you're saying is that the finance fee for this particular one, because of all the work that you've had to do, is going to be much higher than that.

A [GUASTELLA] It has been much higher. It shouldn't be

much higher anymore, because all of the financial statements and projections we've had to make have already been done, so at this point we're only at the point of, once the Commission comes out with a rate decision, SunTrust is waiting for that decision and will not undertake refinancing without that decision, because if the decision is not adequate, they're not going to refinance. So SunTrust is waiting for that. So my additional time for the financing shouldn't be all that much, and I'm not going to apply the 2 percent of the 3.75 because I've already charged the utility for obtaining the $3,250,000, so it's an incremental difference. But the incremental difference is because we would've been able to finance in January of 2016, had we gotten a rate decision that would've enabled us to finance. So now all the extra work that I've been going through with SunTrust, convincing them that we're going to have a successful court decision, convincing them of what this rate case is going to fall out, all of that work has been done but it's a small piece of what the total costs were for going through three years of trying to get this small utility financing.

It's – I don't want to expand my answer, but this is the problem of a small utility. You have to cover the costs of providing service and earn a return that

enables you to finance. If you don't do it, you're not regulating small companies to the best interest of the customers.

Q Okay. So in a nutshell, I think what you're saying is that you've already charged and been paid more than $74,000 for the refinancing that we're discussing right here?

A [GUASTELLA] The only word you're wrong on is I haven't yet been paid for it, because all of my charges do not get paid unless we are covering the cost of serving the customers. That's the way we promised this Commission we would run this utility. Customers come first. Stockholders, essentially, and I have absorbed about a million dollars' worth of costs because we needed money to serve the customers until we got adequate rate relief.

So the goal here is to serve the customers. My fees are geared to doing that, and my efforts have been geared to doing that.

Q All right. And if you get adequate rate relief, then all these amounts that have been charged but haven't been paid will end up being paid.

A [GUASTELLA] Well, it's probably going to take a long time, because the customers aren't going to pay it; the stockholders are going to have to pay it out of future

earnings, somehow. Whether it all gets paid or not is going to depend. It may take a lot of years before that happens, because it's been a lot of accumulation of my fees that have not yet been paid.

Q Okay. But if the customers' rates go to $180 a month for water and sewer, they will actually be the ones who end up paying that, even if it's over time, correct?

A [GUASTELLA] Absolutely wrong. Customers pay for the cost of providing water service, and they get what they pay for; they get water service, or they get sewer service. They're not paying for my costs. The Commission is allowing the rates that the customers will be charged for water and sewer service, based on the cost of providing service, which do not include any retroactive ratemaking to make up for my charges. So customers are not paying for my services. And the rates are not including most of my services, except what the current services are for the management fees and for a portion of the rate-case expenses that's going to be amortized. That's part of the cost of providing service. The customers pay for water and sewer service.

Q To be clear, all of these fees here – finance fee, capital fee, and incentive fee – they're being paid to you by the utility out of their utility revenues, or, if necessary, out of injections of money that are coming

from the shareholders, correct?

A [GUASTELLA] The revenues coming from the sale of water and sewer are covering the operation-and-maintenance expenses, the power, the labor, billing and accounti- – management fees, and then they're getting a return on investment and the cost of debt that's included in the return on investment. That's what the rates are based on.

The customers are not paying these fees directly. And most of these fees are not being paid by the customers. The incentive fee is not being paid for either – the percentage applied to that operating income's not being paid by the customers. That's being paid for return on investment that the Commission finds is reasonable for the utility to maintain financial viability and attract capital. The finance fee is not being paid for the customers because it hasn't been paid, and in the future it's not part of the overall rate of return. It might be worth noting that the rate of return that ORS allowed does not include the cost of undertaking of financing. It included only the bare cost that the SunTrust loan was, and that's 5.29 percent. I think it was wrong, but we're not going to – we were trying to get this case done.

Q Okay. Let's go to Article V, "Termination," which is on

the very next page of what we were looking at.
A [GUASTELLA] Yes.
Q This management agreement lasts for three years but then it automatically renews for another three years, correct?
A [GUASTELLA] Yes, depending on my continued existence and Gary's continued existence.
Q Correct. And in this paragraph, it states on the next page, right, about one, two, three, four, five, six, seven lines down, it says Guastella may terminate this agreement without cause by giving the company 60 days' advance written notice. Correct?
A [GUASTELLA] Yes.
Q Okay. Can the utility terminate this agreement without cause in that same fashion?
A [GUASTELLA] No. If you'll look at the termination paragraph in total – and I'm not going to go through and read it for you, but if the utility or its owners find that we are not performing the duties that they expected us to perform, they can say, "If you don't correct those deficiencies, we'll terminate the contract." So I would have 30 days to correct any complaint that the utility owners would have, in terms of my performance under this agreement.
Q So the utility does not have the right, under this

agreement, to terminate it without cause, correct?
A [GUASTELLA] Correct.
Q But Guastella Associates does have the right to terminate it without cause.
A [GUASTELLA] Yes.

MR. BEACH: Okay. Nothing further. Thank you.

CHAIRMAN WHITFIELD: Thank you, Mr. Beach. ORS?

MR. NELSON: I promise I only have a couple of questions, and they're going to be very quick.

CROSS EXAMINATION

BY MR. NELSON:

Q Mr. Guastella, I'm going to address these to you, because I wanted to go over a couple of statements that you made this morning in your direct testimony. One of the things you talked about, you had mentioned – and we were talking about the utility plant-in-service adjustment, and you had mentioned that your reading of the Supreme Court Order was that none of the ORS adjustments to plant-in-service were supported by any evidence. Can you point to anything, language or anything, directly in that Supreme Court Order to support that statement, that belief, of yours?
A [GUASTELLA] Yes. I thought I had cited it in my

testimony, but let me take a look [indicating]. May I just grab my bag, please?

Q [Indicating.]

[Brief pause]

A If we could go to the Court decision, please? Cover page, one, two, three, four, five, sixth page, there's a Footnote 8 on that page.

Q Yes?

A [GUASTELLA] The last sentence on the last paragraph before the footnote: "While we are reversing and remanding for a new hearing as to all issues, in order to provide guidance to the Commission on remand, we address three allegations of error." So I take the language that says, "We are reversing on all issues," and then I also refer to the page that starts with the side heading "Settlement Agreement," last paragraph: "Moreover," and I'm quoting from this agreement. "Moreover, the settlement agreement did not resolve any issues before the Commission because DIUC was not party to the agreement."

There's one more, if you can give me a second [indicating]. On the next page from that, last paragraph also. About the middle of that paragraph, I cite: "Furthermore, the settlement agreement contained multiple adjustments which were entirely unsupported by

the evidence presented to the Commission."

So it's my understanding from the language there that the Court looked at all the evidence, all the settlement agreement, found nothing that was presented to the Commission to support multiple adjustments, for the entire adjustments in the settlement agreement.

Q The Court just, specifically, addressed, what, four issues. They addressed the settlement agreement, and they made specific rulings as to the elevated tank, property tax, and bad debt. There's no specific finding in here, is there, regarding – we're really talking about, what, about $700,000, I think, in rate-base adjustments, right?

A [GUASTELLA] See, I don't believe that's correct, because the Court states "Issues presented," and the second of those issues, number two paragraph, and this is what the issues were that were presented to the Court. "Were Commission findings of fact and conclusions with respect to property taxes, management fees, rate-case expenses, rate base, and bad debts, supported by substantial evidence of the record?" Then the Court goes on to the other cites that I gave, that there were multiple issues and that, with respect to the settlement, the settlement did not present evidence to the Commission with respect to the multiple issues. Then the Court goes on to

address three specific issues. It doesn't give specific instruction, but it does say for all the issues that were presented to it by DIUC, there was no evidence in the settlement agreement. And, indeed, the settlement agreement includes those issues.

So if there was no evidence supporting the settlement agreement that contains all of these five issues presented to the Court, while they gave specific adjustment on some, they rejected the others as there being no evidence to support them. That's how I read this, anyway.

Q And I'm just looking at interpretation, so I'll let that go; that's clearly your reading. I want to go to something else. When you were talking about the bad debt this morning, too, on direct testimony, you were — and, again, as part of the Supreme Court Order, we looked at their Order addressing the $100,000 plus. The number that you talked about, you said, I believe, it was approximately $200,000 in bad debt, is your current calculation? Is that $200,000 you're referring to, is that an estimated number that you have produced for purposes of this hearing, or is that a specific known-and-measurable number?

A [GUASTELLA] That's an estimated number based on what we anticipate the new level of revenues would be.

Q Okay.

A [GUASTELLA] So if the new level of revenue varies off of that, the bad debts are going to go up in proportion to the additional revenues. The bad-debt number that is now and that the Court discussed was based on, I believe it was $1,073,000 worth of revenue. With a rate increase that increases that $1,073,000 – we're looking at something over $2 million – the bad debts are going to also increase along with that, and our estimate was based on a couple of things. One is, we looked at what the new bad-debt level was after we implemented the 108.9 percent increase, on a temporary basis subject to refund. Once that rate increase was in effect for a year, I took a look at the year that it was in effect, which was approximately like in September of 2017, so we looked at what happened from July 1 of '16 when the 108.9 percent went into effect, through the end of June 30th, and we found that the bad debts were up at close to that $200,000 level, because the rates and the revenues were up by that much. Much of our revenues come from availability service.

I also looked and provided in discovery all of the actions we've been taking to collect bad debts, and the liens that have been placed on the system. There's about $650,000 worth of liens on the system that now are

subject to becoming bad debts. So I think the formula that addresses the level of bad debts of about $200,000 is supported by the actual numbers, the revenues under the 108 percent per year, compared to collections of 108 percent per year, and the bad debts that we now have for properties that are under liens.

Q I was a little surprised by the number, because I don't believe I've seen it before. Can you tell me where – I mean, I think you said it was provided in discovery from the Intervenors? Is that right?

A [GUASTELLA] Well, I believe – discovery of Intervenors, which I'm assuming was also provided to ORS.

Q All right. Is there anything that you had provided in your direct or your rebuttal testimony that had given us the number, previously?

A [GUASTELLA] I don't know. I'd have to look. I just don't recall.

Q And I'll let the record stand on itself, but –

A [GUASTELLA] Okay.

Q – just to get the question out there. One more question, and then I'm going to sit down. You also stated this morning – and I think it's also in your rebuttal testimony, I believe, that was filed – you talked about a Q&A that took place, or a question, I guess, Justice Hearn asked of Ms. Hudson at the Supreme

Court hearing, and you take the position that that supports your view that Daufuskie Island Utility and Guastella Associates wasn't at fault for the elevated tank property falling into tax foreclosure. Is there anything that was contained in the Supreme Court Order itself, dicta or a finding of the Supreme Court, that addressed that issue or made that finding?

A [GUASTELLA] Not that I'm aware of. I replayed the video portal of the Supreme Court, of the oral argument. And in order for me to get that cite exact, I replayed it, replayed it, replayed it.

Q So we're going to legal opinions here now, again. Does that question from Justice Hearn have any legal precedent or weight to it?

A [GUASTELLA] I don't know. I hope the Commission would take a look at that, however, and see that it seems like Justice Ahearn[sic] and the Supreme Court recognized all of the evidence that we provided in the primary case – that notices were sent to the wrong place, billings were sent to the wrong place, notices were posted on the wrong place – and it was not our fault. That's my testimony. It was not our fault. We had no way of knowing that. It seems to me that if Justice Ahearn[sic] looked at the testimony and evidence, which surprisingly to me it seems like she did thoroughly, she made a statement. I

think that's something that the Commission could take into account, whether it has legal precedent or not. But I leave that up to the Commission.

MR. NELSON: Thank you, Mr. Guastella.

No further questions, Mr. Chairman.

CHAIRMAN WHITFIELD: Thank you, Mr. Nelson.

At this time, we'll now turn to questions from the Commissioners. Commissioners?

COMMISSIONER FLEMING: Mr. Chairman.

CHAIRMAN WHITFIELD: Commissioner Fleming.

EXAMINATION

BY COMMISSIONER FLEMING:

Q Good afternoon.

A [GUASTELLA] Good afternoon, Commissioner.

Q Another long day with Daufuskie.

A [GUASTELLA] I know.

Q I'd like to – this management process seems to be a very complex issue, and I'd like to ask a couple of questions about that. Could you explain the process by which management contracts are awarded for Daufuskie Island?

A [GUASTELLA] Well, there's really only one contract that I'm aware of, and I can tell you how it came about, if that satisfies you.

Q That's what I – I'm wanting to know how, I guess, you acquired this management contract.

A [GUASTELLA] I did International Paper. When International Paper owned Haig Point Utility Company, I did its rate case in 2005. Before I did its rate case, I held a rate seminar for real-estate-developer-owned-related utilities, and the accountant – I believe his name is Tom Connor – attended my rate seminar, and that was in 2002 or 2003, one of those. He later came to me and said, "It was a great rate seminar, but I'm not a rate expert, yet," so could I do the rate case? So I did the rate case.

A couple of years later, I get a call from a gentleman who was one of the early owners, a Mr. Karibinchack, and he said, "John, would you help me buy the utility off of International Paper?" And I said, "Sure," I said, "Let me check because I don't think there's a conflict of interest, but I'd be happy to do it." He said, "Well, International Paper was the one that recommended that I get you to help me buy the system off of them."

In the process of trying to work with both International Paper and Mr. Karibinchack, which was one of the stockholders of CK Materials or one of the members of CK Materials, one of the provisions was, in order to approve the acquisition, the parties – and I believe ORS was involved, because we had meetings; I

believe Mr. Beach was involved, because we had discussions of settlement – Guastella Associates had to be part of that acquisition for managing the utility, because they knew that I knew how to do utility management and rate work, and they weren't confident that Mr. Karibinchack and the other owners – who were two attorneys in New Jersey – could properly manage the utility. So I was involved specifically in the settlement that I had to – Guastella Associates – had to be the manager of the utility. And I became the manager of the utility, indeed, when the utility was acquired on July 9, 2008. I became the manager of the utility. And then I entered into an agreement of how I was going to manage this utility for the owners, to manage the utility, and I entered into that – I drafted an agreement; they reviewed the agreement. I think there were some back-and-forth on the provisions. And that's how the agreement came about.

Q Okay. And I believe you said that the agreement is a three-year term, correct?

A [GUASTELLA] We renew it every three years. And every three years, either I or Mr. White has to be around, and another person. But at this point, again, it's a fellow named Michael Guastella. Before Michael Guastella, it was John Guastella – John M. Guastella, who passed away.

So it's – as long as someone who knows the utility, knows the operation, has got experience to run the utility, then that would be renewed every three years.

Q So you don't – there's no bidding or going out to see if there are any competitive bids, to manage it?

A [GUASTELLA] No.

Q You're the sole one. Okay. Do you use a competitive process to solicit goods and services?

A [GUASTELLA] Yes.

Q And how do you – so, for that, you – so you do use a competitive process for that.

A [GUASTELLA] Yes. If we have specific work to be done, we will ask different contractors. One of the contractors we ask happened to be Terry Lee Construction. Terry Lee is the president and one of the owners of the utility, but he also has a construction company. And he comes in with a lower price because he had facilities on the Island, and he just gives us a lower price than other people. So we were able to get the benefit of one of the owners having a construction company. It turned out to be a bigger benefit than I ever expected, because, after the last rate increase and before – or during the last rate increase in 2012, and before the rate decision, we had a major lagoon liner failure. We didn't have the money, because we didn't

have the rates and we didn't have the financing, to make the repairs, but Terry Lee was able to come in and make temporary repairs, with the approval of DHEC, and then make other repairs at a lower price than other contractors were giving to us – and there weren't that many. And he was able to do it without getting paid, because, you know, I'm not sure the others would've undertaken a job without getting paid. Terry Lee was willing to do it without getting paid. I think we may still owe him for some of that work, but we also still owe him for other construction work that he's done, so –

Q Okay. And could you just tell me about the – I guess the chain of command? There seems to be a consulting company, a management company, stockholders. And I believe in the agreement it says that you answer to the president?

A [GUASTELLA] That's correct.

Q And who is the president?

A [GUASTELLA] The president is Terry Lee.

Q The guy that does your –

A [GUASTELLA] He's the president and he – he also has the contracting company, and he's one of the owners. He owns 67.7 percent of the individual owners of Daufuskie Island Utility Holding Company, which was a newly created utility when CK Materials was dissolved from any

relationships with the utility. Had to form another utility. Mr. Karibinchack was no longer going to be part of the ownership of the utility.

The other owners are two attorneys in New Jersey that were looking to this, I believe, as just an investment. But the primary people who are familiar, were familiar, with the utility, were initially Mr. Karibinchack and Mr. Lee. Mr. Lee, as president of the company, is the one that I report to – and I didn't want to report to three different people; I wanted someone who was going to be an officer of the company, responsible for recognizing and approving any work that I did. And I have been in many, many contacts with Mr. Lee for many, many reasons. I report to all three, but primarily I look to Terry Lee as the president of the company for two reasons: One, he's the president of the company; and two is, we've had to undertake several different things, like condemnation proceedings, and fighting off a CoastalStates foreclosure action, and then obtaining financing – very complex things, and all of them involved – I think in the primary case, I provided dozens and dozens of exchanges of e-mails back and forth between me and the owners and Terry Lee as to all of how I keep them informed of everything that's going on.

Q And how does your consulting company fit into that?
A [GUASTELLA] My consulting company is the manager of the company. I'm not just personally the manager of the company; Guastella Associates is the manager of the utility, and I happen to be president of Guastella Associates.
Q Okay, so you're the president of –
A [GUASTELLA] Yes.
Q Okay. I wanted to find out – we talked – the fees have been discussed, for the legal fees. The fees for these hearings.
A [GUASTELLA] Yes.
Q And I think they're around a little less than $800,000. Correct?
A [GUASTELLA] Yes.
Q That you're presenting?
A [GUASTELLA] Yes.
Q Okay. Could you divide those fees up, for me, according to attorneys and your consulting company and the management company?
A [GUASTELLA] Yes. The consulting company is the management company. Or the consulting company –
Q Well, you are –
A [GUASTELLA] – happens to be the same as the management company, but Guastella Associates does the rate work.

So the same company, Guastella Associates, that does the management, we also do the rate work for the utility as the rate consultants.

Q But I thought Terry was the president of the –

A [GUASTELLA] He's the president of the company.

Q The management company?

A [GUASTELLA] No, he's the president of Daufuskie Island Utility Company.

Q Okay.

A [GUASTELLA] I'm not an officer of Daufuskie Island Utility Company.

Q Well, what about the management?

A [GUASTELLA] I'm – Guastella Associates manages the utility under the management agreement.

Q Okay. So you are head of the management –

A [GUASTELLA] I'm president of Guastella Associates; Guastella Associates manages the company. Terry Lee is president of the utility company.

Q Okay.

A [GUASTELLA] And the utility company has its own on-site operators. But we supervise – "we," Guastella Associates, as managers, supervise them, as well.

Q Well, that's a very confusing circle. But, anyway, that – your explanation helps me understand that. Now I understand why it seemed so confusing and complicated.

But if you could give me a breakdown of those fees?
A [GUASTELLA] Yes, ma'am. Bear with me [indicating].
Q And what about your son, while you're looking for that? Wasn't he involved in the management company?
A [GUASTELLA] What about who? I'm sorry.
Q Your son?
A [GUASTELLA] My son works for Guastella; he's vice president of Guastella Associates.
Q Okay. Because I –
A [GUASTELLA] And actually how I use him is he's the one that spends most of the time in the field with the operators. For example, during the hurricanes, he was up there trying to get generators that we didn't have, because we didn't have financing to have the generators. And he was able to work with the State, DHEC, finding generators. This last time was a bit challenging because most of the generators were out in Texas, because those hurricanes happened first. So he was able to contact the person from whom he got the generators in the previous year's hurricane, and the fellow guaranteed Mike Guastella that Daufuskie Island would be the next to get the generators. And we have emergency access with first-responders to get on the Island once we're – when people are let on the Island. And we were able to get on the Island before residents were able to get on

the Island, to make sure we can keep our facilities up and running. So Michael Guastella really handles, directly, all the operators, and Michael Guastella, of course, reports to me.

Q Of all of your companies that you manage, are you saying, or just –

A [GUASTELLA] I only – at this point, I only manage Daufuskie Island Utility Company.

Q Oh, okay. All right.

A [GUASTELLA] I have other –

Q So, does he live –

A [GUASTELLA] – clients.

Q – on the Island, or –

A [GUASTELLA] No, he lives in Florida.

Q Okay, thank you.

A [GUASTELLA] If I may, the breakdown?

Q Yes.

A [GUASTELLA] Up until the time of the Commission's decision, Guastella Associates' fees were $415,000 – $416,000, roughly. The legal fees were, I believe, about $40,000.

Q For the attorneys?

A [GUASTELLA] For the attorneys. So those were the two categories. From the time of the Commission's decision, for requests for rehearing or reconsideration and then

the Court appeal, Guastella's fees were $127,000; the attorneys' fees were $95,000. So up until September 30th of this year, we spent about $222,000 for post-decision work. And pre-decision work, we had spent about $451,000, in total. And we're expecting that the attorneys and Guastella Associates would each have, for October, November, and December, approximately $60,000 worth of fees, so we projected fees through the end of the case of $120,000.

Q In addition to the 127?

A [GUASTELLA] In addition to – yes, in addition to Guastella Associates' 127, there would be another $60,000. And in addition to the attorneys' $95,000 there would be another $60,000. So the total of all rate-case work for the three or three and a half years that this has been going on, the total has been about $794,000, but ORS found another $8500, so that's probably closer to about $800,000. And then were also fees of $60,000 to get the bonds to assure refunds, if necessary. That $60,000 includes the cost that the bond company charged. And on the second bond, they wouldn't give it to us unless we got a letter of credit. And we got a letter of credit from SunTrust Bank, and that cost us about $7000 on top of the bond company. So the total for the bond company and SunTrust's line of credit was –

letter of credit, I'm sorry, was $60,000.

So for attorneys and consulting fees, it's – I'll call it $794,000 with some adjustments. As Mr. Gressette mentioned this morning, ORS made a few adjustments to the legal bills of $1470, and then there was some printing charges that were rendered to the company by the attorneys and then we also paid them directly, so there was a duplication of charges there. So there's an adjustment of – two adjustments of $39,005 each that we accepted that the ORS has made. ORS made a total of about $10,000 worth of adjustments, which we accepted.

Q So the attorneys – that amount includes about 200 for the attorneys, just rounding it off, and about 650 for your group, correct?

A [GUASTELLA] That's correct. The attorneys were around $200,000 spent so far through December – $222,000. And we – I'm sorry. About $95,000 plus 60, you're right, about $150,000. We expect the attorney fees to be about $150,000.

Q Well, I believe you said 95, 60, and 40.

A [GUASTELLA] The $95,000 was all the payment, all of the payments to the attorneys, through September from the start. So that's the $95,000. I don't know if it's permissible; I'd be happy to provide a late-filed.

Q That's okay. I just was trying to get an idea of how much was going to which company.
A [GUASTELLA] Yes.
Q And I wanted to – I wanted to just understand a little bit more about the cost in construction versus the paid-in-capital. How did you make that decision?
A [GUASTELLA] Actually, International Paper made that decision. The way the utility was created was that International Paper was developing over a thousand acres on Daufuskie Island. In order to serve Daufuskie Island, it had to create a utility.
Q Right, I understand that. We went through that.
A [GUASTELLA] And International Paper paid for all those facilities. At some point – and as I mentioned, Haig Point Utility had no money, had no customers, had no ability to do anything. At some point, the assets were turned over to Haig Point Utility Company at the cost of the assets. So that's how the cost of the assets was established, construction cost of the assets. As an investment, therefore, International Paper was the owner of Haig Point Utility Company, and it financed those assets through an equity investment in the utility. So the assets' cost at the time may be $4-$5 million. The equity investment – the liability side of the balance sheet represents the owner, at that point Haig Point,

Inc., which was next in line after International Paper Realty Company, had an investment of the paid-in-capital because it financed those assets. So when the utility received the assets, Haig Point, Inc., represented its equity investment in those assets on the liability side of the balance sheet. It became their investment in the utility.

Q And has this discussion of that, one way or the other, being put in rate base been discussed with ORS and the other company – the residents, customers? Haig Point and others?

A [GUASTELLA] I don't – I think it's been discussed in the rate cases. I mean, that goes back – ORS was aware of the books of the company back in the 2004 rate case, and I think I mentioned that a number of times, where the accountant for ORS said that the balance sheet that represented the construction cost of the assets that were booked as utility plant-in-service, and the paid-in-capital, which represents the equity, that was used in the 2004 by ORS. And that's a fact. And I'm not saying what the ratemaking should be, but that's a fact of how it was booked.

The 2012 was the same, where the ORS used the original cost of the assets booked at that time, and those assets grew because then there was more money

spent for the storage facilities and other facilities, so the $4-$5 million became $7-$8 million. And the balance sheet also reflected mostly equity.

The purchase by CK Materials of the utility from International Paper reflected those similar structuring, where the assets were identified as to individual and cost, and the balance sheet reflected the paid-in-capital, the equity investment, that was on the utility's books. So when CK Materials bought the stock, it bought the utility's stock for a utility that had X million dollars' worth of construction cost and Y million dollars' worth of equity.

And then in this last rate case, that was the same. And then when we financed with SunTrust, those were the booked figures, and the ORS figures that SunTrust looked at, because it wanted to have assets to support its line. So they not only looked at the books and records; they looked at all of the documents that demonstrated that Haig Point Utility Company owned all the assets. And we had attorneys that we spent an awful lot of money on, to create all of those documents, file documents, surveys, maps, costs. I mean, it was quite a process.

So throughout the whole development of this utility, the assets were utility plant-in-service on the balance sheet of the company, and the equity investment

was on the liability side of the company. And those all – those are facts. Now what you want to do with rate base – ORS is doing things with rate base, and some of it, we're just arguing what the costs are, I suppose, to whether there should be an imputation of contributions.

Q But that 2004 and 2011 were settlement agreements, correct?

A [GUASTELLA] They were. But if you look behind the settlement agreement, the settlement agreement in 2012 was a $5 million rate base. It would never have been a $5 million rate base if ORS's position had been applied then – not ORS – the Intervenors' position had been applied then.

Q But I believe –

A [GUASTELLA] But the rate-base settlement did not change what the books reflected. It was just a rate-base settlement.

Q But the 2011 Order, I guess, didn't require what was in the rate base at that time to be continued, correct? It wasn't binding that it –

A [GUASTELLA] The rate base was not binding.

Q Yes.

A [GUASTELLA] But it did not say that the books and records were wrong.

Q Right, but it wasn't binding to what went in?

A [GUASTELLA] Right. The rate base – I guess we could argue the rate base for a long time, but it seems to me – and I'm not an attorney, but I don't know if you ever get stopped from arguing the same issue, case after case after case. I mean, how much money does the utility have to spend to argue and succeed on the same issue?

Q Okay. I just wanted to clarify it wasn't binding in 2011.

And Mr. White?

A [WHITE] Yes, ma'am.

Q Yes. I wanted to ask you a question. I believe you were the one who talked about Mr. Sullivan's testimony?

A [WHITE] Yes.

Q Yeah. And they adopted the adjustments in the original testimony, in Audit Exhibit ICG-5?

A [WHITE] Correct.

Q Those adjustments lowered the base rate by about $1.6 million due to undocumented costs, at that time.

A [WHITE] That sounds correct.

Q Have you provided any documentation to support those items that were adjusted in the first, primary case?

A [WHITE] Sure. I would argue that to say something was undocumented, if you have booked values, those values were established somewhere with some documentation. If the documentation is missing, it doesn't mean the value

is zero. If you lose an invoice over a 15-year period of time, does that structure then become zero? If you've got a building there that you paid $200,000 for, because the invoice is missing doesn't mean that that building is worth nothing. If it was booked at $200,000, it's worth $200,000.

Q So, it sounds like, though, that you haven't satisfied ORS to that, for these remand purposes.

A [WHITE] Well, ORS tends to – has argued in the past that, if they disagree with the appraisal of the land, the land has zero value. They've argued that because the invoice on the building is missing, the building has zero value. My contention would be, if your choice is either a book value on that building of $200,000, or zero, it doesn't make sense to make the value zero. The building is there. You can see it. It's physically there. They've inspected the system. They know the building exists. How can they say it's worth nothing? But that's what they're saying.

Q Okay. So it hasn't been reconciled, though?

A [WHITE] No.

Q Okay. All right. Thank you.

A [WHITE] You're welcome.

CHAIRMAN WHITFIELD: Thank you, Commissioner Fleming.

Commissioner Randall.

VICE CHAIRMAN RANDALL: Thank you, sir.

EXAMINATION

BY VICE CHAIRMAN RANDALL:

Q I just – I had one question on the front lobe of my brain, and I wanted to get it before it left. I think Commissioner Fleming had asked – was asking about the rate case, about the split-up, and I wanted to make – I was going to ask what percentage of the rate case is prepared in-house by the company, but I think, Mr. Guastella, you said that Guastella Associates does all the work on the rate case, right?

A [GUASTELLA] That's correct.

Q Okay.

A [GUASTELLA] We keep all the books and records – part of our management is to keep all the books and records, supervise all construction, run the utility, and obtain financing. So when it comes to doing the rates – Mr. Lee is a good businessman and contractor, but he's not a rate person.

Q Gotcha.

A [GUASTELLA] That's why they hired Guastella Associates to do the rate work.

VICE CHAIRMAN RANDALL: Thank you.

Thank you, Mr. Chairman.

CHAIRMAN WHITFIELD: Thank you, Commissioner Randall.

Commissioner Hamilton.

COMMISSIONER HAMILTON: Thank you, Mr. Chairman.

EXAMINATION

BY COMMISSIONER HAMILTON:

Q Mr. Guastella, today we discussed a lot of the expenses that have happened since the rate case that have been remitted back to us from the Supreme Court, but the fact of the matter is what we're trying to decide today is the case that we had before, that had been remanded to us. Isn't that correct?

A [GUASTELLA] I believe so, yes.

Q Okay. So we don't have to get too bogged down, that will be in the next rate case. Correct?

A [GUASTELLA] Yes, I believe so.

Q I believe so, too. You've had a great deal of discussion, too, with Mr. Nelson about the bad debts. And I just – I caught one part that I'd like for you to go into a little more detail. Most of the bad debt, you say, came from the availability part, the lots that no one – I guess someone may be – somebody owns all of them, but have been purchased and there's a monthly fee for ones that have availability of service but there's

no property there?

A [GUASTELLA] That's correct. It's a quarterly fee, and those are the lots where the owners have not yet built a home. So most of that is what compromises the bad debts, because the connected customers, we can shut off and then they pay their bill. We get some bad debts because some of them may just leave, and I think there've been a couple who have just left. But for the most part, I would say 99 percent of the time, it's the availability customers who have not paid their availability charges.

Q And these bad debts are protected by liens on the property?

A [GUASTELLA] Well, you know, what happens, if we can't get payment after due notices and attempts, then we turn it over to an attorney to do whatever can be done to try to get them to pay, and typically what happens is you put liens on them. Now sometimes the liens work well and sometimes they don't. If the customer just abandons it, we may not be able to ever collect on the lien. The lien may become worthless, and that's, in large part, what happens. But sometimes, I believe, the homeowners' association acquires those lots and then the homeowners' association begins to pay the bills. But they don't pay for the past-due amounts, I don't think.

Q You don't think?
A [GUASTELLA] So –
Q All right. Well, thank you, sir.
A [GUASTELLA] Okay.

COMMISSIONER HAMILTON: Thank you, Mr. Chairman.

CHAIRMAN WHITFIELD: Thank you, Commissioner Hamilton.

Commissioner Howard.

COMMISSIONER HOWARD: Thank you.

EXAMINATION

BY COMMISSIONER HOWARD:

Q Mr. Guastella, I've got a couple questions. Are you a member of the board?
A [GUASTELLA] Yes.
Q Do you disclose a conflict of interest when they vote on anything concerning the rate base, or the rate case, or how do you handle yourself with that?
A [GUASTELLA] Well, I basically, as a member of the board, I'm there to really advise the board as to what's going on with the utility. I mean, we do all the bookkeeping, the billing, the accounting, supervision of the operators, so – and we don't have – it's a small utility, so when I say the board and we have meetings, typically it's an e-mail exchange where I keep the

owners up to date on what's going on, and we may or may not have a conference call after it, or we may get individual owners asking questions. So it's an informal process, but it's a small company.

Q Do you ever have a vote? Do you take a vote on anything that might be a conflict of interest for you?

A [GUASTELLA] Well, we say, "This is where we're going. Should we proceed?" And they say yes. And sometimes I say, "We need $100,000 to pay the attorneys. You don't have to pay me yet, but you have to pay the attorneys, and you have to pay for insurance and some other bills, and there's no money, so you guys have to kick up $100-$125,000." And I don't think they vote on it. What happens is they come up with proportionate shares of the money, so – it's informal. I have to acknowledge it's a very informal process, but it's a very small company. And I try not to spend a lot of time going up to New Jersey or bringing New Jersey people down to South Carolina to have meetings. They know what's going on, in detail, and there's been so much going on that it's –

Q You might've answered my next question. How many stockholders are there? Stockholders?

A [GUASTELLA] There are – the stockholder of the utility is one: Daufuskie Island Utility Holding Company.

Daufuskie Island Utility Holding Company then has three members. The members are two attorneys from New Jersey and Mr. Lee, who's also the president of the company. So there are three individuals involved. Mr. Lee has two-thirds of the ownership, of the membership of the LLC, Daufuskie Island Utility Holding Company. So technically there's only one stockholder, Daufuskie Island Utility Holding Company, but Daufuskie Island Utility Holding Company's simply a corporation that is comprised of three members: a Mr. Shimanowitz, a Mr. Hutt, and a Mr. Lee.

Q Do they have a residence on Daufuskie Island?

A [GUASTELLA] Mr. Lee has a residence. I think it's off the Island, but he also has property on the Island where he has construction equipment, so I believe he's got a strong presence on the Island. The other two are attorneys up in New Jersey.

Q I don't want to spend any time on this, but I was looking over your testimony and I saw some pages that made absolutely no sense to me, and I'm talking about your Exhibit -R6. What it is is attached for the Intervenors for the bad-debt detail. This right here [indicating], and a zillion pages of it. But I just don't know what I'm looking at, and I guess –

A [GUASTELLA] -R6?

Q And I don't know what page; it says your exhibit -R6, page 16, is the one I'm on, just for lack of a –
A [GUASTELLA] Okay. Almost there, Commissioner [indicating].
Q The first seven are the same account. Going by account numbers.
A [GUASTELLA] Intervenors asked us to give them the customers, the date, and the amounts –
Q Well, what is –
A [GUASTELLA] – of the bad debts. And we couldn't give the – we didn't want to give the customer's name, so we gave the account number.
Q I understand that. So the first item is irrigation, MBP. What is MBP?
A [GUASTELLA] Melrose and Bloody Point.
Q I thought that – and then SWR, the next one, is sewer?
A [GUASTELLA] Sewer.
Q And then, again, we've got water for Melrose?
A [GUASTELLA] Intervenors asked for a breakdown of how much of the bad debt was water, how much was sewer, and that's what we provided here.
Q So this is a three-month period. You said you billed quarterly on it?
A [GUASTELLA] We bill quarterly.
Q So this one account has these seven items in a three-

month period?
A [GUASTELLA] This is the multiple accounts of the bad debts of all different customers, availability customers.
Q So a customer account number doesn't mean a whole lot?
A [GUASTELLA] No, it's just how we identify – there's a name behind the account number, so let's call it Mr. Jones, the account that we're showing. We didn't show "Mr. Jones." I don't know if we have a Mr. Jones.
Q You answered my question. Much too much time on that.
A [GUASTELLA] Okay.
Q Thank you, very much.
A [GUASTELLA] You're welcome. Thank you, Commissioner.

CHAIRMAN WHITFIELD: Thank you, Commissioner Howard.

Commissioner Bockman.

COMMISSIONER BOCKMAN: Thank you, Mr. Chairman.

EXAMINATION

BY COMMISSIONER BOCKMAN:

Q Good afternoon, Mr. Guastella.
A [GUASTELLA] Good afternoon.
Q And Mr. White.
A [WHITE] Good afternoon.
Q Who are the other members of the board of the utility

company, besides yourself?
A [GUASTELLA] The three owners: Mr. Lee, Mr. Shimanowitz, and Mr. Hutt.
Q Are they also members of the board of the holding company?
A [GUASTELLA] They're members of the holding company. The holding company is an LLC. So the managing member, I believe, is Mr. Lee, and Mr. Shimanowitz and Mr. Hutt are members of the LLC.
Q Does the Board of Directors approve the management agreement that your company has with the utility company?
A [GUASTELLA] The management agreement was approved by the utility, itself, as well as the owners of the utility. All three, that I just mentioned.
Q And the members of the board? Do you have any – do you approve the management agreement?
A [GUASTELLA] No. No. I submit the management agreement for Guastella Associates. I personally am on the board, but –
Q You're on the board.
A [GUASTELLA] Yes.
Q Do you recommend to the shareholders that they approve the management agreement?
A [GUASTELLA] Yes, I do. I mean, in a way I do. I mean,

I prepare the management agreement; I give it to them, and say, "This is what I'm doing and willing to be compensated for, as I manage the utility." And they can either say yes or no.

Q The first management agreement your company had was in 2008? Is that – executed in 2008? Is that – do I recall your testimony correctly?

A [GUASTELLA] Yes.

Q Who were the clients or the opposite, the other parties, to that agreement?

A [GUASTELLA] At that time, it was the utility and there were four individual owners. It's complicated because CK Materials was the owner. It was an LLC that was the owner of the utility.

Q The owner of the utility, the equivalent of the holding company, the parent company –

A [GUASTELLA] Today, yes.

Q – today. All right.

A [GUASTELLA] And there were – and I don't know if it was an LLC; I think it was. But there were stockholders of that utility, and when they set up that utility, Mr. Karibinchack and his wife – complicated – had formed CK Materials and that existed at the time they wanted to acquire the utility. So they made that the vehicle of who would own the utility, and CK Materials would buy

the utility from International Paper.

In addition to Mr. Karibinchack, Mr. Hutt, and Mr. Shimanowitz, and Mr. Lee were also made members of JK Holding Company, and there was – some of the stock of CK Materials was in JK Holding Company, and some was in CK Materials. But part and parcel, all of – in addition to the utility, all of the owners of the utility, whether CK Materials or the individuals, were those who entered into the agreement with Guastella Associates.

Q You have – the original agreement was in 2008. The current management agreement was executed in June of 2015. Is that right?

A [GUASTELLA] 2016, I believe, the current one. Or was it '15?

Q You did say that there's a revision. The one that we've been looking at is dated June 18, 2015.

A [GUASTELLA] Okay.

Q Is there a subsequent one?

A [GUASTELLA] No. That one is still in effect, and that will be in effect until next year.

Q Next year, right. How many management agreements have there been between 2008 and 2015?

A [GUASTELLA] Every three years, so I guess –

Q Were they similar –

A [GUASTELLA] – two, so far.

Q – in form? I'm sorry.
A [GUASTELLA] I believe two, so far. Maybe this is –
Q But every three years, so whatever that amounts to. And I'm not very good at math. Were they similar with respect to the terms of the agreement?
A [GUASTELLA] The terms of the agreement were the same. There was one change in the last agreement, I believe, where there was a 15 percent incentive fee, which I changed to a 20 percent incentive fee, because I was absorbing all of the costs that were not paid without charging any interest. So it turned out that I was providing, indirectly, as much money to operate the utility as the owners were, because –
Q So you have a financial interest with respect to the fact that the company owes you –
A [GUASTELLA] The company owes me a lot of money from past charges that they were not able to pay. When I say the company wasn't able to pay them, I knew the company wasn't able to pay them, so I didn't pay Guastella Associates with utility funds because the utility funds had to be used to operate the system.
Q How much does the company owe you?
A [GUASTELLA] I think it's over $600,000.
Q And that was accumulated over a period of how long?
A [GUASTELLA] Since 2008. In 2008 – in 2008, I was paid

part of my cost of helping them buy the utility, but there was still a balance left. So there was a part of the initial cost of just helping them acquire the utility. And then there was the management fees and other costs, and then we had the rate work for the last rate case, and Guastella Associates still hasn't been paid for the last rate case. Then we went through all of the financing costs, and we haven't been paid for all of the financing costs. So the cash flow just hasn't been there. I mean, the utility started out, if you recall – and then I mentioned the Exhibit 7 in the earlier case. We had that construction reserve report to the Commission that we had to get to the Commission; it really lays out the background of the history of the company and how it was formed. But all along these years – and, you know, by the way, I wasn't the only one contributing to serve the customers. The stockholders have never gotten any dividends, and they have infused, I believe it's hundreds of thousands of dollars, themselves, either directly by cash infusions or by paying for utility bills and the utility owes them for the money that they paid for the bills.

Q You mentioned that, in negotiation of the original management agreement in 2008, I think you said there was some back-and-forth with respect to some of the terms of

the agreement. With respect to the compensation – what was it, Article IV, I guess – how much back-and-forth was there, with respect to the management fee, the capital fee, the finance fee, and the incentive fee? How much back-and-forth was there with respect to those?

A [GUASTELLA] Not very much. There wasn't very much back-and-forth at that point in time. There was back-and-forth on – when I helped them acquire – when I helped CK Materials acquire the utility, one of the requirements was the utility had to be owned by somebody who knew how to manage and run the utility. So then there was back-and-forth as to who was going to do what, what was I going to do, and I began to list out and go back and forth with the owners, and then the attorneys were working on the acquisition, what duties we'd be performing. And if you read my management agreement, there are certain things – I'm going to make sure the customers get service and we comply with regulatory requirements, and I'm going to do the day-to-day billing, accounting, dealing with banks, just – you know, you'll see the big list of duties. I'd say there was back-and-forth on that. And then there was some back-and-forth when –

Q Well, specifically, with respect to the terms of compensation is what I asked.

A [GUASTELLA] Not very much. I mean, the owners recognized that without me not getting paid, they were going to lose their investment. And they also recognize that I saved them from foreclosure and the utility being turned over to a trustee when they weren't paying the CoastalStates Bank.

Q Well, in 2008 – I don't mean to interrupt you – well, yes, I do.

[Laughter]

But in 2008 you said, you know, that – did the owners have the impression that you were not going to be paid for your work?

A [GUASTELLA] No, I didn't have that impression either.

Q I wouldn't have thought so. But, so, but now in the interim agreements between 2008 and 2015, was there back-and-forth with respect to compensation in those interim agreements?

A [GUASTELLA] No, because what happened was from almost day one of them – of CK Materials and the individual owners therefor acquiring the utility, we found out that Melrose Utility Company, that had a joint-venture ownership of the wastewater treatment plant at Haig Point, they were supposed to be paying 40 percent of the share of that. They stopped paying that. They eventually disappeared. They abandoned everything;

there is no operator, no accountant, no office, or anything. Our operators then were able to go in there and operate that system, but we lost 25 percent of the revenue. So from year one, Melrose Utility Company didn't live up to its agreement on the joint-venture ownership of the treatment plant, so the company started with 25 percent less revenues than anybody expected.

I even filed with the Commission to open an investigation – which I believe the Commission did – to try to get paid from Melrose Utility Company. But then Melrose Utility Company went bankrupt, and, eventually, what happens is, on March 1st of 2010, Melrose Utility Company was merged with Daufuskie Island Utility so that it became a part of our operation.

Q But back to the compensation, with respect to the fees, the company agreed to – well, let me ask it – your company proposed those various numbers in those fees. Is that correct?

A [GUASTELLA] Yes.

Q And the company accepted that without any back-and-forth, I think was your term.

A [GUASTELLA] That's correct. They were – they were happy to do it. I saved them from losing all their investment. They knew I saved them from losing all their investment.

Q And over that period of time from 2008 to the interim agreements to 2015, how did those fees change in those agreements?
A [GUASTELLA] In accordance with the agreement.
Q Yes, but what – how did they change? I mean, was it lower? Higher?
A [GUASTELLA] Well, there's a provision in the agreement that the Guastella Associates management fees would increase by 3½ percent a year, and they would increase with growth in customers, by taking 20 percent of the growth in customers and applying it, 25 percentage of that, and increasing the cost per customer, or the existing cost per customer. So if this system – which, if the economy didn't change, we were expecting to have all this growth, and our fees would've gone up, because we do the accounting, the billing, the collecting.
Q Sure.
A [GUASTELLA] And over the years, I demonstrated to the owners – not only did I save them from foreclosure – we also began to save them significant amounts of money on billing and operations. I mean, at one point, we saved them $450,000 in taxes. You know, we got a tax bill we never knew – never got before. They never knew we existed – Beaufort County and the Department of Revenue didn't know we existed. So in 2012, after the rate

decision, when we had about $10,000 a year built into the rates, we got a tax bill for $350,000 for 2010, 2011, and 2012. I was able to negotiate, with the help of our friendly attorneys, an elimination of the 2010-2011 taxes. I was able to negotiate a payment plan for the 2012, '13, '14, and '15 taxes. So in all total, we saved the customers and the utility about $450,000. The owners are seeing all this. They're seeing all of what's going on, and they were pretty happy with what was going on. We had a reasonable rate decision. They saw what it took to get financing, but we eventually were successfully in even getting financing, which seemed impossible, and they –

Q Is that the SunTrust arrangement that you're talking about now?

A [GUASTELLA] Yeah, but before – yes, but before the SunTrust arrangement, there was the possibility of CoBank, Wells Fargo, and all those fell through. And then they recognized the work I had to go through to reorganize all of their system, and they were an integral part of the reorganization, because CK Materials was comprised of the individuals of CK Materials plus the JK Holding Company, I believe it is, so all of that stock had to be arranged, all the operating agreements between those parties had to be

reversed, new operating agreements had to be formed, and every individual owner had to provide personal guarantees. Every year, they have to provide their tax-return information to the banks. This turned out to be a massive effort that I have never seen any small company have to undergo, ever. And I think the owners appreciated that we kind of took them through all of it and, as we sit here, we're fairly successful, but the real success is yet to come.

Q Well, so they've accepted your proposal for all these fees every time that the agreement was negotiated?

A [GUASTELLA] Yes, they did.

Q And in Mr. Beach's cross-examination, he went through, you know, essentially, your efforts to do the refinancing that's ended up with, presumably, an arrangement with SunTrust. And you talked about the amount of time that you spent and the fact that finance fee, your fee, would be based on your hourly rate, not on that 2 percent percentage. Is that correct?

A [GUASTELLA] It was whichever would be higher.

Q Whichever would be higher, which I think you conceded to him would be the hourly rates. So, the more time, the longer that these efforts take, the higher your fee would be. Would that be a fair interpretation?

A [GUASTELLA] Exactly.

Q Okay. All right. And so there's no real incentive for you, on that fee, to conclude arrangements like that expeditiously.

A [GUASTELLA] Except I've been doing this for over 50 years, and I've testified at 250 or more cases, and I've had 600-700 clients, and I always do what's right for the customers. And the clients know it, and that's what we're going to do. If we could've gotten this financing accomplished – it wasn't Guastella Associates' fault that the financings fell through. CoBank said, "What if it gets wiped out in a hurricane? We're not going to give you the loan." Wells Fargo said, "We're going to give you the loan." "Gonna give you the loan." Then I got an e-mail saying, "We're not going to give you the loan." Not the fault of Guastella Associates.

Then we created all of this that worked. So all the work we were doing was not created by Guastella Associates. Going through the rehearing and going through the cost of this rate case on rehearing: Not the fault of Guastella Associates. I do what's in the best interest of the customers. I don't get the stockholders or the owners any money until we pay the customers first. All of my costs that have increased over the years, the stockholders are either going to have to absorb – and I hope I can get it, over time, someday.

So when I act, I act on behalf of the customers.
Q Does your company recommend capital projects, construction projects, for the utility company?
A [GUASTELLA] Yes.
Q And there's a fee associated with capital improvements that the company makes that is paid to your company. Is that correct?
A [GUASTELLA] That's right.
Q Okay. So the more projects that you recommend, the higher your fee would be, under this agreement?
A [GUASTELLA] Well, the projects we recommended – we have such limited ability to attract capital that we would recommend the projects that DHEC wants us to include. And I might add that our construction portion fee is half of what's typically charged for engineering fees for supervision. So the utility is getting construction supervision and management at a fee that's less than what's typically charged, and that evidence was presented in the previous hearing.
Q All right. What capital improvements has the company made since 2015?
A [GUASTELLA] We've had some improvements to the lift stations, the sewer lift stations. In the 2015, we didn't get – we got approval of the rate increase in 2012, in August. We didn't get the financing until the

end of 2013. It took us that long to get the financing. So then major improvement started to happen in 2014 and '15. I think in '15 maybe was when we completed the failure of the lagoon liner. We also had a replacement of the major lift stations and control panels at the wastewater treatment plant, various work on the various lift stations and pumps. We had to construct a new office building at the treatment plant site. We've been installing some meters on the meter installation program. But we're kind of out of money.

What we haven't been able to do – and then DHEC required a number of improvements. We submitted to DHEC a Capital Improvement Program for their approval. They were the ones who recommended them. They approved our Capital Improvement Program the day we submitted it, and then formalized it with a letter.

So we're doing what's necessary to serve the customers. There's no room to do more. But the system began in the '80s, so we're now having to keep and maintain the system.

Q You get your direction from Mr. Terry Lee; is that right?

A [GUASTELLA] I report to Mr. Lee. And he has access to the bank account with SunTrust, so he knows every dollar that's coming in and out of the utility. He could spend

money on his own, doesn't need me for that. But he kind of supervises what's going on, and then we work closely with him because he undertakes some of the capital improvements, so we – I supervise his people, as a matter of fact, and if his people aren't acting fast enough, I call Terry Lee and Terry Lee then lights a fire under them. So there's a lot of interaction between us.

Q You tell him what to do, or he tells you what to do?

A [GUASTELLA] I pretty much tell him what to do. I mean, he's a contractor and he does construction work, so he understands what's going on.

Q Are any, well, any of the shareholders, the people with an interest in the company, are they here today?

A [GUASTELLA] No.

Q You have their authorization to appear as –

A [GUASTELLA] Yes.

Q – a representative of the company?

A [GUASTELLA] Yes.

COMMISSIONER BOCKMAN: Thank you, Mr. Chairman.

Thank you, Mr. Guastella. I've got no further questions.

CHAIRMAN WHITFIELD: Thank you, Commissioner Bockman.

I know we had told the parties we were going to try to stop around 4:30 today. And Commissioner Elam and I still have some questions, and I know there will be an opportunity for redirect. So at this time I think we're going to recess until in the morning, and we'll start back at 10:30 in the morning.

[WHEREUPON, the witnesses stood aside.]

[WHEREUPON, at 4:27 p.m., the hearing in the above-entitled matter was adjourned, to reconvene at 10:30 a.m., December 7, 2017.]

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 rehearing on remand 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 14TH day of December, 2017.

Jo Elizabeth M. Wheat, CVR-CM/M-GNSC
Hearings Reporter, PSC/SC
My Commission Expires: January 27, 2021.

BEFORE THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

COLUMBIA, SOUTH CAROLINA

HEARING #17-11494 DECEMBER 7, 2017 10:30 A.M.

DOCKET NO. 2014-346-WS:
DAUFUSKIE ISLAND UTILITY COMPANY, INC. – Application for Approval of an Increase for Water and Sewer Rates, Terms, and Conditions

Rehearing on Remand of the Supreme Court of South Carolina

TRANSCRIPT OF TESTIMONY AND PROCEEDINGS **VOLUME 2 OF 2**

HEARING BEFORE: Swain E. WHITFIELD, CHAIRMAN; Comer H. 'Randy' RANDALL, VICE CHAIRMAN; and COMMISSIONERS John E. 'Butch' HOWARD, Elliott F. ELAM, Jr., Elizabeth B. 'Lib' FLEMING, Robert T. 'Bob' BOCKMAN, and G. O'Neal HAMILTON

ADVISOR TO COMMISSION: F. David Butler, Esq.
SENIOR COUNSEL

STAFF PRESENT: Jocelyn G. Boyd, Chief Clerk/Administrator; Joseph Melchers, General Counsel; James Spearman, Ph.D., Executive Assistant to Commissioners; William O. Richardson, Douglas K. Pratt, Thomas Ellison, and John Powers, Technical Advisory Staff; Jo Elizabeth M. Wheat, CVR-CM/M-GNSC, Court Reporter; and Calvin Woods and William O. Richardson, Hearing Room Assistants

APPEARANCES:

G. TRENHOLM WALKER, ESQUIRE, and ***THOMAS P. GRESSETTE, JR., ESQUIRE,*** representing DAUFUSKIE ISLAND UTILITY COMPANY, INC., **APPLICANT**

APPEARANCES *[Cont'g]*:

JOHN F. BEACH, ESQUIRE, and ***JOHN J. PRINGLE, ESQUIRE,*** representing HAIG POINT CLUB & COMMUNITY ASSOCIATION, MELROSE PROPERTY OWNERS ASSOCIATION, and BLOODY POINT PROPERTY OWNERS' ASSOCIATION, **INTERVENORS**

JEFFREY M. NELSON, ESQUIRE, and ***ANDREW M. BATEMAN, ESQUIRE,*** representing **THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF**

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CHAIRMAN WHITFIELD: Please be seated. I'll call this hearing back to order, and I believe we will resume with Mr. Guastella and Mr. White on the stand, and we're still under the Commissioners' questions' time, and I think Commissioner Elam is up next.

THEREUPON came,

JOHN F. GUASTELLA,

GARY C. WHITE,

recalled as witnesses on behalf of the Applicant, Daufuskie Island Utility Company, who, having been first duly affirmed, were examined and testified as follows:

EXAMINATION

BY COMMISSIONER ELAM:

Q Good morning, Mr. Guastella.

A [GUASTELLA] Good morning.

Q Beautiful day in the neighborhood.

A [GUASTELLA] Sure is.

Q Chamber of Commerce weather. Mr. Guastella, what is the current status of the elevated tank property?

A [GUASTELLA] The latest decision from the Court was –

Q I'm sorry. Which court, please? Circuit Court, or Court of Appeals?

A [GUASTELLA] Circuit Court. – was that the utility was

successful in being able to condemn the property and then it also established that the property only includes the land; it does not include the utility facilities. And now it's going to go to trial at some point.

Q So all that is at issue is the land itself?

A [GUASTELLA] Correct.

Q And that is still pending in the trial court?

A [GUASTELLA] Correct.

Q Do you have a trial date for that?

A [GUASTELLA] No.

Q And can you tell me what the approximate value of just the land is?

A [GUASTELLA] We had an independent appraiser appraise the land at $3700. However, as you might not know, I perform appraisals myself for utilities. Value is value to the owner, not the purchaser. There's storage facilities and wells on the property, so the owner cannot use the property. So, from my perspective, the value is zero. The owner paid, in the tax sale, about $540 for the property.

Q Okay.

A [GUASTELLA] So when it comes to trial, my testimony is going to be the value is zero. An independent appraiser had a value of $3700, but did not take into account the cost of – hypothetical cost – of removing facilities if

the property could be used. But facilities cannot be removed, so the value's anywhere from zero to $3700, from our perspective. The appraisers of Mr. Sabry, who's the owner, had come up with an appraisal of over $100,000, I believe, but that included the value of all the facilities.

Q Okay.

A [GUASTELLA] So that's more or less where it stands.

Q Okay. Who did the County send the tax bill to this year?

A [GUASTELLA] The tax bills are coming to our offices.

Q Okay. So, I'm sorry, what did you say the man's name was? Sarab, or – I'm sorry.

A [GUASTELLA] Oh, Sabry.

Q Sabry.

A [GUASTELLA] Mr. Sabry is the owner of the land. The tax bills for the utility facilities are coming to the utility.

Q Okay.

A [GUASTELLA] The tax bills for the land itself, I don't know where they're going.

Q Okay. Is the land in your rate base, right now?

A [GUASTELLA] No.

Q Okay.

A [GUASTELLA] And the – if you're interested in the full

story, the only reason we're even taking action to condemn the land was because that was part of what we were required to do when we borrowed the money from SunTrust. They had a provision that we would acquire the land. From my perspective, I don't need to own the land, because all of our documents indicate that we could have access to and use our facilities, regardless of whether or not we own the land. So our pursuit of this was because it was a provision in the SunTrust loan.

Q You wouldn't require some sort of an easement from the owner of the land, if you didn't own the land?

A [GUASTELLA] No, because I believe the original development documents, the covenants and restrictions documents, give us easements for all land that we need access to our facility, so there's a blanket easement for us to – "us," being the utility – to gain access to all of our facilities.

Q Okay. And the owner, if it's someone else, would not have the ability to take the facilities down?

A [GUASTELLA] Oh, no.

Q Okay.

A [GUASTELLA] No.

Q All right. Let's talk about return on equity. You proposed a 10.5 percent rate of return on equity be

used?

A [GUASTELLA] Yes.

Q And I think you may have discussed this prior, perhaps with Mr. Beach. You didn't do any kind of an independent analysis of comparable companies or risk assessments?

A [GUASTELLA] I didn't present any exhibits, at all, referring to that. My comparable analysis comes from having 600 developer-related, water-system clients, small utilities, and every single one of them either cannot finance, or if they do finance it requires personal guarantees of the owner or the parent corporation. And they are so sensitive to earnings erosion that any unusual expense or shortfall in revenue, as a result from, say, a rate case, pretty much wipes out their return on equity or reduces it to a percentage that is half of what was allowed, or some small percentage. That sensitivity to earnings erosion for small utilities – the couple thousand or 15,000 that are in the country, of which maybe 1000, or so, I'm familiar with – always invariably shows that they are unable to achieve the rate of return allowed by the regulatory agency - even achieve the 10.5 percent, frankly – and they cannot borrow without guarantees from the owners. Same thing with Daufuskie. Daufuskie's

loan required the owners to commit to guaranteeing the loan with their own assets.

Q Okay.

A [GUASTELLA] So the cost of capital analyses, from my perspective, that deal with large companies, that are hundreds if not thousands of times bigger, just don't apply; they don't have that - they don't have that impact that the small utilities have, and that's - when I come up with 10.5, did I do an analysis? I've been doing this for over 50 years, as a regulator for 400 companies and a consultant, I find the exact same thing. And it's the same thing for small companies to attract capital. The 10.5 is basically, from my perspective, a nominal amount, because when you start looking for a 25 percent return on equity investment, it's never going to happen, because it sets a precedent by the regulatory agency that the regulatory agency doesn't want to set.

Q Okay. Mr. White.

A [WHITE] Yes.

Q You had some discussion, I guess perhaps in your direct or in your cross-examination by Mr. Beach, talking about the bad-debt issue. You recall that?

A [GUASTELLA] That was –

Q Well, okay, either one of you.

A [GUASTELLA] That was me.

Q Okay. And I'm trying to see if I understand what the testimony was. I thought I heard that bad-debt rate would go up as the rates go down. Is that what I heard?
A [GUASTELLA] No. The level of bad debts will increase with the increase in revenue.
Q Okay.
A [GUASTELLA] So when you apply a consistent percentage for bad debts to the level of revenue, as the revenue increases, the bad debts increase. So, in other words –
Q Using the same percentage.
A [GUASTELLA] The same percentage or same analysis. In other words, if you adjust – if there's a 50 percent increase in revenue, there's likely going to be a 50 percent or thereabouts increase in bad debts, because the same lot owners that are paying availability fees, that are not paying the fees now, are not going to be paying the fees at the higher level of fees.
Q Okay. Now, I know this is Mr. White. I don't want to leave you out.
A [WHITE] Okay.
Q There was an exhibit, which was an attachment to your direct testimony, that you talked a bit about yesterday with Mr. Beach. It was your Exhibit GCW-R1, page 45?
A [WHITE] Okay [indicating]. Yes.
Q Talking about the utilization percentages.

A [WHITE] Yes.
Q And you said it did not equate to used-and-useful.
A [WHITE] Correct.
Q What does it equate to?
A [WHITE] It's merely the percentage of customers currently connected to the system, versus the number of customers that could be connected to the system, potential customers. So in other words, what we're doing is reducing the depreciation rate or increasing the service life because not as many customers are using those particular facilities – active customers using those facilities.
Q And I don't want to read too much into the words, calling it excess capacity, but capacity you have that is built beyond where you have customers building homes, that's what you're talking about?
A [WHITE] Well, yes, to some level. I mean, right now - this has nothing to do with used-and-useful. Right now, any additional capacity that is available is covered by the availability fees. I mean, theoretically, the availability fees are charged to the customers to cover their cost of having the facilities available.
Q Are you - and I don't know what percentage it was you were talking about of the total system that is really not being utilized, because it was – if I recall, the

system utilization was less than half of what it's built to be able to hold; is that correct?

A [WHITE] Correct. It's probably around 40 percent, 42 percent, somewhere.

Q So the availability fees you're collecting are covering your costs to maintain and have recovery of investment on over half the system?

A [WHITE] Theoretically, that's the way it's supposed to work, yes.

Q And theoretically, I got it. Is that, in fact, true?

A [WHITE] I haven't done a cost-allocation study to know if it's exact or not, but, I mean, theoretically, that's the way originally it was set up and designed.

A [GUASTELLA] If I may, Commissioner? It is true. That's the way the system was designed. We have mains that extend throughout the entire area, so the availability customers also extend beyond the entire area, and there's a requirement to have enough capacity to serve the availability customers whenever they connect. So to the extent that there's a - the capacity that we have is all used and useful, it's either being used to serve customers that are connecting or it's been – it's being, in effect, used to provide availability service to whenever those customers want to connect to the system. So it's a requirement we must provide service to any of

those customers whenever they connect to the system.

And the reason it's 100 percent used and useful is because you can't design treatment plants in two or three steps, because total cost of those treatment facilities would be three times more than what the existing costs of those facilities are. So when we talk about used-and-useful analyses, what is the prudently sized and least expensive plants to install to serve availability customers, without saying, "We're going to phase in this project. We're going to build enough for the first 100 customers, the next 200 customers, the next 300 customers." The cost of those facilities would triple the investment in the facilities, so you build economically sized plants to be available to serve the full development and the availability customers. So that's 100 percent used and useful.

Q Okay, I understand. You get availability fees when somebody buys a lot?

A [GUASTELLA] Yes. The availability fees are charged to every owner of every lot.

Q Okay. Unsold lots, you get - have you gotten or do you get availability fees from whoever owns the unsold lots?

A [GUASTELLA] I don't believe there are unsold lots. I would have to check, but if there –

Q Really?

A [GUASTELLA] Yes. – if there's any unsold lots, it would be very few of them. I'm not aware of any unsold lots. I believe we're providing service to about 1100 lots, and I believe that's the level that's out there.

Q Does any one person or company own a majority of those lots or are we really talking about individual owners of each lot?

A [GUASTELLA] Mostly individual, but there are some lots that are owned by one entity, and that entity might own four, or five, or ten. There are maybe a couple of those, not too many of those. But there are some owners of multiple lots.

Q And –

A [GUASTELLA] And if I might, just as a matter of interest, some of those owners have said, "We only want to pay one availability fee for these three or four lots." In order for them to do that, they have to take action to combine those lots through the County, or wherever they combine those. And then if they're able to do that, they then request we charge them only one service availability fee for maybe one or two or three lots.

Q At the single amount, or at –

A [GUASTELLA] At the single availability per-lot charge. And we would do that, provided they convert their lots

into one lot and they do not revert to splitting them up again.

Q Yeah.

A [GUASTELLA] Yeah. So if they split them up again, we're then telling them – and I don't know if we're telling them just with a letter or a commitment – that if they then split them up again, they're going to have to pay for three of them, and retroactively. So we're trying to make sure that they're not working the system.

Q How do you monitor that?

A [GUASTELLA] We would know from - I guess we would know from the records that we obtain from the County as to who owns the lots.

Q Do you get regular updates from the County about who does or doesn't –

A [GUASTELLA] No, we would have to pursue that.

Q Is that something you do as a matter of course?

A [GUASTELLA] This is just happening, so it's – you know, it hasn't happened before. That's just come up during this last year or so. Maybe not even over a year, maybe within this past year we've had those requests. So we're just dealing with that for the first time now.

Q Right. If you have those requests – you say the system was designed to cover costs through a certain availability fee. If you start having lots combined,

does that not cut down your projected revenue from those unsold lots?

A [GUASTELLA] It would adjust the revenue, yes.

Q So how many of those have you had?

A [GUASTELLA] Two. I believe it's two.

Q All right. Excuse me if I sound a little snarky. And was it just three or four lots, or was at nine or ten lots?

A [GUASTELLA] I believe it was somewhere between three and five lots.

Q For both of them, or – you said –

A [GUASTELLA] I would have to look.

Q Okay.

A [GUASTELLA] This is obviously not a big, major issue that we're dealing with.

Q And let me clarify. Is that a one-time fee or is it monthly, yearly?

A [GUASTELLA] The availability fees?

Q Right.

A [GUASTELLA] The availability fees are quarterly.

Q Okay. I'll let either one of you address this. When you were discussing depreciation yesterday, you made the statement – and I believe it was you, Mr. White – that there were some inconsistent useful lives on ORS's part, for some of the properties – some inconsistent useful

lives for depreciation of property.
A [WHITE] Right, yes.
Q Can you give me an example of what you're talking about?
A [WHITE] Off the top of my head, for example, in Ms. Stutz's depreciation study in 2011 for the test year ending June 30, 2011, I believe she used 10 years for all general plant items. In this particular – under this particular rate filing, the ORS has proposed using 15 years for some general plant items, 16 years for some general plant items, six years for some general plant items. So in those terms, that has changed. I know that for mains, I believe Ms. Stutz used 42 years as the useful life; Mr. Sullivan is using 43 years for the useful life. I just don't - I don't know why we're changing the useful lives by one year, but – the service lives by one year – but we are.
Q All right. You don't have – you don't project like only one number – 10 years, 15 years, whatever – for all the equipment, as far as useful life. Correct?
A [WHITE] The useful life - are you speaking about general plant items?
Q No, I think you said prior that there was – ORS was using kind of a flat 10-year life for everything, I guess including mains?
A [WHITE] No, no, no.

Q Oh.
A [WHITE] This was just general plant items, which would be office structures, office furniture and equipment.
Q Okay.
A [WHITE] That kind of thing. Tools, vehicles.
Q All right. And they've gotten more specific now?
A [WHITE] Yeah, more specific now.
Q What are the specific differences between your judgment on that and what ORS has put forward?
A [WHITE] Well, I mean, my judgment – or my criticism, I guess, is why we continually are changing the service lives of any plant asset. I mean, the company has been consistent in their use of useful lives since 1984, and so they've brought everything forward on a consistent basis. ORS seems to change every couple of years, change something about the depreciation rates.
Q And perhaps in the past, if cases were settled, really setting a rate was a little less important? Would you agree with that?
A [WHITE] Well, yeah, under settlement, it doesn't become cast in stone.
Q Right. Thank you. I have nothing further.
A [WHITE] Okay. Thank you.
CHAIRMAN WHITFIELD: Thank you, Commissioner Elam.

EXAMINATION

BY CHAIRMAN WHITFIELD:

Q I have a few questions for you, myself. A good many of them have been asked already. But, nonetheless, I want to go forward with a few, and I'm going to start with one on capacity and then I'll circle back to that a little bit later with some questions in the middle. Commissioner Elam asked you some questions about capacity, and I think not – you, Mr. Guastella, said 1100 – you serve 1100 customers there. And I guess what I would ask is, what is the capacity of the water and wastewater systems there? Is that it, the 1100 max number that you mentioned?

A [GUASTELLA] Well, the capacity for the water system, for example, is based on the ability to provide the maximum day plus fire demands.

Q Right.

A [GUASTELLA] It's not based on the number of customers. So at some point, when – you have to have the physical capacity there to provide water at any rate, but when you design the system, when you decide the treatment plant, you must design the treatment plant to provide water on the maximum day plus the fire demand on the maximum day.

Q And the same with the wastewater treatment plant, too.

A [GUASTELLA] Well, the wastewater treatment plant is actually –
Q The maximum –
A [GUASTELLA] Well, it's either maximum month or maximum three months' demand, because the wastewater treatment plant, obviously, doesn't provide fire service, and you do not design the treatment plant just for quantity; you design the treatment plant to meet, you know, the biological demands on the treatment system.
Q As if everyone is using it all simultaneously, too, is that not correct?
A [GUASTELLA] No. No, no. It's what's being used on either a month or three-month basis. You don't assume that every customer is flushing toilets at the same - at the same rate in the same period of time. So it's a - it's a different design criteria than for water.
Q Well, okay. That said, I think Mr. White may have answered and told Commissioner Elam that the capacity that's being currently utilized is 42 percent. Was that the number you tossed out?
A [WHITE] I misspoke if I said that. It's not the capacity that's at 42 percent. We, right now, have approximately 42 percent of the potential customers connected to the system.
Q That's what I'm saying. Being utilized.

A [WHITE] Yes.
Q That's my question. Okay. And 42 percent is your answer, right? Let's shift gears just a little bit, and I'll come back to some of that in a minute. I guess this would be for you, Mr. Guastella – and I may need to give you a minute to get there. I'm going to reference something in Ms. Dawn Hipp's testimony. I'm assuming you've had a chance to look at her testimony. And on page eight of her testimony - if you need to let your attorney bring it to you, let's pause for a minute.
A [GUASTELLA] Sure.
MR. GRESSETTE: [Indicating.]
WITNESS GUASTELLA: [Indicating.] And that's page eight of surrebuttal testimony?
BY CHAIRMAN WHITFIELD:
Q Ms. Hipp's - yes, her rehearing testimony, on page eight.
A [GUASTELLA] Okay.
Q She testifies that ratepayers with similarly situated utilities pay far less per month for management fees than Daufuskie Island Utility Company. Now, you've been real clear in here yesterday, and again, I guess, a little bit today – or mainly yesterday – that your management fees are very different from your consulting fees for rate-case consulting, for rate-case expenses.

And so right now, we're just going to focus on the management fees. And my two questions relating to Ms. Hipp's statement is, does Guastella Associates provide additional services that management companies of these other utilities, similarly situated utilities that she's referring to, does Guastella Associates provide additional services that those other management companies don't provide? Are there any additional services you provide?

A [GUASTELLA] I can't tell you what services those other companies provide. I can tell you that the comparisons that Ms. Hipp makes are for Harbor Island Utilities and Kiawah Island Utility. Those are not similarly situated utilities. Harbor Island –

Q Well, I was going to ask you – that's my next question. How can you explain this, it being so much higher for Daufuskie Island Utility?

A [GUASTELLA] Well, two things. First of all, the comparison that Ms. Hipp makes is a cost for management per customer, per month. Harbor Island has no treatment plant. Its investment is, I believe, about 1/10 of what our investment is. It has one wastewater treatment plant; we have two. It has no wells; we have seven. So the whole operation is completely different.

Kiawah Island, the management fee Ms. Hipp includes

in Kiawah Island does not reflect all the management costs at Kiawah Island. That is just the outside parent company allocation of management fees. Kiawah Island also has an employee of itself that does the same kinds of management services that we perform, so that - we're not comparing the total amount of fees for Kiawah Island.

The significant point, however, is Ms. Hipp's allowance for management fees is at $25 a month per customer. Her exhibit shows for Kiawah Island $7 a month per customer. Ours that we're requesting is $30 a month per customer. So the difference between Ms. Hipp's allowance of $25 a month and our request for $30 a month is similarly more than the $7 a month comparison that she makes. I don't believe it's possible to evaluate the difference between ORS's $25 a month and our $30 a month. I mean, it's only a $5 difference. That $5 difference merely means that we've had increases for inflationary increases that Ms. Hipp is not reflecting, because her $25 a month is based on the allowance for the 2011 management fee level. Ours is based on the allowance for the 2014 management fee level.

So the comparisons that Ms. Hipp is using is not based on comparable utilities, and it's not based on a

comparable analysis of the period of times that are being examined. And the difference between the allowance by ORS of $25 and $30 a month certainly cannot be interpreted that we're not providing a different level of management services. Now I know for a fact that the level of management work that we do for this utility is unlike pretty much anything any other utility has faced. I mean, I'm not going to go through and -- again, the record shows all the problems that we have faced even since the last rate case. I'm not aware of any of those problems for Harbor Island and I'm not aware of any of those kinds of problems even for Kiawah Island Utility Company. I mean, I did work for Kiawah Island Utility for rate work, and also for valuation work, to help them with the sale of the utility, so I'm pretty familiar with what Kiawah Island is doing. I'm not familiar at all with Harbor Island, just knowing it's a utility that has access by land. We don't. All of our work has to be - costs include an island that's not accessible by land.

So these are just not comparable utilities, and even if they were comparable, the difference of $5 a month when you're looking at $25-$30 a month, certainly, to me, is not an indication that our management fees are excessive.

Q So your answer is they're not similarly situated or comparable, if you will, utilities, is what your –
A [GUASTELLA] That's correct.
Q – response is? Well, thank you for your answer to that one, Mr. Guastella. I got a couple more questions. Let me ask you one other question, because this other – my last one may involve you and Mr. White. Let me ask you one other question. Commissioner Elam asked you a little bit about this, this morning, and you were also asked about it yesterday, and it has to do with the water tank. And your testimony here in this case, the way I remember it from last time is consistent in the fact that you say that it's never been your belief that you needed to own that property anyway, that you could use the tank whether you owned it anyway. You said that in the last case and you're saying that again now. However, we went through a list of questions of things that you did, and you answered yesterday about your efforts to get Beaufort County to send you the tax bill. And in the last case, we didn't have any witnesses from the Department of Revenue here to compute those values; we did have the Beaufort Treasurer here. But you went through quite a list, giving them the right address, telling them what your address was, all those sorts of things. And it looks like to me you did do – make some

efforts, but one last thing you left out. Did you happen to call the Beaufort - you are anybody from Guastella Associates? I think it's obvious that you should have gotten a tax bill. My question is, did you or anyone from Guastella Associates actually call the Beaufort County Treasurer's Office and request a tax bill?

A [GUASTELLA] I don't know the exact answer to that, because back when we were receiving taxes for various pieces of property, or back in 2008 when all this happened, the people who were dealing with Beaufort County and sending them notices were my administrative person, and I couldn't tell you for sure whether she did or did not call them. I seem to recall that there was communication with them and I believe there were e-mails, copies of e-mails that were there, and whether the e-mails were a result of calls or not, I couldn't tell you. I, personally, don't make those calls. I have administrative people who were doing that back then.

It was not obvious to us that we were not getting a tax bill for that particular piece of property. We have - we get tax bills for a number of pieces of property, and I believe we don't get tax bills for some pieces of property. So, you know, whatever tax bills we were

getting, we received. We had no idea that we were not getting a tax bill for something. It was not obvious that we were not getting a tax bill for something. We were paying whatever bills are sent to us, and if we were or were not getting tax bills for certain pieces property, including this piece of property, we weren't pursuing why we were not getting bills. So it was not something that was obvious to us. We were paying the bills we were getting. You know, we began managing this utility in 2008. Whatever bills we were getting, we were getting. And when we didn't get a bill, you know, it didn't jump into our minds, "Oh, we didn't get a bill for a piece of property. Let's go looking for a bill." We were busy running a utility.

Q Well, I understand. Whether it's a call or an e-mail, I mean, it did look like you sent a forwarded-address thing, but some kind of follow-up – I've run a business, too, and I didn't go looking for bills, either, but what was the assumption of Daufuskie Island Utility or Guastella Associates when there was no bill? Surely, you had to be aware that there was going to be or should have been or was going to be an annual tax bill for this property and for the asset on it.

A [GUASTELLA] Well, we were getting bills for multiple parcels of land, so it wasn't that we weren't getting

bills. And we sent notices as to what address to be sending those bills.

Q You're saying one of those bills was the tank.

A [GUASTELLA] I don't know what we were assuming at the time; we were just getting bills and we were paying the bills. And the bills were nothing to be of big concern. Some of them were for $15, some of them were for $150. We're talking about peanuts. We weren't concerned about getting tax bills for all of the parcels. I don't think the total tax bills came out to be - it was less than $10,000. So we were getting - some parcels had tax bills well under $100. It's just not something that was prime in our thoughts, "Are we not getting another bill for another $15, or another $20?" It just wasn't - it just was not a concern or an issue or something we'd even think about.

Q Well, obviously, that tax bill is a lot more than that.

A [GUASTELLA] Well, I don't know what that tax bill was for. The property was sold for $546, which represented past-due tax bills. So the tax bill was probably less than $100 or $150. We're not pursuing $150 worth of absent bills. We were struggling to pay the bills we had. We had 25 percent less revenue than when we began, than we thought we were going to have. Our concern was whether we were going to pay the bills we were getting,

let alone go looking for another bill for $150. It just was not something that we could've contemplated at all.

Q Well, let me ask you another - shift gears away from that subject just a minute. Both of you have given a good history of the development of the property, back to International Paper Company. And let me kind of get my arms around this, because it has to do with the overall operation of the utility and customer base. If IP donated – I think Mr. White said – $4.3 million, quote, "for nothing in exchange." With all the history you've given, did they get a – are you aware of any kind of tax credit they got for that, or was there any kind of benefit - I know you mentioned – you explained about CK Materials, too. I got all that, too. But what was the benefit, initially - of course, I know they wanted the development to succeed, and to succeed you had to have utility services. But was there any kind of benefit from a tax standpoint, or other benefit? I think Mr. White said they received nothing in exchange, but could either one of you address that?

A [GUASTELLA] I can address that. Like any other developer, when a developer of real estate, when you go to sell real estate, it's got more value if it has utility facilities. So when they sell the real estate, they're selling at a higher value because they have

utility facilities. Because they didn't have any, of course, as I mentioned, they had to construct utility facilities. Therefore, they are making an investment, and they created a separate utility corporation to provide that utility service.

At some point, when you transfer the assets to the utility – the utility doesn't pay for those assets – it becomes the developer's investment in the utility, and that's recorded as equity investment.

Now, in terms of taxes, when they file federal income taxes, those utility facilities are reflected on the utility's federal income taxes, and the advances in aid of – the contributions-in-aid-of-construction and equity investment is also reflected. The developer could not have written off the cost of the utility facilities and taken a tax benefit on its real estate operations, and also take depreciation on the assets through the utility corporation. So they - even – and the tax returns reflect exactly what the books are reflecting. The assets are the utility's. IRS is allowing them to depreciate the utilities, and the source of capital to fund the utilities is the equity investment by the developer.

Q All right. Well, thank you for your answer on that, Mr. Guastella. Now, lastly, I want to try to tie this back

into the capacity a little bit, and – utilization, I guess, more than capacity. In the last case, I think we remember hearing from customers and ratepayers who were describing being reeling from the recession. Many of them had invested down there, and the recession it. Property values took a hit. And then some of them even used the word – you know, mentioned that they were forced to sell, and that sort of thing. My question is, has that leveled off? I know we've moved past the recession, but sometimes properties like this don't come back around as quickly. And my question is, did you lose your or erode your customer base some, and, of that, the ones who are left - of course, Commissioner Elam got out of you that only two of them are combined. But the ones that are left, if you start getting that number smaller and rates are going up, is there a bad cycle there for the customers and, really, the development itself? Do you see - what do you see - because you're asking for this significant increase, here, that was the original request, I guess, and where do you see things heading?

A [GUASTELLA] And that's probably best for me to respond to that. As far as the utility rates are concerned, in order for us to serve the customers that we have and remain, we have to cover our cost of providing service.

There's just no escaping that. What the economy does to the real estate market may have some effect, and, apparently, I don't doubt that it may have had some effect on some customers not paying their bills, for the availability customers. The ones that are there and connected are paying their bills, and the availability customers, we have liens on a number of pieces of property. We had to make an effort to pursue that. There are still sales of lots going on, I know. It may not be - it, obviously, wasn't as big as it was when the whole area was being developed, but we still have new purchases of existing lots going on.

The rates that we're now charging, I put in an exhibit showing that if we compare those to municipals and adjust the municipals' operations for things like income taxes and property taxes and lower cost of capital and regulatory fees, our charges for operating the utility, the relative expenses, are less than those other utilities. So our rates are - if you make the difference between investor-owned and municipal utility, our rates are comparable to those. So to the extent that there's an impact on the value or growth in real estate, it probably should be no more for Daufuskie Island Utility than any other place. It's not being driven by the utility rates; it's being driven by

outside factors. But to the extent we may lose 5 or 10 percent of customers - and I don't know if that's a number; I'm just giving you a hypothetical – we still have to provide service and have service available to other customers. And to the extent, for example, that the homeowners' associations are acquiring some of the lots for the customers who are not paying homeowners' association fees either, then at some point maybe the economy will turn around and they'll have the growth and we'll have more connected customers.

We can't set rates based on factors beyond our control, but we do have to have rates that are covering the costs for the service we're providing to connected customers and making it available to availability customers. I mean, there's no choice. We can't – a utility can't take on the burden of correcting the economic reality of the real estate market. And I think, eventually, the real estate market will turn around. It always does. It always does.

CHAIRMAN WHITFIELD: Well, thank you. That's all I have.

Any other - Commissioner Elam, I think – or, excuse me. Commissioner Bockman, first.

COMMISSIONER BOCKMAN: Thank you, Mr. Chairman. Mr. Chairman I just would make a request

that the company – in some of Mr. Guastella's testimony yesterday, he referred to revisions to the management agreement with the utility company. I wonder if we might ask that the company provide that for the record, please.

CHAIRMAN WHITFIELD: Yes, I believe we entered the management agreement in, but I don't believe we entered the revisions.

Mr. Gressette?

MR. GRESSETTE: Yes, sir, Mr. Chairman. The hearing exhibit that was admitted in the earlier proceeding, a copy of which – which is the management agreement, dated June 2015 – a copy of which was circulated yesterday during that testimony, so I believe that, itself, is the latest amended agreement. There was an original agreement, I believe, in 2011. But what has been presented to the Commission is the later agreement. We can attempt to obtain the earlier one, if that would be of use.

COMMISSIONER BOCKMAN: Mr. Chairman, the one I had in mind – I thought Mr. Guastella testified that there was a revised version of the 2015. Perhaps I misunderstood.

WITNESS GUASTELLA: No. Maybe I misled you a

little bit. There's not a revised version of the agreement, but one of the provisions in the agreement has an adjustment to the fixed management fee, annually, by 3½ percent. So if we were dealing with a 2015 agreement and we're now in 2017, the amount of the management fee, in accordance with that same agreement, has changed.

EXAMINATION

BY COMMISSIONER BOCKMAN:

Q Well, so the agreement itself has not changed, just the application of the automatic percentage increase?

A [GUASTELLA] Correct.

COMMISSIONER BOCKMAN: Thank you, Mr. Chairman. That –

WITNESS GUASTELLA: I'm sorry if I misled you before.

COMMISSIONER BOCKMAN: I don't know that you did, and I may have misunderstood.

Thank you, Mr. Chairman. I would withdraw that request.

CHAIRMAN WHITFIELD: Okay. And I think we may have used that language when we entered it in, as well. So we may have that – since there is no other change to the management agreement. So if that satisfies your request, Commissioner Bockman,

we'll move on.

Commissioner Elam?

COMMISSIONER ELAM: Yeah.

EXAMINATION

BY COMMISSIONER ELAM:

Q Mr. Guastella, I did forget something I wanted to cover with you. Is the biggest cost item that the utility's rates are not covering the management fee?

A [GUASTELLA] Probably not. I believe our costs for monitoring the system are the largest. I think our operating labor may be in that same level. I think our power costs are approximately in that level. So when you have revenues that don't cover your costs, you know, there's a whole range - we have $900,000 worth of operating expenses.

Q Right.

A [GUASTELLA] Which operating expense is – you know?

Q You don't cover them one at a time; you cover everything.

A [GUASTELLA] No, everything is covered. However, the only one that I'm able not to pay is Guastella Associates' management fees, because I have control over that. I have to pay - and taxes, of course, is the biggest. I mean, we pay $200,000 year in taxes, plus $65,000 a year in [word inaudible]. Our taxes are like

$250,000 a year.

Q Okay.

A [GUASTELLA] So the only one I have flexibility with is not paying Guastella Associates' fees. And, of course, not paying directors' fees to the stockholders, or the president's salary.

Q Okay.

A [GUASTELLA] So those are the first things to go, and those are, indeed, what I have not paid so I could continue to meet the obligations we have to provide service.

Q So when was the last time you paid Guastella Associates?

A [GUASTELLA] I believe we're - we caught up on our management fees. I don't think we're current to date, but I think we've caught up on some of the past management fees. We have not had enough money to pay for the past accounts payable for other work that we've done for either obtaining financing or the last rate case. And there were some other old outstanding accounts payable to Guastella Associates that we haven't had - and by the way, all of those past amounts are not being passed on to the customers.

Q Right.

A [GUASTELLA] That would be retroactive ratemaking.

Q At what point does Guastella Associates kick this client

to the curb for nonpayment?

A [GUASTELLA] I am convinced that when we get adequate rate relief - we've been able to run this utility and provide adequate service despite all of this, because of, frankly, the benefit of the management that I've been providing and the use of the money we have to serve the customers. I'm convinced that, once we get adequate rate relief - we're almost there. I thought we were there in December of 2015 with what the rate decision was going to be. But we're almost there. And once we're there, I'm going to be able to go to SunTrust Bank – and I've had personal discussions with them. I've provided – I provide them with operating statements on a quarterly basis, and sometimes more frequently than that. I'm convinced that we'll be able to finance – refinance with SunTrust, once we get adequate rate relief. They are waiting for that. They won't let me do it unless I can show them the rate relief we get. That's going to let me attract capital, make investments, and we are then going to begin to earn a return on investment – not just to cover debt service, but also maybe that unusual thing of actually earning a profit. And at that point in time, then, we're going to - what's past is past; we can't recover that, but moving forward they're going to start to earn a return on

investment, and they'll have a utility that's functioning and that's valuable.

Q Are you this patient with all your other clients?

A [GUASTELLA] I don't have this much control over any of my other clients.

Q If any of your other clients were in the position now, would you have long since disassociated yourself from them?

A [GUASTELLA] No. I provide service to clients as much as is needed, and I've had like 600, or so, of them.

Q You have 600 now?

A [GUASTELLA] No, no. I've had, over the years.

Q Okay. How many – guess, ballpark – do you have now?

A [GUASTELLA] I usually have at least a dozen or so going. Sometimes it's 20, sometimes it's six.

Q Okay. And there's nobody you're representing now that has the kind of cash-flow issues that this client does?

A [GUASTELLA] There are a couple, yes.

Q Okay. Are they in South Carolina?

A [GUASTELLA] Excuse me?

Q Are they in South Carolina?

A [GUASTELLA] No.

Q Okay.

A [GUASTELLA] No.

COMMISSIONER ELAM: Thank you, Mr. Chairman.

CHAIRMAN WHITFIELD: Thank you, Commissioner Elam.

Any other Commissioner questions?

[No response]

If not, Mr. Gressette, it's your time for redirect.

MR. GRESSETTE: Thank you, sir. We will be very brief.

REDIRECT EXAMINATION

BY MR. GRESSETTE:

Q Mr. Guastella, yesterday, during your examination by Mr. Nelson, he asked you about testimony in the record regarding bad debts. I just wanted to be sure that the record was clear.

MR. GRESSETTE: And if it's all right with the Commissioner, I'm going to approach the witness with a copy of his testimony.

CHAIRMAN WHITFIELD: Yes, sir. Go ahead.

BY MR. GRESSETTE:

Q [Indicating.]

A [GUASTELLA] [Indicating.]

Q Does the testimony that you have provided in this case address bad debts?

A [GUASTELLA] Yes.

Q And can you, just for purposes of the record, identify

where?
A [GUASTELLA] Yes. This is on page 21 of my testimony.
Q And is there an exhibit referenced in that testimony?
A [GUASTELLA] Yes. It's our Responses to the Interrogatories to the Intervenors.
Q And is that Exhibit JFG-R6?
A [GUASTELLA] Yes, I believe that is the number. I - [indicating]. I don't know. I'd have to go look at the number, but I believe it's one of my exhibits.
Q [Indicating.] Just read that – Mr. Guastella, if you would –
A [GUASTELLA] "A copy of the Responses is attached hereto as exhibit..."
Q The microphone, sir?

CHAIRMAN WHITFIELD: Mr. Guastella, would you pull your mic back around?

BY MR. GRESSETTE:
Q If you would, just for the record, identify what you're reading for the Commission.
A [GUASTELLA] I'm reading from page 21 of my testimony, and I'm on lines four through eight. "A copy of Responses," and the Responses refer to Responses to Interrogatories from Intervenors. "A copy of the Responses is attached hereto as Exhibit JFG-R6 and incorporated into my testimony as if restated herein.

These Responses also include information that supports DIUC's position as to bad debts."

Q And was it your intention in submitting that testimony that the attachment you've referred to as Exhibit JFG-R6 be included in your testimony for the Commission?

A [GUASTELLA] Yes.

Q Mr. Guastella, the management agreement that you discussed a good bit yesterday includes provisions regarding a management fee, finance fee, capital fee, and incentive fee. Is that correct?

A [GUASTELLA] Yes.

Q And are the terms of that agreement, as it relates to those fees that I just identified, consistent with reasonable industry standards?

A [GUASTELLA] Yes.

Q And are those fees that I just identified, as represented in your management agreement, consistent with reasonable industry standards as to the calculation method of those fees?

A [GUASTELLA] Yes.

Q And yesterday you discussed a couple of things with one of the Commissioners regarding your role at Daufuskie Island Utility Corporation, in the corporate body. Are you on the board of DIUC, Incorporated?

A [GUASTELLA] Yes.

Q And did the corporation itself make a decision to enter into the management agreement with Guastella Associates?
A [GUASTELLA] Yes. They entered into that decision initially before I was on the board. Those were separate entities who entered into the decision to enter into a management agreement with me.
Q Okay. So before you were on the board of Daufuskie Island Utility, Inc., Daufuskie Island Utility, Inc., entered into the original 2011 Guastella Associates management agreement.
A [GUASTELLA] Yes, that's my recollection.
Q And then there's also a 2015 Guastella Associates management agreement, and when that agreement was entered into by the utility, did you serve on the board of the utility corporation?
A [GUASTELLA] Yes.
Q And did the utility corporation, in making its decision to enter into the management agreement, determine that that agreement was reasonable?
A [GUASTELLA] Well, they did, but that was part and parcel of the original agreement, that there were going to be renewals every three years, and unless there was some reason for not continuing that I could not correct, then each of the owners of the utility signed that agreement, or they signed – the agreement was signed on behalf of

the utility, as well as each of the owners of the holding company.

Q Okay. So I guess what I'm getting at is, when the decision to enter into the 2015 management agreement was made by the corporation, was it a close vote?

A [GUASTELLA] No.

Q Did you influence that vote?

MR. BEACH: Objection. Mischaracterizes the testimony. I believe his testimony was that there was no vote.

CHAIRMAN WHITFIELD: Can you get to a microphone, Mr. Beach?

MR. BEACH: I'm sorry [indicating]. I'm objecting to the question because it mischaracterizes the testimony. I believe Mr. Guastella's testimony was that there was no vote or approval of the 2015 management agreement because it was a renewal of the one that had ended after three years.

CHAIRMAN WHITFIELD: Mr. Gressette?

MR. GRESSETTE: I don't recall the testimony that way. I'm happy to ask the witness to clarify now, so that we are clear for the record.

CHAIRMAN WHITFIELD: Okay.

MR. BEACH: Without objection.

CHAIRMAN WHITFIELD: Okay. Go forward, Mr. Gressette.

BY MR. GRESSETTE:

Q Mr. Guastella, would you explain how the utility entered into the 2015 management agreement?

A [GUASTELLA] Yes. I send the renewal agreement to the owners and, on their behalf, it's signed and approved. That's the way it works. I do not - other than sending them the agreement and asking them to agree to this agreement, they then send it back to me, signed.

Q So each of the other members of the Board of Directors for Daufuskie Island Utility Company made their own independent decision, without your participation.

A [GUASTELLA] Correct.

Q With regard to the availability customers and the utilization of the system, so that we are clear - because you had to explain this to me a couple of times, and I want to make sure we're clear for the record - customers who access water from the system for their homes utilize the system. Is that correct?

A [GUASTELLA] Yes.

Q Customers who pay an availability fee, under the rules of South Carolina law and ratemaking, they also utilize the system. Is that correct?

A [GUASTELLA] Yes.

Q So –

MR. BEACH: Mr. Chairman, I don't want to prolong the proceeding and I don't want to limit Mr. Gressette, but his testimony – I mean, his question right now – and that was a Freudian slip when I said "Mr. Gressette's testimony" – is leading, and I don't think that it's appropriate for him, on redirect, to be asking leading questions of this witness.

CHAIRMAN WHITFIELD: I'm going to sustain your objection, Mr. Beach.

MR. BEACH: Thank you, Mr. Chairman.

CHAIRMAN WHITFIELD: Let's stick to the redirect.

MR. GRESSETTE: Certainly. My intention was to move things, not to proceed improperly.

BY MR. GRESSETTE:

Q If we talk about customers utilizing the system, does that utilization by availability customers and customers who are retrieving water through the system, for example, have an impact on the determination of utility plant-in-service for ratemaking?

A [GUASTELLA] No, none. And utilization factor is a utilization factor applied to depreciation rates; it is not applied to utility plant. Depreciation rates are

based on average service lives that reflect recovery of the cost of the assets over time, due to wear and tear, depreciation, decay, and other regulatory requirements. So the utilization factor impacts only how much you want to recover through depreciation expense of the plant and at what rate do you want to recover it, so that if we use a utilization factor, we want to recover the cost of the plant over a longer period of time because of the utilization, and wear and tear, and action of the elements on the facilities. It's not changing the cost of the facilities; it's not eliminated any of the facilities that provide service. It's addressing the cost recovery of the facilities over either a shorter period of time or a longer period of time, so that today's customers pay their fair share of the recovery of the cost through depreciation and future customers pay their fair share of the cost through appropriate depreciation rates.

So this is a matter of a utilization factor to establish the appropriate period of time and customer base over which the costs are being recovered. This is not a factor of is the plant or is it not being fully utilized. The plant is being fully utilized for the two purposes: connected customers and availability service to availability customers.

Q The last question I have relates to your response to one of the Commissioner's testimony[sic] about a tax return?
A [GUASTELLA] Yes.
MR. GRESSETTE: May I approach the witness?
CHAIRMAN WHITFIELD: Yes.
BY MR. GRESSETTE:
Q [Indicating.]
A [GUASTELLA] [Indicating.]
Q Can you identify the document that I've handed you, Mr. Guastella?
A [GUASTELLA] Yes. This is a Request for Production of Documents from the Intervenors, and our Responses.
Q And I have included something at the conclusion of that set of Responses. Can you flip to the back?
A [GUASTELLA] Yes.
Q What is that document?
A [GUASTELLA] That's the Daufuskie Island Utility Company, Inc., corporate income tax return for 2008.
Q And is that the 2008 return you were referencing in your answers to the Commissioner's questions?
A [GUASTELLA] Yes.
MR. GRESSETTE: At this time, we would move this document in as a hearing exhibit.
CHAIRMAN WHITFIELD: Yes, sir Mr. Pringle.
MR. PRINGLE: Mr. Chairman, just can I quickly

ask, the line of questions said it was in response to a tax return - a question about a tax return, and then this line of questions. I'm trying to determine what this - where this redirect is coming at.

CHAIRMAN WHITFIELD: Mr. Gressette, could you answer Mr. Pringle's question?

MR. GRESSETTE: Certainly. The Commissioner asked about how the utility addressed the plant that was transferred to it from the developer and the developer's utility company. In reference to explaining that, Mr. Guastella said that the facts were as he described and that the 2008 tax return of Daufuskie Island Utility Company confirmed that, and so I was planning to provide this to supplement his testimony. In addition, one of the other Commissioners had asked questions about whether the utility or the developer took any tax benefits, and I thought it would also help clarify that.

MR. PRINGLE: Okay, so the - and the exhibit is being offered for the purpose of just showing how Daufuskie Island Utility Company, the utility, carried assets or recorded assets on its tax return?

MR. GRESSETTE: Yes, sir.

MR. PRINGLE: That's – I don't have any problem with that. Okay.

CHAIRMAN WHITFIELD: All right. We'll enter that in as Hearing Exhibit No. 4, Mr. Gressette.

MR. GRESSETTE: And I do have additional copies, if the Commissioners would like them for their files.

CHAIRMAN WHITFIELD: Give them to Mr. Richardson, if you would, and our court reporter. Make sure our court reporter has one.

[Document distributed]

[WHEREUPON, Hearing Exhibit No. 4 was marked and received in evidence.]

MR. GRESSETTE: Commissioners, you've been very patient. Thank you, so much.

CHAIRMAN WHITFIELD: Thank you.

MR. PRINGLE: Could I very quickly jump in and just ask where we are on the exhibit numbers?

CHAIRMAN WHITFIELD: That was No. 4.

MR. PRINGLE: No. 4. Okay.

CHAIRMAN WHITFIELD: No. 4.

Mr. Beach?

MR. BEACH: Mr. Chairman, there is – I'm sorry [indicating]. In response to the Commissioners' questions, Mr. Guastella gave some testimony that

gave his version of what had happened with regard to an emergency generator, following Hurricane Matthew. And the property owners have all very vocally communicated with me that that version of what happened is completely inconsistent with what they –

MR. GRESSETTE: Objection, Your Honor.

MR. BEACH: So I would like to be able to ask a few questions on recross to try and clarify that.

MR. GRESSETTE: First, we'd ask that the record exclude the testimony provided by counsel.

MR. BEACH: This is going to be based in response to specific questions that the Commissioners asked.

MR. GRESSETTE: In addition, Commissioner, I would object because it doesn't relate to my redirect.

CHAIRMAN WHITFIELD: Hold on, if you two would just bear with me one second.

MR. GRESSETTE: Yes, sir.

[Brief pause]

CHAIRMAN WHITFIELD: I'm going to sustain Mr. Gressette's objection.

MR. GRESSETTE: Thank you, sir.

MR. BEACH: Okay, Mr. Chairman. Thank you.

With that ruling, we're going to ask at the appropriate time to be able to present some testimony of one of the representatives of the property owners' associations, so that they can clarify their version of what occurred at that time.

MR. GRESSETTE: Well, Mr. Commissioner, we would object on the same grounds that Mr. Beach has provided objections to the Commission, which is, none of that information has been presented in any of the Intervenors' prefiled testimony.

CHAIRMAN WHITFIELD: Mr. Pringle?

MR. PRINGLE: The issue came up for the first time on a question from the Commissioners, and we're trying to have the opportunity to respond to that.

CHAIRMAN WHITFIELD: You're saying it came up during the Commissioner questions' time, Mr. Pringle?

MR. PRINGLE: It did.

CHAIRMAN WHITFIELD: All right. Hold on, and I'm going to recognize Commissioner Elam just a minute.

COMMISSIONER ELAM: I just wanted some clarification. The issue for – can I have an

explanation from counsel for what purpose he's offering this hearing exhibit?

MR. GRESSETTE: The tax return, sir?

COMMISSIONER ELAM: Yes.

MR. GRESSETTE: Yes, sir. It is simply to document or provide support for the statement that Mr. Guastella made about how the taxes were paid at the time in 2008. The document speaks for itself, simply that if the Commission finds anything in the document that is helpful, we wanted to be sure you had it.

COMMISSIONER ELAM: All right. And it is evident on the face of the tax return it supports Mr. Guastella's testimony without you having to ask him to provide more information on top of what's here?

MR. GRESSETTE: Yes, sir.

COMMISSIONER ELAM: All right.

CHAIRMAN WHITFIELD: We've entered it in as Hearing Exhibit No. 4, and Mr. Pringle and Mr. Beach had no objection. Neither did anyone else.

Okay. I'm sorry to leave you standing. I thought Commissioner Elam had a concern involving this issue, so –

COMMISSIONER ELAM: Well, I do.

CHAIRMAN WHITFIELD: – I think we are going to let you, at the appropriate time maybe, put your witness up. But we've already sustained Mr. Gressette's objection for now.

MR. BEACH: Thank you, Mr. Chairman.

CHAIRMAN WHITFIELD: And Mr. Gressette, you will have your opportunity to cross that witness, as well.

MR. GRESSETTE: Thank you, Your Honor.

CHAIRMAN WHITFIELD: Anything further from ORS? Or did the Intervenors have any further redirect? I'm sorry.

MR. PRINGLE: No recross, no regression, no reversion.

CHAIRMAN WHITFIELD: Okay. I had jumped and gone to ORS, so I'm going to come back to ORS.

MR. NELSON: I think I did have just one follow-up.

CROSS EXAMINATION

BY MR. NELSON:

Q Mr. Guastella, I want to go back to the bad debt that, once again, we've already talked about it here. The bad-debt number, and that was just referenced by Mr. Gressette, that was included, that was included in your rebuttal testimony, would that be correct?

A [GUASTELLA] Well, we included a level of bad debts in our direct rehearing testimony, as part of the schedules that we provided through Mr. White.
Q And going to that bad-debt number, y'all have been collecting rates under bond for, what, since July of last year; is that correct?
A [GUASTELLA] July 2016.
Q So we're about, what, 16 months past that now. Do you know what the company's actual bad debt is, then, for the approximate last year?
A [GUASTELLA] Yes. We estimated the bad debts based on the billings in relation to collections.
Q I'm not asking for an estimate. Do you have an actual bad-debt number for the last year, for the company?
A [GUASTELLA] What last year are you referring to? I have a number of $191,000.
Q Is that actual bad debt or is that going, again, to the estimate? Is that an estimated number?
A [GUASTELLA] Well, that's our calculation of bad debts. You know, and I combine that with the additional liens that we've had to place. So it has to be an estimate until we know whether or not any of that could possibly be collected or we have - we've had to add about $73,000 of new bad debts, for example. So all of the actual information we have as of today is that we have

somewhere in the magnitude of $650,000 worth of liens. Of that, we added about $73,000 additional to what was already liened.

Q So the –

A [GUASTELLA] And we had the difference between the billings and collections for a full year under the 108.9 percent increase that went into effect on July 1 of 2016.

Q Okay. That was - I'm trying to follow up, but I didn't quite understand what you were talking about. The $600,000 number you're talking about there, that's liens? Is that the value of the property that you have liens on, then? I don't –

A [GUASTELLA] They're liens on the property to collect the amounts owed for the utility availability fees.

Q So that is not a dollar figure that you have collected but that's the value of the property that you –

A [GUASTELLA] No, it's not the value of the property.

Q Okay.

A [GUASTELLA] It includes the accumulation of bad debts for specific properties for multiple years, as well; it's not just in one year, that's multiple years. But there are new bad debts, new liens that we need, amounting to about another $73,000. So there's a level of liens for bad debts that's supporting that the actual

bad debts that were on the books for 2014 of $105,000, the estimate that ORS made of $108,000, and what the level is going to be with the increase in rates, moving forward, all being supported.

Q You already had that increase, so you should have an actual number for, what, the last 12 months? Or whatever your last fiscal year was. Do you have a number?

A [GUASTELLA] Well, you don't know how much of that last year is going to be fully paid. When we start going to collections and we start advising the customers that they're late, and then we give them time to respond to whether or not they're late, and then we give them time to respond to "We're going to put liens on your property," and then we put liens on the property, I mean, what actually happens after that doesn't happen immediately after the 12-month period under the new rates.

MR. NELSON: Going to that collecting, then, too - and this is following up on a question of Commissioner Elam, if that's permissible. I don't know that there was a direct question asked on redirect on this.

CHAIRMAN WHITFIELD: Go ahead, Mr. Nelson.

MR. NELSON: Thank you, Mr. Chairman.

BY MR. NELSON:

Q Commissioner Elam had mentioned about – he'd gone over some of the costs and the fact that management fees still weren't being paid. You're not collecting those from the utility, yet, for Guastella Associates, correct?

A [GUASTELLA] Well it's an expense that's incurred by the utility and its real cost and real expense. If you send a bill to a utility, whether it's me or anybody else, that gets put into an accounts payable –

Q I understand that, but –

A [GUASTELLA] – and they pay the bill.

Q – you haven't been –

A [GUASTELLA] That's how it's done.

Q – getting paid is what you're saying, right?

A [GUASTELLA] I'm sorry?

Q You haven't been actually getting paid that money that's owed, correct?

A [GUASTELLA] Some of it has been paid. Some of it has not been paid yet. It depends on – well, for the management fees, we're pretty much caught up, so those have been paid.

Q And, again, you've been collecting rates under bond for about 16 months, now, so you're collecting everything you asked for. If you got 100 percent of what you asked

for in this case, that's what you've been collecting, right?

A [GUASTELLA] No. We've been collecting - we've been collecting about - we've billed approximately $2 million or $2.1 million. We collected about 191 - $190,000.

Q Are the rates that you're billing -

A [GUASTELLA] I'm sorry. We billed about $2.1 million and collected about a million nine. So we're short by about $200,000. So we're not collecting all that we are billing.

Q But you are billing the rates that you've applied for in this case, correct?

A [GUASTELLA] Yes.

Q You're still not managing to pay all of your bills; is that correct?

A [GUASTELLA] That's correct. There have been bills that are - there have been bills beyond our actual normal annual level.

MR. NELSON: Okay. I have no further questions. Thank you, Mr. Chairman.

MR. BEACH: Mr. Chairman, I -

CHAIRMAN WHITFIELD: Thank you, Mr. Nelson. Yes, sir, Mr. Beach.

MR. BEACH: I do actually have a quick line of questions, in response to Mr. Gressette's questions

about this utilization.

CHAIRMAN WHITFIELD: Mr. Beach, I'm afraid you've missed your opportunity. We've already gone through for redirect, and ORS was the last party, because I went to you all first.

MR. BEACH: Mr. Chairman, I would like to have your indulgence. We were on the heels of asking or discussing the question about following up on the Commissioner's –

CHAIRMAN WHITFIELD: Well, I understand that is my call at this point. So what I'm going to do is I'm going to ask Mr. Gressette if he objects.

Do you have any objection to this, Mr. Gressette, to him being able to ask these questions?

MR. GRESSETTE: The Applicant doesn't object.

CHAIRMAN WHITFIELD: Okay. Then, Mr. Beach, you have been extended a courtesy. Go ahead.

MR. BEACH: Thank you.

Ms. Wheat, I'm going to need to get on the overhead projector, please.

[Reference: Attached "Schedule S-C.3"]

CHAIRMAN WHITFIELD: Let me take just a minute and ask, on the record, Mr. Nelson, does ORS have any objection to Mr. Beach –

MR. NELSON: No objection.

CHAIRMAN WHITFIELD: All right. Thank you.

CROSS EXAMINATION

BY MR. BEACH:

Q Mr. Guastella, we were talking again about the analysis that you have used in order to - in order to state depreciation expense at a rate that was less than the straight-line depreciation that the POA witnesses testified was necessary, here, and that was done for the sewer by this document here [indicating]. Am I correct?

MR. GRESSETTE: Objection, Commissioner. None of the POA witnesses have testified.

CHAIRMAN WHITFIELD: I'm going to sustain his objection.

MR. BEACH: All right. Well, let me restate that.

BY MR. BEACH:

Q You have used this formula that we're looking at here to calculate depreciation expense for the company. Is that correct?

A [GUASTELLA] Yes.

Q Okay. And if you were to use straight-line depreciation, those 35.47 percent numbers would've been 100 percent, correct?

A [GUASTELLA] No.

Q Would not have been?
A [GUASTELLA] No. We are using straight-line depreciation.
Q Okay.
A [GUASTELLA] We're changing the rates and the rates are being recovered over, in effect, over a longer service life. So we're using straight-line depreciation but we're using rates that change the average service lives to serve today's customers, so they pay their share, and future customers pay their fair share. But it's still straight-line depreciation.
Q Okay. The 35.47 utilization, that indicates that there are only 35.47 of the total number of sewer customers, that are currently on-line. Is that correct?
A [GUASTELLA] No, not necessarily. What that means is we're going to depreciate the plant based on an adjustment to the depreciation rates and factors, to reflect the utilization, for depreciation purposes, for the recovery of the cost of the plant. The ratio Mr. White explained is the ratio as how we develop that utilization factor. That's not a utilization of the plant; it's the method of determining how to extend the average service lives.
Q Okay. Well, I think I may have been asking the wrong person this question, then.

Mr. White, that 35.47 percent number, where did that come from?

A [WHITE] As I explained earlier, it took the number of active customers divided by the total number of potential customers.

Q Okay. So –

MR. GRESSETTE: Mr. Commissioner?

CHAIRMAN WHITFIELD: Yes.

MR. GRESSETTE: I hate to interrupt, but I do need to make an objection that I don't believe there's been any redirect of Mr. White.

MR. BEACH: Well, Mr. Chairman –

CHAIRMAN WHITFIELD: Yes, Mr. Beach.

MR. BEACH: – I'm just trying to get the answer. And the answer Mr. White gave me is – according to Mr. Guastella, Mr. White's the one who testified on this point, as he said just now. And so Mr. White has answered the question, and his answer is, in fact, as I understand it, the answer as to how – what that number means. I don't know why – I mean, they are here for a panel. I don't know what benefit we get from that if I can't ask Mr. White this question if he's the one who actually knows the answer.

MR. GRESSETTE: That's fine, Your Honor.

CHAIRMAN WHITFIELD: And we've run into that with panels, so go ahead, Mr. Beach.

MR. BEACH: All right. Thank you.

BY MR. BEACH:

Q So just so I understand this, for instance, the power generating equipment, that is one of the - is that one of the ones that the utilization factor is applied to?

A [GUASTELLA] Well, it -

Q Mr. White?

A [GUASTELLA] Well, it's a panel, so should I discuss that? I think I'm more appropriate to answer it.

Q Okay. If you can give me an answer with a yes or no, I'm fine with that.

A [GUASTELLA] Yes -

CHAIRMAN WHITFIELD: I think at this point, either one of you that can answer Mr. Beach's question would be great.

MR. BEACH: Okay.

WITNESS GUASTELLA: Great. The utilization factor is for the purpose of establishing average service lives and resulting depreciation rates for the recovery. It does not indicate - the calculation that Mr. White described is correct; that does not indicate the plant is not being utilized. It indicates that the depreciation of

the plant should reflect an average service life that is, essentially, reducing the depreciation of that plant to reflect the proper recovery of the cost that is not reduced, but the recovery of that cost over the average service life that is more appropriate for this utility at this point in time.

BY MR. BEACH:

Q Does the theory depend on the notion that if only 35 percent of the total customers who could possibly use these particular components are actually using them, then the component is not depreciating at as fast a rate as it would if 100 percent of the customers were using it?

A [GUASTELLA] That's approximately correct, yes.

Q So my question is this: If you take these exact same components - these components right here – and you apply these exact same utilization factors, right here, to determine also the percentage of the plant that should be calculated for the purposes of rate base, wouldn't that be using precisely this same concept but in a way that would be consistent across the board?

A [GUASTELLA] No. You would be using an entirely different concept that's inapplicable to the establishment of depreciation rates. The percentages are applied to the depreciation rates; they're not

applied to the plant. If you were going to apply that theory to the plant, you're than assuming incorrectly that the plant is not used and useful. Absolutely incorrect. The methodology for establishing used-and-useful is not this methodology. This methodology establishes the appropriate depreciation rates and depreciation expenses. There's a used-and-useful analysis that would establish whether or not the plant is used and useful. It's a completely different analysis. If that analysis is made, the finding is that the plant is 100 percent used and useful, and I believe I went through that process, and I won't do it again.

MR. BEACH: Thank you.

CHAIRMAN WHITFIELD: Thank you, Mr. Beach. At this time, I think we're going to - hold on one second.

[Brief pause]

If the panel can stand one more, Commission Fleming does have one more question at this time.

COMMISSIONER FLEMING: It's not just the panel, it's all of us that need to break. Yes.

EXAMINATION

BY COMMISSIONER FLEMING:

Q It was my understanding that Exhibit JFG-R6 is your evidence for bad-debt expense. Correct?

A [GUASTELLA] I believe - is -R6 - -R6 is our Responses to Interrogatories; is that correct?
Q Yes.
MR. GRESSETTE: [Indicating.]
WITNESS GUASTELLA: [Indicating.]
BY COMMISSIONER FLEMING:
Q Yes, it's over 100 pages, I believe.
A [GUASTELLA] Oh. That's the Responses. The 100 pages - not all of those 100 pages - I believe Commissioner Howard asked me about one of those exhibits that had each account, the date, and the bad-debt amount. And we responded to that, and that's - it didn't - it didn't seem to matter to Mr. Howard and it doesn't matter to me, either. That was a question. What we do have, then -
Q Excuse me. This was - I believe your attorney wanted to point that this was your exhibit concerning that was for bad-debt expense. Not what you said.
A [GUASTELLA] Okay, but the exhibits that also has -
Q Well, that's my next question. If that's what it is, it's a lot of verbiage and I think, in terms of numbers for bad-debt expense, could you point to -
A [GUASTELLA] Yes.
Q - specific pages that indicate the numbers of bad-debt expense?

A [GUASTELLA] Yes.
Q That's what I'm asking.
A [GUASTELLA] If we look at page 27.
Q Okay.
A [GUASTELLA] JFG-R6, page 27. The bottom of the page is the pages.
Q Oh, I see. There are two different numbers. Twenty-seven? Page 27?
A [GUASTELLA] Yes.
Q That says page 89 of the exhibit, correct?
A [GUASTELLA] I don't know – I don't know what page 89 is. I don't know what page 89 is, I'm sorry.
Q Oh, this is in a different – it's actually page 1?

COMMISSIONER ELAM: Perhaps over a lunch break, counsel could determine which pages out of this he wanted in the exhibit, and tell us which pages it is, other than the, you know, north of 100 in here that we have right now?

CHAIRMAN WHITFIELD: I don't think Mr. Guastella has what Commissioner Fleming is referring to right now. Could we – maybe when we take a break, when we resume from lunch, let's give Commissioner Fleming one quick chance when we come back from lunch and then make sure Mr. Guastella has the document that she's questioning about.

MR. GRESSETTE: And with the Commission's permission, I will confer with witness to identify the pages that support the bad-debt calculation, for the Commission.

COMMISSIONER FLEMING: Yes, the actual numbers that supported.

MR. GRESSETTE: Yes, ma'am.

CHAIRMAN WHITFIELD: And we'll – we're going to – all right, thank you, Commissioner Fleming. We're going to take a break now for lunch. And when we resume in an hour, I will let Commissioner Fleming quickly question him about this, and hopefully he will have the right document in front of him at that time.

So let's – at this time, let's recess for lunch, and we'll come back at 1:25.

[WHEREUPON, the witness stood aside.]

[WHEREUPON, a lunch recess was taken from 12:20 to 1:30 p.m.]

CHAIRMAN WHITFIELD: Please be seated. I'm going to call this hearing to order.

THEREUPON came,

J O H N F . G U A S T E L L A ,

G A R Y C . W H I T E ,

recalled as witnesses on behalf of the Applicant, Daufuskie Island Utility Company, who, having been first duly affirmed, were examined and testified as follows:

CHAIRMAN WHITFIELD: And when we broke for lunch, I think Commissioner Fleming, in lieu of asking a question, had a request. Have we - have you met her request?

MR. GRESSETTE: Mr. Chairman, the pages I believe that the Commissioner seeks are JFG-R6, 27 and 28. I'm also happy for Mr. Guastella to specifically explain what those are, and —

COMMISSIONER FLEMING: But not 11. Didn't you mention page 11 when we left — before we left?

MR. GRESSETTE: Oh —

COMMISSIONER FLEMING: Not 11. What page was it?

COMMISSIONER BOCKMAN: Twenty-seven and twenty-eight?

COMMISSIONER FLEMING: I thought they mentioned like an earlier page, before we left.

All right, fine.

MR. GRESSETTE: Commissioner, you are correct. On page JFG-R11 is a Response to an Interrogatory regarding bad debt. That is a textual response, and then the documents that contain the actual rates charged and amounts received are on the two pages previously numbered, 27 and 28.

COMMISSIONER FLEMING: Okay, thank you.

COMMISSIONER ELAM: Are those –

COMMISSIONER FLEMING: Are those the only pages that pertain to bad debt, in all of those 100-plus pages?

MR. GRESSETTE: Commissioners, within JFG-R6, pages four and five, in parentheses, are Discovery Responses that relate to Interrogatories about bad debt. And then the documents produced to support those answers that relate to bad debt are contained on JFG-R6, pages 16 through 40. And within those pages are the overdue balance procedures, a listing of liens, and a listing that we discussed earlier by account. But for calculation purposes, the pages 27 and 28, the difference between those two numbers makes up the amount of bad debt for the actual year of collections indicated at the top of the transaction list.

COMMISSIONER FLEMING: So page 11 does not - is not included in that? Or is?

MR. GRESSETTE: Yes, ma'am, page 11 is.

COMMISSIONER FLEMING: Oh, okay, so you still - so could you list those pages again, just to make sure we have them?

MR. GRESSETTE: Yes, ma'am. Pages JFG-R6, all of these are, four and five. Not page 11, you are correct. And then pages 16 through 40. Those are the pages from that exhibit intended to refer to and support the testimony related to bad debt. Of course, bad debt also is referenced in various other schedules and testimony, but those are the pages of that exhibit that are intended to support the testimony.

COMMISSIONER FLEMING: And 27 and 28 are the specific -

MR. GRESSETTE: Twenty-seven and twenty-eight -

COMMISSIONER FLEMING: - figures?

MR. GRESSETTE: - demonstrate the rates charged and the rates collected for the period 7/1/2016 through 6/30/2017. Mr. Nelson asked about the difference between collections and charges for that period of time, and those two sheets

demonstrate the difference between those.

COMMISSIONER FLEMING: Okay. But are you still wanting to include the entire exhibit for bad debt, or just those specific pages?

MR. GRESSETTE: Just those particular pages as to bad debt. There may be additional information in the exhibit that is helpful to the Commission, so we'd like for the whole thing to be included. But the pages that we highlighted are those for bad debt.

COMMISSIONER FLEMING: Okay.

COMMISSIONER ELAM: Mr. Chairman?

CHAIRMAN WHITFIELD: Yes, Commissioner Elam.

COMMISSIONER ELAM: I believe this whole exhibit is already an exhibit.

CHAIRMAN WHITFIELD: Right. We're not going to enter it in. It's already in the record.

COMMISSIONER ELAM: Okay. So we're not establishing a new hearing exhibit for all those.

CHAIRMAN WHITFIELD: She's just getting the pages that are pertinent to the bad debt.

COMMISSIONER ELAM: Okay.

COMMISSIONER FLEMING: But I think that they should be listed for the bad debt.

CHAIRMAN WHITFIELD: Well, they're already in

the record.

COMMISSIONER FLEMING: I know, but they should be recognized that those are the specific pages in that exhibit pertaining to bad debt.

CHAIRMAN WHITFIELD: I think it's so noted. I don't think it's proper to enter it in as another hearing exhibit.

COMMISSIONER FLEMING: I'm not asking to.

CHAIRMAN WHITFIELD: Okay.

COMMISSIONER FLEMING: But it needs to be recognized that those are the specific pages.

CHAIRMAN WHITFIELD: I think he's done that.

COMMISSIONER FLEMING: Okay.

MR. BUTLER: Mr. Gressette delineated that in answer to your questions.

COMMISSIONER FLEMING: All right. I just didn't want it to get lost in the 100-plus pages.

MR. BUTLER: Understood.

CHAIRMAN WHITFIELD: Commissioner Fleming, does that answer your question?

COMMISSIONER FLEMING: [Nodding head.]

CHAIRMAN WHITFIELD: Any further questions for Mr. Gressette or the panel?

COMMISSIONER FLEMING: No. He answered mine.

CHAIRMAN WHITFIELD: Okay. Okay. Well, if

not, I'm going to – the panel may step down from the stand.

[WHEREUPON, the witnesses stood aside.]

And, Mr. Gressette, does this complete your case?

MR. GRESSETTE: Yes, Mr. Chairman, except that we may wish to make a very brief closing if that's acceptable.

CHAIRMAN WHITFIELD: Yes, sir.

All right. Well, at this time, I'm going to turn it over to the Intervenors, to Mr. Pringle and Mr. Beach. It's my understanding you're going to present your panel and that you're not going to present the unknown witness that we mentioned earlier; you're going to go forward with your panel at this time.

MR. BEACH: That's correct, Mr. Chairman.

CHAIRMAN WHITFIELD: All right. Well, it's yours and Mr. Pringle's time now, Mr. Beach.

MR. PRINGLE: Great.

MR. BEACH: Thank you, Mr. Chairman.

MR. PRINGLE: Mr. Chairman, Commissioners, the two witnesses that will be presented on the panel are Mr. Loy and Mr. Lanier, so I'll start with Mr. Loy, after I allow –

[Witnesses affirmed]

THEREUPON came,

C H A R L E S L O Y ,

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

called as witnesses on behalf of the Intervenors Melrose Property Owners Association, Bloody Point property owners' association, and Haig Point Club & Community Association, who, having been first duly affirmed, were examined and testified as follows:

DIRECT EXAMINATION

BY MR. PRINGLE:

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

A [LOY] I am Charles Loy, and –

Q Microphone.

CHAIRMAN WHITFIELD: Mr. Loy, could you cut your mic on?

WITNESS LOY: [Indicating.] My name is Charles Loy. My business address is 919 Congress, Suite 1110, Austin, Texas.

BY MR. PRINGLE:

Q Okay. By whom are you employed and in what capacity?

A [LOY] I'm employed by GDS Associates, and I'm a principal.

Q Okay. Have you, in connection with this proceeding,

specifically what we've been referring to as the rehearing, caused to be prefiled direct testimony consisting of 28 pages in question-and-answer format?

A [LOY] Yes.

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

A [LOY] Yes. On my direct testimony, page 25.

Q Let's let everybody turn to that?

A [LOY] On line seven, I would strike "confidential," and on line nine I'd replace "confidential" with "$1.75 million." An on line nine, on the same – just a few words over, I would replace "confidential" with "around $300,000."

Q Do you have any additional additions, deletions, or changes to make to your testimony, your direct testimony?

A [LOY] No.

Q If I ask you all the questions that appear in that direct testimony, would your answers be the same?

A [LOY] Yes.

MR. PRINGLE: Okay. Mr. Chairman, I'd ask that Mr. Loy's direct testimony, as amended on the stand, be read into the record as if given orally from the stand.

MR. WALKER: Objection.

CHAIRMAN WHITFIELD: Yes, sir, Mr. Walker.

MR. WALKER: Replete with hearsay. No foundation has been laid. If you look at his testimony –

CHAIRMAN WHITFIELD: I need you to get to a mic, if you would.

MR. WALKER: Yes [indicating]. We're objecting under the Rules of Evidence that his testimony does not show that he has a foundation for saying many of the things that he says, that it's hearsay relying on hearsay, and that it is speculative. And under the Rules, the Rules of Evidence apply, and, here, this witness purports to be – or he testifies to conclusions based on documents that he didn't prepare. There's no showing he knew what the makers of those documents intended nor that he was involved with the utility at the time he makes these sweeping conclusions. It's unfounded and speculative. He goes on – and that goes to his statements about the 2004 filing, his conclusion related to that. He goes on to do that as to the 10-K that was filed by IP, to make conclusions without any foundation. And he has, basically, legal conclusions or questions that say, "Is there any evidence of this?" That's not a

proper question. He should be asked based on his knowledge of certain things.

So we object to the entry of this testimony because it is, for the most part, testimony without a factual foundation, that is hearsay relying on hearsay, and it is speculative.

CHAIRMAN WHITFIELD: We'll have to give Mr. Pringle a chance to respond.

MR. PRINGLE: Okay. Oh, good. Well, let's start with that – and I may have turned my microphone off [indicating].

CHAIRMAN WHITFIELD: Can you make sure that other one is off? Or it's muted, okay. I think Ms. Wheat has muted it, so if you can get that one back on.

MR. PRINGLE: It is on, but –

[Brief pause]

Let's take all those in turn. As the Commission is aware, Mr. Loy testified in the previous iteration of this hearing, and his qualifications have already become part of the record. His Appendix was attached here, again, and his qualifications as certainly not a fact witness but as an opinion expert were established earlier in the proceeding, and certainly I say all this

knowing that, if necessary, I will go through and lay the foundation, or shall we say re-lay the foundation that was already presented in the original part of this case, for Mr. Loy's qualifications to give his opinions based upon the documents he reviewed, the facts that he has seen, and the conclusions that he drew from those things.

CHAIRMAN WHITFIELD: Mr. Pringle.

MR. PRINGLE: Yes.

CHAIRMAN WHITFIELD: Not to drag this out any longer than it already is, but you may want to go ahead and lay those foundations out –

MR. PRINGLE: Okay. All right.

CHAIRMAN WHITFIELD: – and succinctly, if you can.

BY MR. PRINGLE:

Q Mr. Loy, what do you do for a living?

A [LOY] I am a rate consultant with GDS Associates.

Q Okay. What have your job functions been with GDS Associates?

A [LOY] I usually help clients, usually utilities, to file rate cases and do other regulatory matters.

Q Okay. In connection with those rate cases, what do you do?

A [LOY] I usually go participate with or look at what the

filing requirements are, before the state, and we put together the rate filing package to meet those requirements. Then I'll – typically, I'll write written testimony and file that. Sometimes rebuttal. Sometimes we go to the hearing, sometimes it settles.

Q What kind of documents do you review in connection with the work that you do?

A [LOY] I usually look at their general ledgers, their – you know, the accounting-related documents like financial reports, the billing records, billing reports.

Q Okay. Have you offered opinion testimony before any public service commission in the United States?

A [LOY] Yes, I have.

Q How many?

A [LOY] I've testified before about 14 commissions – I've filed testimony in 14 commissions. And I don't know how many I've testified before, maybe 10. I don't know.

Q Okay. In connection with that testimony you have provided, did you review documents that were prepared by people other than yourself?

A [LOY] Yes.

Q Okay. And did you offer opinion testimony about various financial aspects of those documents?

A Yes.

Q [LOY] Were you qualified to do so before the various

regulatory commissions where you testified.

A [LOY] Yes, I was.

Q Okay. Have you ever been qualified as an expert before a commission?

A [LOY] Yes, I have.

Q Okay. As what kind of expert?

A [LOY] An expert on rates and regulatory affairs or ratemaking.

MR. PRINGLE: Okay. Well, with that in mind, you know, given, not only because Mr. Loy has previously testified to matters - oh.

BY MR. PRINGLE:

Q Well, when you've testified previously in this proceeding, what kind of testimony did you offer?

A [LOY] It was opinion testimony after reviewing several documents.

Q Okay. Is the opinion testimony that you're offering here of a similar type as you offered earlier in the case?

A [LOY] Yes.

MR. PRINGLE: Okay. At this time, to the extent necessary, I think – I don't know whether this Commission has a requirement that somebody be qualified to offer the opinion testimony that a rate-case witness would do, but I would ask that he

be so qualified, based upon his experience, based upon his knowledge, based upon his previous testimony in the various rate cases where he has testified.

CHAIRMAN WHITFIELD: Mr. Walker, now that Mr. Pringle's had his say, I'm going to give you one more chance here, and then we'll decide.

MR. WALKER: Thank you. Thank you, very much, Mr. Chairman. I don't know what he is qualifying him for. He hasn't said an expert in what. I don't know if he's here – what he's an expert in. He just says he's an expert and he's qualified. I think he needs to be qualified to render certain opinions in a certain field, and I don't know that he's been certified as an expert.

But, that aside, what he's getting ready to testify to, if his prefiled is any indication, is not an opinion. And I will start on page six. He intends to state, based on a document that was filed by Haig Point Utility, in a prior rate case, the intent of Haig Point, Inc., was to make a donation, or rather a contribution-in-aid-of-construction, when, in fact, he doesn't know what the intent was. That's a fact. He can't say, "I know what the intent of so-and-so was." He can

testify to what the sheet showed, and we can look at it. But there are two – at least two conflicting, or maybe more, reasons why it may have been done this way.

Further, when you look at page - that's on page six. You look at page 10, and the witness goes on to say, from a 10-K in 1997, that based on that – he says it is clear that the down-valuing of the holding company of Haig Point somehow proves, shows the intent that the plant was a contribution-in-aid-of-construction. There's no basis for that. That's just out of the blue. That's pure speculation. He wasn't there. He doesn't know a thing about it. He doesn't know what their intent was.

Later and then below that, there's a question, "Is there any evidence?" That's an improper question.

CHAIRMAN WHITFIELD: Mr. Walker, I think I've kind of heard enough, but I'm going to be candid with you. You will, depending on how we decide, you'll get an opportunity to cross this witness. But I've heard from both sides now, and I'm going to be honest with you: Since I've been doing this, I haven't had an objection to prefiled testimony

yet. So I think I know what I'm already going to do, but if you can bear with me one minute, I want to do the right thing here and I'm going to talk to counsel and then we're going to give you a decision right now.

[Brief pause]

Mr. Walker, I'm going to overrule your objection. You will have an opportunity to cross. And we will take notice of this.

I do have one other question. Did you object to this witness' testimony in the earlier case?

MR. WALKER: I didn't - I don't know - I haven't gone back and looked at it. I'm not sure I objected to the prior prefiled, but this was the first time that I would've had an occasion –

CHAIRMAN WHITFIELD: I understand.

MR. WALKER: – to object to this. And I did not mean to upset the apple cart in terms of ordinary procedures, but I hope the Commission understands that if I wish to preserve an objection, I can't preserve it unless I state it. And I will say I was not surprised by your ruling, whether I agree or disagree, but I had to make the objection. And thank you for considering it, and I will sit down.

CHAIRMAN WHITFIELD: Well, we're going to overrule, and we will take notice of it, and we will rule in the final order.

MR. WALKER: Thank you, very much, Mr. Chairman.

CHAIRMAN WHITFIELD: All right. Mr. Pringle, you may proceed.

MR. PRINGLE: In the words of Matthew McConaughey he kinda' interrupted my groove –

[Laughter]

– but I'll get back on it.

BY MR. PRINGLE:

Q Mr. Loy, did you also prepare six exhibits in connection with your direct testimony?

A [LOY] Yes, I did.

Q Okay. Was one of those exhibits initially designated as confidential by your overcautious attorney?

A [LOY] Yes, it was.

Q Okay. Is that exhibit, indeed, confidential?

A [LOY] No, it's not.

MR. PRINGLE: I'm going to hand this out just to the Commissioners – and the court reporter already has a copy of this.

[Document distributed]

Just so that we can get things –

COMMISSIONER ELAM: Isn't this more than one thing?

MR. PRINGLE: No, it's one exhibit.

I would ask that Mr. Loy's exhibits that were attached to his prefiled testimony be designated as the next hearing exhibit.

CHAIRMAN WHITFIELD: Mr. Pringle, if you'll bear with me a minute, I want to clear up something I said. I overruled Mr. Walker's objection, and what I meant to say is that we are taking notice of it. We're not going to revisit that in the final order. I misspoke. So we've overruled the objection, and your witness' prefiled testimony will be entered in the record as if given orally from the stand.

[See pgs 306-333 ~ Rehrg. direct]

MR. WALKER: Mr. Chairman, at this time he's offered the exhibits. I fully expect the Commission to admit those exhibits. But for the sake of the record here, I need to make the objection to the exhibits on the same ground as my earlier objection. Thank you.

CHAIRMAN WHITFIELD: Objection so noted, and we will enter in his exhibits as Hearing Exhibit No. 5. And Mr. Walker's objection is overruled.

[WHEREUPON, Hearing Exhibit No. 5 was marked and received in evidence.]

MR. PRINGLE: Okay.

BY MR. PRINGLE:

Q Mr. Loy, did you also cause to be prefiled surrebuttal testimony consisting of seven pages?

A [LOY] Yes.

Q In question-and-answer format?

A [LOY] Yes.

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

A [LOY] Yes, I do.

Q Please publish those, if you would.

A [LOY] I don't have a copy of it right in front of me, but page six, there is a reference to the confidential number. I just wanted to go ahead and put that number there.

Q Okay.

A [LOY] It's $1.75 million. It would be - okay [indicating]. It would be on line 19, page six, I would insert – between "paid" and "to" I would strike "to" and put after "paid" – "the purchase price paid of $1.75 million to International Paper."

Q Okay. With those changes, are there any additional changes you would like to make to your rebuttal

testimony?
A [LOY] No.
Q Okay. If I asked you all the questions that appear in that testimony, would your answers be the same?
A [LOY] Yes.

MR. PRINGLE: Mr. Chairman, subject to Mr. Walker's continuing objection, which I guess may be supplemented, I'd like to ask that Mr. Loy's surrebuttal testimony be read into the record as if given orally from the stand.

MR. WALKER: Same objection as earlier.

CHAIRMAN WHITFIELD: Mr. Walker's objection noted and overruled, and Mr. Loy's surrebuttal testimony will be entered into the record.

[See pgs 335-341 ~ Rehrg. Surrebuttal]

MR. PRINGLE: Okay.

BY MR. PRINGLE:
Q And that testimony did not have any exhibits, did it?
A [LOY] No, it didn't.
Q Okay. Have you prepared a summary of your testimony?
A [LOY] Yes.
Q Could you please present it to the Commission?
A [LOY] Sure. To sum up, DIUC is not following accepted ratemaking practices and principles prescribed by NARUC. This Commission, like all commissions in this country,

follow NARUC when they set water and sewer rates, and the result of not following these principles and practices typically results in one of the parties – utility or customer – not getting a fair price. And in this case, it's the customers of DIUC that will be paying a much higher or unfair price, should this Commission accept the company's proposed rate increase.

These NARUC violations driving DIUC's proposed excessive rate increase consists of two components or two fatal flaws, as characterized in my direct testimony. The first is the company was reflecting donated plant or CIAC in rate base. As I explain in my direct testimony, the company erroneously credited the plant value to paid-in-capital rather than CIAC. As this Commission knows and has ruled, a utility cannot earn a return on donated plant.

This issue is the same as the one we made in the original case, but we now have additional evidence.

The second fatal flaw relates to the first, in that, since the company did not book the donated plant appropriately, there was too much plant for the number of customers being served. To try and correct this, the company developed utilization factors to identify the customers' proportionate share of utility plant; that is, the utilization factors reflect only the portion of

plant that is serving active, actual customers. This approach is reasonable, in that it reflects the used-and-useful ratemaking principle that is recognized by NARUC and followed by most if not all commissions in the country. Used-and-useful basically means that, if a plant is not used and useful in providing service to customers, it should not be included in rates. This includes both depreciation expense, as well as plant. However, DIUC applied the factors only to depreciation expense, not plant in rate base. And to complicate things a little more, the utilization factors change each year, based on the development's growth from the beginning of the development, which started in 1986 – way before the company even owned the utility – until today, or, in this case, through the test year of the company's rate filing.

So the factors are – or, the factors were very, very low in the beginning, less than 5 percent, and then got larger through time, as more and more customers were added. The problem is that the growth really never came, and the development seems to be stalled around 34 to 47 percent capacity, and has been this way for the last 12 years, or so. As a result of this approach, or applying different utilization factors to the depreciation expense each year, only a fraction of the

actual NARUC or GAAP accumulated depreciation is reflected in rate base. Plant is significantly underdepreciated. As a clear violation of NARUC AND GAAP, this inflates rate base and provides the company an artificially inflated return, which significantly outweighs any depreciation savings reflected in rates, as well as contributes to a massive increase requested by the company.

My direct testimony makes two recommendations. The first is that the actual depreciation should be restated to comply with NARUC and GAAP, and reflect the actual age and condition of the plant. This really needs to be done and it is fully compatible with what all commissions do. In my 30 years of ratemaking, I've never seen a commission accept this sort of treatment of accumulated depreciation. Also, this will decrease the rate increase requested by DIUC.

My second recommendation is for this Commission to either recognize CIAC or donated plant, or apply the used-and-useful principle to the company's plant, using the utilization factors developed by the company. Either of these two approaches applied to net plant that reflects my recommendation in the one above will result in about the same level of revenue requirements or rate increase.

I believe the evidence strongly suggests that recognizing the CIAC is the best approach, and it really automatically eliminates the need to apply used-and-useful factors.

The company broad-brushed their response to my issues on CIAC, accumulated depreciation, and application of their utilization factors in their rebuttal, but my surrebuttal presents and emphasizes six conclusive facts that were also made in my direct. Exhibits – number one, that Exhibit CEL-R1 presents lot sales documentation provided by POA members that show conclusively that International Paper contributed the water and sewer plant. Number two, Haig Point Utility Company only sought to recover operating costs in its initial rate case filing with this Commission, and recovered only operating costs in its rates from 1987 until it's 2004 rate case. That's in Exhibit CEL-R4.

International Paper wrote all the utility plant off in 1997. Exhibit 1 to surrebuttal testimony of my – in the initial case. And in subsequent annual reports, that Haig Point Utility filed with this Commission, they showed zero utility plant balances until - well, through 2003.

Number four, the utility's balance sheet as of June 2004 showed the $4 million of plant – this is in their

annual report, or this is a balance sheet – shows over $4 million of plant suddenly appearing. The plant values were derived from an engineering study that uses bids, County plants, and other documentations, conducted 17 or 18 years after the development started. And given the first three facts above, the supporting County entries debit plant and erroneously credit paid-in-capital when CIAC should've been credited.

The huge spike in - number five, the huge spike in property taxes indicates that the utility plant was virtually unknown by the Department of Revenue until it started appearing in the company's annual reports. Contributed property is typically excluded from property tax valuations.

And, finally, number six, the purchase price paid to International Paper of $1.75 million suggests only the reimbursement of the newly constructed elevated water tank and Well No. 3, and not any payment for the other system plant. Furthermore, the purchase price is far lower than the total claimed plant values transferred to the company.

All these facts establish that the excessive rate increase sought by the company is being driven by a desire to obtain rates to recover investment far higher than they actually paid. That's it.

MR. PRINGLE: Okay.

[PURSUANT TO INSTRUCTION, THE PREFILED REHEARING DIRECT TESTIMONY {W/CORR'NS} OF CHARLES LOY FOLLOWS AT PGS 306-333]

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DAUFUSKIE ISLAND UTILITY COMPANY

DOCKET NO. 2014-346-WS

PRE-FILED TESTIMONY OF CHARLES LOY

BEFORE THE SOUTH CAROLINA PUBLIC SERVICE COMMISSION

Testimony Prepared: November 15, 2017

Hearing Date: December 5, 2017

Q: PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A: My name is Charles Loy. My business address is 919 Congress, Suite 800 Austin, Texas 78701. I am a Principal with GDS Associates, Inc. ("GDS"). GDS is a utility consulting and engineering firm with its principal offices in Marietta, GA.

Q: PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND.

A: I received the degree of Bachelor of Business Administration in Accounting from the University of Texas at Austin. I am a Certified Public Accountant in Texas.

Q: PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE.

A: Before joining GDS in June of 2001, I was General Manager of Rates and Regulatory Affairs of AquaSource Inc., a wholly-owned water and wastewater subsidiary of DQE, a publicly traded electric utility located in Pittsburgh, Pennsylvania. My responsibilities at AquaSource included the organization, preparation and management of various rate filings and testimony in connection with rate requests and other regulatory matters in the twelve states in which AquaSource owned and operated utility properties.

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Before joining AquaSource, I was a Manager of Regulatory Affairs for Citizens Utilities Company - Public Services Sector. I was responsible for various regulatory matters, including rate cases, for water/wastewater, gas, and electric services in eight states. Before joining Citizens, I was a Rate Manager with Southern Union Gas where I prepared rate filings, cost-of-service studies, and testimony for the various jurisdictions in Texas and Oklahoma. My utility regulation experience began with Diversified Utility Consultants as a Senior Analyst, where I assisted in the review and analysis of various gas, electric, and water company rate filings.

Q: HAVE YOU PREVIOUSLY PRESENTED TESTIMONY BEFORE REGULATORY COMMISSIONS AND/OR OTHER AGENCIES?

A: Yes, A list of regulatory proceedings in which I have been involved and presented expert testimony is attached to my direct testimony as Appendix A. I also presented testimony in this case for the first hearing in October 2015.

Q: WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS MATTER?

A: I have been asked to review the rate increase application of Daufuskie Island Utility Company ("DIUC") as submitted and offer testimony on certain aspects of the filing, particularly accounting and rate base issues and some related expenses, including depreciation expense, amortization expense, and property tax expense. In this regard, I have proposed changes to DIUC's rate base, property tax assessments and depreciation and amortization expenses, which will impact revenue requirements for water and for sewer service.

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Q: HAVE YOU PREVIOUSLY TESTIFIED ON SUCH MATTERS BEFORE REGULATORY COMMISSIONS?

A: Yes, I have.

Q: HAVE YOU REVIEWED DIUC'S FILING AND ITS TESTIMONY IN THIS MATTER?

A: Yes, I have.

Q: ARE THE RATES PROPOSED BY DIUC CONSISTENT WITH ACCEPTED RATEMAKING PRACTICES AND DIUC'S HISTORY OF RATEMAKING BEFORE THIS COMMISSION?

A: No. DIUC's proposed rate base reflects two fatal errors:

First, DIUC's proposed rate base (and specifically the net plant component of that putative rate base) is significantly overstated due to an erroneous $4.6 million accounting adjustment made to the books of Haig Point Utility Company[1] (HPUC). DIUC continues to reflect that improper accounting adjustment and the resulting increased rate base forward into the present rate case.

Second, DIUC significantly overstates net plant by under recording accumulated depreciation. Said another way, the accumulated depreciation does not reflect straight line depreciation on the useful life of the plant as required by the National Association of Regulatory Commission's (NARUC) Uniform System of Accounts (adopted by this

[1] Daufuskie Island Utility Company, Inc. ("DIUC") is the same entity as Haig Point Utility Company, Inc. ("HPUC"). According to the South Carolina Secretary of State records and DIUC's Commission filings, at some point between 2008 and 2010, Haig Point Utility Company, Inc. changed its name to Daufuskie Island Utility Company, Inc.

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Commission for ratemaking purposes) as well as Generally Accepted Accounting Practices or GAAP.

In addition, to the extent the Commission does not recognize the donated property and remove it from DIUC's rate base, the Commission must recognize that DIUC's proposed Rate Base mistakenly assumes its Utility Plant is serving every potential customer in its Daufuskie Island service area. This approach is flawed because DIUC attributes substantial investment in excess capacity to DIUC's current customer base, which has increased little since 2004. Consequently, DIUC's Utility Plant must be reduced to the percentage of DIUC's total Plant that is actually providing service to actual customers and serving DIUC customers.

Q: WHAT HAS DIUC PROPOSED THAT THE COMMISSION ADOPT FOR ITS RATE BASE?

A: DIUC has proposed a Rate Base of $3,278,504 for its water system (see, Schedule W-B to Gary C. White's Prefiled Rehearing Testimony ("White Rehearing Testimony")) and $3,806,971 for its sewer system (see, Schedule S-B to White Rehearing Testimony), for a total rate base of $7,085,475.

Q: ARE THESE PROPOSED RATE BASE VALUES VALID?

A: No, they are not. DIUC's prior rate filings (including filings when it was named HPUC) show it has no original cost in a large portion of its Utility Plant because that Plant was donated to DIUC by Haig Point, Inc., the developer of Haig Point. DIUC improperly added the claimed cost of the Utility Plant to its balance sheet as part of its

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2005 application for rate relief, Docket No. 2005-34-WS (the "2005 Rate Case"), as an "adjustment". DIUC's current Rate Base is largely derived from that 2005 balance sheet adjustment. Rate Base must be sharply reduced in order to remove this improper adjustment and its related effects, because the utility's 2005 adjustment to Rate Base violated the NARUC Uniform System of Accounts and accepted ratemaking practices.

Q: PLEASE EXPLAIN THE BASIS FOR YOUR CONCLUSION.

A: DIUC's asserted Rate Base includes "Property Plant, and Equipment" which was journalized onto DIUC's books just prior to the 2005 Rate Case. Schedule A-1 to that Application, attached as **Exhibit CEL-R1**, reflects a Plant in Service of $4,339,598.

Q: WAS THE PLANT IN SERVICE REFLECTED ON DIUC'S BOOKS PRIOR TO THE 2005 RATE CASE?

A: No, it was not. DIUC made this Plant in Service adjustment on its "Trial Balance" work sheet to record the results of a valuation study of the donated plant DIUC had conducted by the engineering firm of Thomas & Hutton. This study was conducted to support the utility's 2005 Rate case. (attached as **Exhibit CEL-R2**.) Under the column "Total Year Ended 6/30/04" the utility's Property Plant and Equipment is $0.00. Then, DIUC makes an adjustment in the next column increasing this amount to $4,339,598. Note (2) shows this increase was "To tie to Thomas & Hutton property schedule ($1,711,549 water and $2,628,049 sewer)." This study *estimated* the cost the developer, Haig Point, Inc., had expended on the Utility Plant, without the benefit of any supporting contracts or invoices. Since there were no actual invoices or cost records for the plant, Thomas & Hutton estimated the cost of the plant by examining land plats and other records, such as construction bids and check requests.

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Q: DID DIUC PAY FOR THIS UTILITY PLANT?

A: No. Haig Point, Inc. transferred the Utility Plant to DIUC at zero cost, donating the plant to DIUC after it was created. This is confirmed by the $0.00 value for Property Plant & Equipment reflected in the Total Year Ended 6/30/2004 column of **Exhibit CEL-R2**. This $0.00 value unequivocally establishes that Haig Point, Inc. gave the plant – donated it – to DIUC. Haig Point's donation is also demonstrated in DIUC's response to South Carolina Office of Regulatory Staff ("ORS") Audit Request # 20 in DIUC's 2011 rate proceeding, Docket No. 2011-229-WS (the "2011 Rate Proceeding") (DIUC Response attached as **Exhibit CEL-R3)** This response provides all deeds and other conveyances through which Haig Point, Inc. transferred ownership of the land and property comprising water and sewer plant to DIUC. The deeds clearly show Haig Point, Inc. donated the entire Utility Plant to DIUC for no consideration.

Q: WHAT ERROR DID DIUC MAKE WHEN IT PLACED THIS ROUGHLY $4.3 MILLION IN "PROPERTY. PLANT AND EQUIPMENT" ONTO THE UTILITY'S BOOKS?

A: DIUC booked this donated "Property Plant and Equipment" by crediting "Paid-in Capital," when it should have credited Contribution in Aid of Construction ("CIAC"). Note (8) of the Trial Balance for the Year Ended June 30, 2004 **(Exhibit CEL-R2)** clearly states DIUC increased Paid-in Capital from $0.00 to $4,635.782 "[t]o record plant and equipment and other adjustments to paid-in capital."

Q: HOW DID FAILING TO RECORD THIS DONATED PLANT AS A CONTRIBUTION IN AID OF CONSTRUCTION VIOLATE APPLICABLE

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RATEMAKING PRINCIPLES?

A: Like all water and sewer utilities regulated by this Commission, DIUC is required to maintain its books and records according to the NARUC Uniform System of Accounts ("USoA"). The NARUC USoA requires that entries to utility plant accounts for plant donated to the utility must be offset by credits to CIAC. NARUC USoA, Accounting Instruction 18, "*Utility Plant - To be Recorded at Cost*" Part D describes how the values of the donated plant should have been initially booked. Part D states:

"D. Utility plant accounts shall be charged with construction costs (estimated, if not known) of the utility plant contributed by others or constructed by the utility using contributed cash or its equivalent. For contributed utility plant, the accumulated depreciation or amortization account shall be charged with the estimated amount of depreciation or amortization applicable to the property at the time it was contributed to the utility. Account 271 - Contributions in Aid of Construction shall be credited with the net of the amounts charged to the plant and the accumulated depreciation or amortization accounts. For plant constructed using contributed cash or its equivalent, account 271 - Contributions in Aid of Construction shall be credited with the amount of the cash or its equivalent contribution."

NARUC defines CIAC as follows:

"271. Contributions in Aid of Construction A. This account shall include:

1. *Any amount or item of money, services or property received by a utility, from any person or governmental agency,* ***any portion of which is provided at no cost to the utility****, which represents an addition or transfer to the capital of the utility, and which is utilized to offset the acquisition improvement or construction costs of the utility's property, facilities, or equipment used to provide utility services to the public. (emphasis added).*

Q: **WHY DO THESE RATEMAKING PRINCIPALS PROHIBIT ADDING THESE GROSS PLANT ADDITIONS TO THE UTILITY'S RATE BASE?**

A. Respected treatises on these ratemaking principles uniformly prohibit the approach taken by DIUC.

"Accounting for Public Utilities" by Robert L. Hahne, states:

"Ratemaking treatment for contributions in aid of construction is a different situation, because no obligation exists for the utility either to repay any funds received or to

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reimburse parties donating physical property. The general rule is that any such contributions should be excluded from rate base, since the related plant investment has not been financed by the utility and customers should not therefore be required to pay a return on the plant."

The Indiana Small Utility Accounting Manual ("ISUAM"), issued by the Indiana Utility Regulatory Commission, provides a good explanation as to why donated plant must be credited as CIAC and *must not* increase the utility's Rate Base:

Such donations may come from developers, customers, governmental entities, or others to upgrade water and/or wastewater systems to accommodate new customers burdening existing customers. ***Plant contributed to a utility increases Utility Plant in Service, but does not increase rate base of investor-owned utilities because CIAC is used as an offset to the plant.*** *The practice of excluding CIAC from rate base also prevents customers from paying twice for the same assets – e.g., once from paying for a customer's home and a second time through utility rates.* [2]

These established rate making principles apply directly to the present situation. If DIUC had properly recorded the 2005 plant addition as CIAC, it could then not have utilized this donated plant to increase DIUC's Rate Base. As the ISUAM explains, by improperly reflecting this donated Plant as part of its rate base, DIUC has caused its customers to "pay twice for the same assets" – once from paying for a customer home (or lot), and a second time through waters and sewer utility rates paid to DIUC.[3]

Q. SHOULD THE UTILITY'S PURCHASE OF MELROSE UTILITY COMPANY IN 2008 CHANGE THE PROPER EXCLUSION OF THIS ORIGINAL PLANT FROM RATE BASE?

A. Not in any way. When HPUC purchased Melrose Utility Company in 2008, HPUC was the surviving entity. Shortly thereafter, HPUC changed its name to DIUC, but the corporate entity that originally filed for rates in 1986 and for a rate increase in the

[2] *Id.*, (emphasis added).
[3] *Id.*

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2005 Rate Case is the same corporation that filed for a subsequent rate increase in the 2012 Rate Case and the present rate case for which we are here today. The books of HPUC are the books of DIUC because they are the same corporation.

Q. WOULD THE RESULT BE ANY DIFFERENT IF THE 2008 TRANSACTION BETWEEN HPUC AND MELROSE UTILITY COMPANY ENDED IN A NEW CORPORATE ENTITY?

A. No. Even if that occurred, the CIAC should have been continued on the surviving entity's books as required by NARUC USA Instruction 21. "Utility Plant – Purchased or Sold" which states:

"A. When utility plant constituting an operating unit or system is acquired by purchase, merger, consolidation, liquidation, or otherwise, the costs of acquisition, including expenses incidental thereto properly includible in utility plant, shall be charged to account 104 - Utility Plant Purchased or Sold.

B. The accounting for the acquisition shall then be completed as follows:

(4) The amount of contributions in aid of construction applicable to the property acquired, and which the purchaser may be required to record, shall be charged to account 104 - Utility Plant Purchased or Sold, and concurrently credited to account 271 - Contributions in Aid of Construction."

Q: IS THERE ANY OTHER EVIDENCE SUPPORTING YOUR CONCLUSION THAT DIUC'S ENTIRE ORIGINAL PLANT WAS DONATED BY THE DEVELOPER AND WAS BEING CARRIED ON DIUC'S BOOKS AT ZERO VALUE PRIOR TO THE UTILITY'S 2004 ANNUAL REPORT TO THE COMMISSION?

A: Yes. In 1997, International Paper (IP) Inc. wrote off its entire investment in Haig Point Inc. In the "Special Items Including Restructuring and Business Improvement Actions" section of IP's 1999 SEC Form 10-K (Exhibit One), Note C in the write-down discussion section states:

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The Company is the developer of a residential golf community named Haig Point at Daufuskie Island, S.C. As the developer, International Paper was responsible for operating this community until a specified number of lots were sold, at which time it would turn the community over to the homeowners. The net book value of our investment in Haig Point was $13 million at June 30, 1997. Given the continuing operating losses, $5 million in 1997, an updated marketing study, and the inability to find a buyer for this investment, ***we concluded that the investment was permanently impaired and wrote it down to zero.*** *The operating loss in 1998 was $500,000. (Emphasis added).*

At the time of IP's 1999 SEC filing, IP still owned Haig Point, Inc., whose assets continued to include the stock and plant of HPUC (now renamed DIUC). If either Haig Point, Inc. or HPUC were holding utility Plant worth an amount between $4 and $5 million, IP would have reflected that value in subsequent SEC filings, either expressly, or by showing some, as opposed to $0.00, value. IP's SEC 1999 filing suggests that it gained a significant economic benefit by offsetting taxable income with the reported write offs of the development investment and subsequent operating losses. Treating the utility's Plant adjustment as anything other than donated Plant (CIAC) would materially contradict Haig Point's prior SEC and, we believe, IRS filings.

Q: IS THERE ANY EVIDENCE THAT LOT OWNERS PAID FOR DIUC'S ENTIRE ORIGINAL PLANT?

A: Yes. When HPUC sought to establish water and sewer rates before this Commission in Docket No. 87-333-W/S, its rate application sought rates that would recover only the utility's operating costs. The capital costs associated with Plant, Property and Equipment were to be underwritten by lot owners. In other words, HPUC never intended to recover the initial utility infrastructure costs through utility rates. This is

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demonstrated by the financials associated with HPUC's 1987 Rate Case application, attached hereto as **Exhibit CEL-R4**.

Q: IS RECORDING THIS DONATED PLANT AS CIAC AND EXCLUDING IT FROM DIUC'S RATE BASE CONSISTENT WITH PRIOR RULINGS OF THIS COMMISSION?

A: Yes. The Commission has addressed this situation on prior occasions. The following are just two examples of Commission rulings directly addressing this point and requiring donated Plant to be recorded as CIAC and excluded from the utility's Rate Base:

Contributions in aid of construction include amounts donated or contributed in cash, services, or property from individuals, states, municipalities, or other governmental agencies, and others for construction purposes. A utility is usually not permitted to include contributions in aid of construction in its rate base and, therefore, cannot earn a return on it. The underlying principle for exclusion of contributions from rate base is that since the utility itself has made no investment in contributed property, it has not financed the cost of contributed property and has no cost of capital related to contributed property. In Re: Application of Commodore Utility Corp., DOCKET NO. 82-202-W/S; ORDER NO. 82-580 (Aug. 27, 1982)

Generally, in ratemaking proceedings, a calculation of the utility's rate base is made. A rate base is comprised of the total net value of a utility's tangible and intangible capital or property value on which the utility is entitled to earn a reasonable rate of compensation. The Company's application did not provide a rate base calculation since the Company had no original cost in its plant, which was completely donated by the developer of the subdivision. As a consequence, the staff's audit report contained no rate base calculation. The Commission finds the staff's approach to be reasonable in the context of this proceeding. IN RE: Petition of Ladson Utilities, Inc. Docket No. 76-587 –S, Order No. 77-176, (Apr. 25, 1977)

Q: HOW WOULD PROPERLY REFLECTING THE 2005 ADDITION OF UTILITY PLANT DETAILED IN THE VALUATION STUDY AS CIAC, INSTEAD OF PAID-IN CAPITAL, CHANGE DIUC'S PROPOSED RATE BASE?

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A: Table 1 below shows the breakdown of DIUC's proposed gross plant in rate base between CIAC (donated plant) and DIUC's actual utility's rate base investment in plant. As shown, a significant portion of total requested gross plant is donated.

TABLE 1

BREAK DOWN OF GROSS PLANT NEEDED TO COMPLY WITH NARUC REQUIREMENTS

Total Requested Gross Plant		Gross Donated Plant		Gross Plant In Rate Base
$8,139,261	=	$4,414,059	+	$3,725,203

However, as I discussed at the beginning of this testimony, the net plant values DIUC is presently asserting are artificially high because plant representing excess capacity has not been depreciated according to the guidelines of NARUC USoA. Table 2 below shows how DIUC's current - artificially low - accumulated depreciation must be corrected to comply with the applicable NARUC requirements.

TABLE 2

INCREASE ACCUMULATED DEPRECIATION TO COMPLY WITH NARUC STRAIGHT-LINE REQUIREMENTS

		Total Requested Accum. Depr.		Increase to NARUC Straight-Line *		Total NARUC Straight-Line Accum. Depr.
1	DUIC Funded Accum. Depr.	($160,306)	+	($703,574)	=	($863,880)
2	Donated Plant Accum. Depr.	($675,776)	+	($1,516,378)	=	($2,192,154)
3	Total Accumulated Depreciation	($836,081)	+	($2,219,952)	=	($3,056,033)

*Represents depreciation on excess capacity and donated plant

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Q WHY IS THE COMPANY NOT DEPRECIATING ITS PLANT ACCORDING TO NARUC?

A: The Company is depreciating its plant based on a highly unconventional and, in my experience, unheard of approach which it calls the "Complete System" methodology. This methodology depreciates plant according to its use, not its useful life as required by the NARUC USoA. Saying it another way, this methodology defers depreciation on the plant that is not "used and useful", a key rate making principle. This unsupported methodology improperly suggests that the service lives of plant representing excess capacity are somehow frozen in time and artificially extended until fully serving customers. If uncorrected, this would cause the utility's relatively-few customers to pay for the entire investment designed to serve a far larger population, but not provide these customers the benefit of straight-line accumulated depreciation. In risk terms, this highly non-standard approach to ratemaking unfairly transfers the risk of low customer build out – a risk which should clearly be borne by utility shareholders - to utility customers.

Q: EXPLAIN THE GUIDELINES FOR DEPRECIATION AS REQUIRED BY THE NARUC USOA.

A: The NARUC USoA requires straight-line depreciation over the useful life of plant in service:

"Straight-line method" as applied to depreciation accounting means the plan under which the service value of property is charged to operating expenses (and to clearing accounts if used), and credited to the accumulated depreciation account through equal annual charges during its service life. Estimates of the service life and salvage will be reexamined periodically and depreciation rates will be corrected to reflect any changes in these estimates

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The Company claims that its depreciation methodology isolates customers from developer risk in that they are not paying rates that include depreciation on plant that is not "used and useful", as required by rate making principles. This is totally false. Rather than isolating customers from developer risk, it places developer risk squarely on the shoulders of customers, particularly in terms of an inappropriately high rate base.

In this case DIUC estimates that only 47% of water plant and 35% of the sewer plant is serving the current level of DIUC customers. The methodology asserts that the plant not serving customer is not "used and useful" and, therefore, it should not be depreciated. Only part of the depreciation expense that represents the useful life is expensed and place in accumulated depreciation on the books of the Company. However, the NARUC publication "Public Utility Depreciation Practices" specifically disallows this approach:

"It is essential to remember that depreciation is intended only for the purpose of recording the periodic allocation of cost in a manner properly related to the useful life of the plant. It is not intended. for example, to achieve a desired financial objective or to fund modernization programs."

In summary, the Complete System methodology pursues a desired financial outcome by delaying the appropriate level of depreciation expense on its books. This approach results in a immediately higher rate base and rates, and even higher rates over time as customers are required to pay for deferred depreciation which should have properly been the burden of the utility's shareholders. The same NARUC publication specifically warns against this:

"If a commission prescribes rates which yield depreciation accruals that are too low. the revenue requirement in the short run may be lower. But the requirements for

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income taxes and return may offset the apparent savings in depreciation expense, so service rates in the long run may be higher."

Thus, while the lower depreciation rates may be desirable for rate setting, if the lower rates are employed for an extended period of time, as in this case, the short run benefits of lower depreciation rates boomerang into much higher utility service rates. Table 3 below shows that the $2.3 million of excess plant, due to an extended period of low depreciation rates (shown in Table 2 above), produces a much higher return and property taxes than the depreciation "savings" claimed under the Company's flawed methodology.

TABLE 3

TRUE RATE IMPACT OF COMPLETE SYSTEM METHODOLOGY

1	Excess Rate Base (Additional Straight-Line Accumulated Depreciation per Table 2)	$2,219,952
2	Return @ 8.73%	$193,802
3	Income Taxes @ 37.3%	$81,616
4	Property Taxes @ 2.63%	$58,274
5	Total Excess Return & Taxes	$333,691
6	Less: Complete System Depreciation Expense Savings	$82,242
7	Proposed Compete System Overcharges to be Included in Rates	**$251,449**

The NARUC publication "Public Utility Depreciation Practices" additionally points out:

"If depreciation rates are set so low that the revenue requirement fails to repay the capital invested in a group of property by the end of its service life, confiscation takes place or the unpaid cost remains in the rate base until amortized or expensed."

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This passage specifically warns that under depreciating plant or extending plant beyond its useful life will result in the plant not being fully recovered by the utility. However, if DIUC is allowed to earn a prolonged return on older, under depreciated *donated* plant, recovery of its original cost is not a concern. On the contrary, DIUC will more than recover its actual costs.

Q: WHAT WOULD BE THE APPROPRIATE WAY FOR THIS COMMISSION TO SET RATES FOR DIUC GIVEN THE WAY DIUC ADDRESSED DEPRECIATION?

A: The full straight-line depreciation expense must be recorded to *accumulated* depreciation in order to comply with NARUC and rate making guidelines. There is no basis for unfairly burdening DIUC customers by adopting unconventional ratemaking hocus-pocus such as the Complete System methodology. All that is needed is to rely on well-established used and useful utility accounting principles. This involves proportionately allocating all components of Rate Base inclusive of net depreciation, that is, depreciation of all non-donated plant, on the basis of customer count, consistent with past Commission practice.

Q: HOW WAS ACCUMULATED DEPRECIATION CALCULATED IN THE 2005 CASE WHICH USED A STIPULATED COMPLETE SYSTEM METHODOLOGY?

A: The rate base schedules included with the Commission's Order approving the settlement reflect accumulated depreciation levels comparable to what I am proposing. Further, it illustrates how the Complete System methodology has grossly distorted the Company's rate base. Table 4 below shows that despite adding $2.6 million of plant

over the last ten years, accumulated depreciation is 57% *lower* than the accumulated depreciation used in the 2005 settlement with the ORS. Further, it shows net plant has putatively doubled while the number of customers receiving service has not grown much at all.

TABLE 4

		2005 Settlement	2015 Rate Case
1	Gross Plant	$5,527,117	$8,139,261
2	Accumulated Depreciation	($1,815,761)	($777,854)
3	Net Plant	**$3,711,356**	**$7,361,407**

Q: WHAT DO YOU RECOMMEND REGARDING THE ACCUMULATED DEPRECIATION BALANCES PROPOSED BY THE COMPANY?

A: The accumulated depreciation amounts recorded by the Company should be adjusted to comply with NARUC and rate making principles as presented in Table 2 above. Table 5 below combines values in Tables 1 & 2 to arrive at the appropriate NARUC net plant values to place in rate base. Note that booked CIAC associated with donated plant has been amortized consistent with the plant it relates to, to comply with NARUC.

TABLE 5

COMBINE TABLES 1 & 2 TO ESTABLISH NARUC RATE BASE

		Gross Plant (A)	Less: Accumulated Depr./Amort. (B)	Net Plant (C)=(A)+(B)
1	Plant In Service	$8,139,261	($3,056,033)	$5,083,228
2	Less: Donated Plant	($4,414,059)	$2,192,154	($2,221,905)
3	Plant in Rate Base	**$3,725,203**	**($863,880)**	**$2,861,323**

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Q: WHAT ARE ADJUSTMENTS TO THE COMPANY'S REQUESTED DEPRECIATION AND CIAC AMORTIZATION AMOUNTS ARE REQUIRED TO REFLECT NARUC STRAIGHT LINE DEPRECIATION?

A: Table 6 below summarizes the adjustments to depreciation expense and CIAC amortization by water plant and sewer plant.

TABLE 6

ADJUST DEPRECIATION EXPENSE AND CIAC AMORTIZATION TO REFLECT NARUC STRAIGHT-LINE

	Description	Requested	Straight-Line	Adjustment
	Water Plant			
1	Depreciation Expense	$46,446	$86,325	$39,879
2	Amortization of CIAC	($4,508)	($44,496)	($39,988)
3	Total	$41,938	$41,829	($109)
	Sewer Plant			
4	Depreciation Expense	$54,993	$106,142	$51,149
5	Amortization of CIAC	($1,665)	($62,923)	($61,258)
6	Total	$53,328	$43,219	($10,109)

Q: PLEASE ADDRESS YOUR PROPOSED ADJUSTMENT TO THE ANNUAL PROPERTY TAX AND THE BACK TAXES OR PAST PROPERTY TAXES?

A: Table 7 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

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than requested.

TABLE 7

ESTIMATED PROPERTY TAXES WITH CIAC

		2011	2012	2013	2014
1	Net Plant	$4,703,358	$4,552,231	$4,526,446	$5,083,228
2	Net CIAC	($2,773,722)	($2,678,977)	($2,544,518)	($2,838,523)
3	Taxable Base	$1,929,635	$1,873,253	$1,981,928	$1,981,928
4	Assessment Ratio	10.5%	10.5%	10.5%	10.5%
5	Millage Rate	0.197540	0.200850	0.240033	0.197540
6	Tax Due	$40,024	$39,506	$49,951	$41,109
7	Total Back Taxes			$124,756	
8	Requested 2014			$526,864	$192,301
9	Adjustment Back Taxes/Test Year			($402,108)	($115,995)

Q: IF THE COMMISSION REJECTS YOUR RECOMMENDATION TO RECOGNIZE THE DONATED PLANT AND REMOVE IT FROM RATE BASE, DO YOU HAVE AN ADDITIONAL RECOMMENDATION?

A: Yes. DIUC's rate base must be adjusted to reflect the level of plant that is actually in service. In the 2005 rate case, ORS applied this concept in its recommendations in its Audit Report[4]. ORS proposed removing "plant in service based on most recent system utilization factors of 40.94% for water and 34.16% for sewer".[5] The utilization factors were developed by the Company to identify the portion or percentage of the water and

[4] *See* Docket No. 2005-34-W/S, Testimony of Sharon G. Scott, p 24, Audit Exhibit SGS-11, relevant portions attached as **Exhibit CEL-R5**.
[5] *See Id.*, Note (G) to ORS Audit Exhibit SGS-11.

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sewer systems that are "used and useful". In the 2005 Rate Case test year, the utility was serving only 40.94% of the potential customers its water system could serve, and only 34.16% of the potential customers its sewer system could serve. ORS applied the utilization factors to the Company's proposed plant by these percentages, which resulted in a $2,277,603 reduction in that component of the utility's rate base.

Q: DO YOU BELIEVE THIS ADJUSTMENT IS APPROPRIATE?

A: Yes. It follows the key rate making concept of "used and useful" and is consistent with my earlier discussion in this testimony. This adjustment assures that a utility's customers do not bear the economic burden of excess capacity and possibly a developer's imprudent decision to overbuild a water or sewer system.

Q: PLEASE EXPLAIN.

A: A developer has the ability to either construct a utility system in phases, as the development proceeds, or construct a much larger system initially - one that could serve the entire development, if and when it is entirely built-out. Here, the developer decided to initially build a system large enough to serve a fully-built out Haig Point development, before determining whether the development would even be a success. In 2004, roughly twenty years after development of the Haig Point community began, system utilization was only 41% (water) and 34% (sewer). ORS's proposal to reduce the utility's gross plant to these actual utilization percentages ensured that current customers did not bear an undue economic burden otherwise caused by the developer's decision to construct such a large system at the beginning of the development.

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Q: HOW HAS UTILIZATION OF DIUC'S UTILITY SYSTEM CHANGED SINCE THE 2005 RATE CASE?

A: System utilization has not changed materially in the last 12 years. Since 2004, the water system utilization has increased from 41% to 47% and sewer system utilization has increased from 34% to 35%. This essentially immaterial growth in system utilization over the twelve years period demonstrates that the developer grossly overbuilt the water and sewer systems when it began developing Haig Point in the 1980s. Including all the plant in Rate Base, as proposed by DIUC, would unfairly burden DIUC's customers and unfairly compensate DIUC. DIUC should not be allowed to charge rates that cause DUIC's customers to bear the burden of the developer's initial decision to build out the entire system when future success of the development was unknown.

Q: DO ACCEPTED RATE MAKING PRINCIPLES CALL FOR REDUCING PLANT TO REFLECT THE ACTUAL SYSTEM UTILIZATION?

A: Yes. The adjustment follows the well-known rate making concept that only plant that is "used and useful" should be included in rate base. Numerous authoritative texts on utility ratemaking cite this principle or rule. For example, "Accounting for Public Utilities" by Robert L. Hahne, states:

"Only plant currently providing service or capable or providing utility service to the consuming public is allowed in rate base."

"The Regulation of Public Utilities" by Charles F. Phillips Jr. states:

"For decades, used and useful referred to needed capacity; that is, a determination as to whether a plant was actually used in service and was useful in providing service."

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"Principles of Water Rates, Fees, and Charges" also known as the "Manual of Water Supply Practices M1" published by the American Water Works Association states:

"The primary issue related to including plant in the rate base is whether the plant is used and useful in providing utility service."

Further, the 2005 ORS adjustment agrees with the "Rate Case and Audit Manual" developed by NARUC to assist utility commission staffs with rate case audits which states:

"In reviewing specific rate base items, the auditor will want to continually be considering the concept of ***used and useful****. This principle is widely adopted by regulatory commissions and requires that plant be functioning and necessary to be included in the revenue requirement. Plant that is considered to be excessive may not be appropriate for inclusion in rates at this time." (Emphasis added)*

Q: DO YOU RECOMMEND MAKING THE SAME ADJUSTMENT TO PLANT AS RECOMMENDED BY THE ORS IN THE 2005 RATE CASE?

A: Yes, in the event that the Commission does not take into account the donated property in DIUC's rate base. The same factors supporting ORS's proposed adjustment in 2005 apply today with even more force. As discussed above, customer growth over the last twelve years has been materially insignificant. Like in 2005, DIUC's system today is largely unutilized. Table 8 shows how the booked plant values must be reduced to reflect actual utilization and demonstrates how that reduction is computed.

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TABLE 8

APPLY CURRENT SYSTEM UTILIZATION FACTORS TO DUIC GROSS PLANT AND ACCUMULATED DEPRECIATION

		UPIS Account	Total Pro Forma Gross Plant	Percent of Unutilized Plant	Plant Not Utilized
	Water Gross Plant		A	B	C = -A x B
1	Wells	307	$794,865	52.8%	($419,848)
2	Misc. Equipment - Source	339	$9,104	52.8%	($4,809)
3	Water Treatment Plant	320	$321,643	52.8%	($169,892)
4	Distribution Reservoirs	330	$869,379	52.8%	($459,206)
5	T&D Plant	311	$75,414	52.8%	($39,834)
6	Mains, Hydrts, Serv	331	$1,509,688	52.8%	($797,417)
7	Meters	334	$8,786	52.8%	($4,641)
8	100% Utilized Plant		$361,078	0.0%	$0
9	Total Water Gross Plant		$3,949,957		($1,895,646)
	Water Accumulated Depreciation				
11	Plant Non-Utilized Accum. Depr.		$1,236,245	-52.8%	$652,985
12	Plant 100% Utilized Accum Depr.		$41,315	0.0%	$0
13	Total Water Accumulated Depreciation		$1,277,560		$652,985
14	**Total Water Net Plant**		**$2,672,397**		**($1,242,661)**
	Sewer Gross Plant				
15	Collection Mains	361	$2,118,279	64.5%	($1,366,925)
16	WW Pumping Plant	371	$158,189	64.5%	($102,079)
17	WW Treatment & Disposal Plant	380	$259,462	64.5%	($167,431)
18	Plant Sewers	381	$818,187	64.5%	($527,976)
19	Outfall Sewer Lines	382	$66,704	64.5%	($43,044)
20	Power Generation Equip	355	$4,632	64.5%	($2,989)
21	100% Utilized Plant		$763,852	0.0%	$0
22	Total Sewer Gross Plant		$4,189,304		($2,210,445)
	Sewer Accumulated Depreciation				
23	Plant Non-Utilized Accum. Depr.		$1,741,238	-64.5%	$1,123,621
24	Plant 100% Utilized Accum Depr.		$37,235	0.0%	$0
25	Total Sewer Accumulated Depreciation		$ 1,778,473		$1,123,621
26	**Total Sewer Net Plant**		**$2,410,831**		**($1,086,824)**
27	**TOTAL NET PLANT**		**$5,083,228**		**($2,329,485)**

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And Table 9 shows both the effect on rate base that removing donated plant would have (without any plant utilization adjustment), and the effect on rate base of applying a plant utilization adjustment.

TABLE 9

PLANT UTILIZATION ADJUSTMENT

		With Removing Donated Plant	Without Removing Donated Plant
1	Gross Plant	$8,139,261	$8,139,261
2	Accumulated Depreciation	($3,056,033)	($3,056,033)
3	Net Plant	$5,083,228	$5,083,228
4	CIAC	($4,414,059)	$0
5	Accumulated Amortization	$2,192,154	$0
6	Net CIAC	($2,221,905)	$0
7	Unutilized Plant/CIAC	$0	$ (2,329,485)
8	**Total**	**$2,861,323**	**$2,753,743**

Again, this demonstrates that the developers of this system took the risky approach of completely building out the water and sewer system in the 1980s. That is, they laid water distribution and sewer collection mains to every available lot in the development and constructed a 640,000 gallon per day sewer treatment plant, rather than designing their infrastructure and treatment plant to be built in phases, if and when lot sales progressed. The bulk of the donated plant amounts consist of water distribution and sewer collection mains. Customers should not be forced to pay for the developer's bad business decision, especially when the current customer base is not using that plant. If the Commission decides not to reduce DIUC's gross plant to eliminate the donated plant, it should apply the current system utilization factors to DIUC's entire (although,

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now, overstated) Gross Plant, and reduce DIUC's Rate Base accordingly.

Q. HAVE THE POAS AND ORS LEARNED ANYTHING THROUGH DISCOVERY IN THIS RATE CASE THAT FURTHER SUPPORTS THE COMMISSION MAKING THESE PROPOSED ADJUSTMENTS TO RATE BASE?

A: Yes. DIUC disclosed how much the new shareholders of CK Materials, LLC (CK Materials) paid to Haig Point, Inc. for DIUC in 2008, which I attach as **Confidential Exhibit CEL-R6**. This document shows the purchase price for HPUC was **$1.75 million** CONFIDENTIAL plus closing costs of **around $300,000** CONFIDENTIAL. The price paid by CK Materials covers the plant investment Haig Point, Inc. made in 2005. The sale to CK Materials took place in roughly 2008, or about three years after the Commission approved a rate base of around $5.2 million. This purchase price made it completely clear the developer donated the plant to the utility which, as discussed above, proves DIUC's asserted Rate Base is dramatically overstated.

Regardless of the reason, whether there is donated plant or a significant amount of unutilized plant, the fact of the matter is that there is too much plant in rate base. Proper regulatory accounting, as prescribed by NARUC and numerous other regulatory authorities, support this argument.

Q: WHY DIDN'T THE POAS CHALLENGE DIUC'S ASSERTED RATE BASE IN PRIOR PROCEEDINGS?

A: While the POAs raised concerns about the utility's Rate Base calculation in prior proceedings, it was unnecessary to waste Commission and party resources seeking a

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final Commission ruling on Rate Base issues because the parties reached a settlement in both the 2005 and 2012 Rate Cases. Moreover, as set out below, no rate base established in particular rate case becomes a "precedent" that cannot be challenged in a subsequent Docket.

Q: DOES THE POA'S OPPOSITION TO DIUC'S ASSERTED RATE BASE CONTRADICT THE SETTLEMENT THE POAS REACHED WITH DIUC AND ORS IN 2012?

A: No. In fact, the Settlement Agreement approved by the Commission in the 2012 Rate Case establishes that the Rate Base reflected in that proceeding cannot be used as a precedent in later rate cases. The Settlement Agreement expressly authorizes the POAs and ORS to challenge DIUC's propose Rate Base today.

In their settlement of the 2012 Rate Case, ORS and the POAs negotiated the following Settlement Agreement safeguard:

2. In the current proceeding, the Parties disputed the adjustment in rates, fees, and charges that would be necessary to provide DIUC a fair return on its investment as well as the rate of return and other matters.

3. The Parties agree and stipulate that DIUC shall be allowed to set rates and charges on a rate base of $5,000,000. ***This stipulated rate base shall not be binding in future proceedings, instead those proceedings will be determined based on the evidence presented in each docket and the applicable law.***

. . .

13. The Parties agree that this Settlement Agreement does not constrain, inhibit or impair in any way the arguments or positions they may choose to assert in future proceedings.

(Emphasis added) The Commission approved the Settlement Agreement, including this provision, through Order No. 2012-515.

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The Settlement Agreement also embodies the principle that each rate case is always determined based on the evidence presented therein and applicable law.

Q: DOES THIS CASE'S CURRENT PROCEDURAL POSTURE ALLOW THE POAS AND ORS TO CHALLENGE DIUC'S ASSERTED RATE BASE IN THIS REHEARING?

A: Yes, the parties are free to challenge DIUC's asserted Rate Base. The South Carolina Supreme Court remanded this rate case to the Commission "for a new hearing as to all issues" and "for a de novo hearing."[6] Following remand, DIUC argued the Standing Hearing Officer must prohibit the parties from filing new testimony on anything other than property taxes, plant in service, bad debts, management fees, and rate case expenses – all issues that could only increase DIUC's proposed rates. DIUC also asserted the Supreme Court opinion did not allow any additional discovery.

After hearing arguments from all parties, the Standing Hearing Officer denied DIUC's position, ruling:

"the [Supreme Court's] 'de novo' terminology clearly means that the Court intended that the Commission hold a new hearing on all issues in the case. Further, since the Commission will hold a new hearing on all such issues, the Commission's discovery rules are clearly applicable." [7]

It is therefore appropriate for the POAs and ORS to present evidence and testimony demonstrating why DIUC's proposed Rate Base is flawed and urging the Commission

[6] *See* Daufuskie Island Utility Company, Inc. v. South Carolina Office of Regulatory Staff, 803 S.E. 2d 280 (2017).

[7] *See* Order No. 2017-59-H. DIUC filed a motion for the Hearing Officer to reconsider its ruling, which the Hearing Officer subsequently denied. *See,* Order No. 2017-61-H.

to make the resulting necessary adjustments in setting DIUC's new rates.

Q: DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A: Yes, it does. I am prepared to respond to any questions the Commission or other parties may have.

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[PURSUANT TO INSTRUCTION, THE PREFILED REHEARING SURREBUTTAL TESTIMONY {W/CORR'N} OF CHARLES LOY FOLLOWS AT PGS 335-341]

DAUFUSKIE ISLAND UTILITY COMPANY

DOCKET NO. 2014-346-WS

PRE-FILED SURREBUTTAL TESTIMONY OF CHARLES LOY

BEFORE THE SOUTH CAROLINA PUBLIC SERVICE COMMISSION

Q: PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A: My name is Charles Loy. My business address is 919 Congress, Suite 800 Austin, Texas 78701. I am a Principal with GDS Associates, Inc. ("GDS"). GDS Associates, Inc. ("GDS") is a utility consulting and engineering firm with its principal offices in Marietta, GA. My business address is 919 Congress, Suite 1110 Austin Texas 78701.

Q: DID YOU SUBMIT REHEARING DIRECT TESTIMONY IN THIS CASE?

A: Yes.

Q: HAVE YOU READ THE REBUTTAL TESTIMONY OF DIUC WITNESS JOHN F. GUASTELLA?

A: Yes.

Q: WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A: I will address Mr. Guastella's so called "conclusive facts" that he presents toward the end of his Rebuttal Testimony regarding my recommendation to impute CIAC in rate base or, alternatively remove utility plant from rate base as not "used and useful". Further, I will address the possibility if the Commission does not accept the recommendations presented in my Direct testimony.

Q: HOW DOES MR. GAUSTELLA ADDRESS YOUR DIRECT TESTIMONY?

A: Mr. Gaustella seems to "broad stroke" the fatal flaws in DIUC's proposed plant values I addressed in my Direct Testimony as non-issues by presenting six so called "conclusive facts" that purport to establish that the issues I addressed are not pertinent. In fact, Mr. Gaustella's "conclusive facts" are neither "conclusive" nor or they "facts". They are just plain untrue.

Q: PLEASE ADDRESS THE FIRST THREE OF MR GAUSTELLA'S "CONCLUSIVE FACTS" CITE PRIOR SETTLEMENTS WITH THE COMMISSION.

A: Mr. Gaustella's first three "conclusive facts" argue that settlements of the 2005 Rate Case[1], the 2008 approval of sale and transfer of the stock of Haig Point Utility Company, Inc. ("HPUC") from Haig Point, Inc. to CK Materials LLC ("2008 Stock Transfer")[2], and the 2011 Rate Case[3] somehow establish that the $4.6 million in utility plan donated by the developer to HPUC around 1985 is not properly categorized as a Contribution in Aid of Construction, as required by accepted ratemaking principals historically followed by this Commission. DIUC's claim contradicts its previous agreements and is legally unsupportable.

- The 2005 Rate Case. That rate case does not establish a rate base. The Parties to the Settlement Agreement, which included DIUC, ORS, and Haig Point Club and

[1] Docket No 2005-34-WS.
[2] Docket No 2007-414-WS.
[3] Docket No. 2011-229-WS.

Community Association ("HPCCA"), reserved their right to challenge the utility's rate base in future proceedings through the following settlement provision:

> 5. 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 proceedings.

Therefore, any data from the 2005 Rate Case, including the utility's rate base (which the Commission never expressly established for any future proceeding, in any event[4]) is inapplicable to the current rate case.

- The 2008 Stock Transfer. As with the 2005 Rate Case Settlement, the Settlement Agreement in the 2008 Stock Transfer Docket made clear that no party was bound by whatever took place in that Docket in any future Commission proceeding:

> "[T]he parties have varying legal positions regarding the issues in this case...The Parties stipulate and agree that the prefiled testimonies of Trent Thompson, Terry R. Lee, Jamie Karabinchak, John Guastella, Willie J. Morgan, and Jeffrey P. Debesssonet be entered into the record *as evidence and support that the sale and transfer of stock, assets and operating authority of HPUC to CK is in the public interest.* ***[t]his agreement does not bar or otherwise limit any party from contesting any portion of these prefiled testimonies in any future Commission docket or other legal proceeding***."[5]

Therefore, the assertion that the 2008 Stock Transfer matter limited the ability of the Intervenors to challenge subsequently the Utility's rate base and/or the value of its assets, is simply incorrect.[6]

- The 2011 Rate Case. That rate case does not establish a rate base that could not be

[4] *See,* Commission Order No. 2005-436(A), Docket No. 2005-34-WS.

[5] *See,* Attachment A to Explanatory Brief and Joint Motion to Aprove Settlement Agreement and Request for Expedited Review, filed in Docket No 2007-414-WS

[6] *See,* Order No. 2008-448.

challenged, subsequently. As I explained in my Direct testimony, DIUC, ORS, and the POA's entered into a settlement of that rate case that included the following provisions:

> 2. In the current proceeding, the Parties disputed the adjustment in rates, fees, and charges that would be necessary to provide DIUC a fair return on its investment as well as the rate of return and other matters.
>
> 3. The Parties agree and stipulate that DIUC shall be allowed to set rates and charges on a rate base of $5,000,000. ***This stipulated rate base shall not be binding in future proceedings, instead those proceedings will be determined based on the evidence presented in each docket and the applicable law.***
>
> . . .
>
> 13. The Parties agree that this Settlement Agreement does not constrain, inhibit or impair in any way the arguments or positions they may choose to assert in future proceedings.[7]

Mr. Guastella's first three "conclusive facts" are directly refuted by the very Commission Orders upon which those "facts" are based, as well as by the three settlement agreements into which DIUC entered.

Q: PLEASE ADDRESS THE FOURTH "CONCLUSIVE FACT" MR. GAUSTELLA CITES REGARDING THE COMMISSION-APPROVED 2012 FINANCING WITH SUNTRUST BANK.

A: Mr. Gaustella's assertion that the Commission-approved 2012 financing with Sun Trust Bank somehow establishes DIUC's rate base, is patently absurd.[8] DIUC's applications for these approvals[9] do not mention DIUC's rate base or include any matter relating to rate base Likewise, the Commission's orders approving these

[7] *See*, Order No 2012-515, Attachment 1, pp. 2, 4
[8] *See*, Commission Docket No. 2012-397-WS.
[9] *See*, Id

applications mention nothing about DIUC's rate base or its financial or rate making data in general.[10] This is consistent with my knowledge of other utility commission financing orders, which are never intended to have any affect on the determination of rates.

Q: MR. GAUSTELLA'S FIFTH "CONCLUSIVE FACT" STATES THAT THE ORS TESTIMONY DOES NOT AGREE WITH YOURS. PLEASE COMMENT.

A: Mr. Gaustella's "fact" suggests that either Intervenors are limited to addressing only issues that have been raised by ORS, or that only ORS and Company recommendations are worthy of consideration. Mr. Gaustella is incorrect. The fact that ORS did not raise imputation of CIAC as an issue does not preclude Intervenors from doing so. This Commission can accept recommendations from parties other than the Company or the ORS. Regardless, the ORS witnesses had not seen my latest analysis prior to filing their Direct Testimony; thus, it is speculative for Mr. Gaustella to conclude that ORS disagrees with my analysis and recommendations.

Q: FINALLY, WHAT DOES MR. GAUSTELLA'S SIXTH "CONCLUSIVE FACT" STATE?

A: Mr. Gaustella's sixth "fact" states:

There is no evidence that the lot purchasers paid for anything other than the value of the real estate, and other than minor tap in fees no connection fees to fund utility plant assets.

Mr. Guastella attempts to sidestep what I demonstrated in my Direct Testimony (and

[10] *See*, Order Nos. 2012-930 and 2013-605.

which he did not refute): the developer donated the utility plant to the Utility. From a ratemaking perspective, the point is not whether the lot owners paid for the system in their lot purchases, but that the Utility *did not* pay for the system. Accordingly, the rates established in 1986 and in effect until 2005 did not include any recovery of system investment or any return on system investment. DIUC has failed to demonstrate that the plant in question was not contributed. I have clearly shown that a large portion of DIUC's plant is CIAC. Here are the *real* conclusive facts:

1. Haig Point Utility Company only sought to recover operating costs in its initial rate case filing with this Commission, and recovered only operating costs in its rates from 1987 until its 2004 rate case. (Exhibit CEL-R4).

2. International Paper wrote off all the utility plant in 1997 (Exhibit One to Surrebuttal Testimony of Charles Loy in initial rate case) and subsequent Annual Reports to the Commission show $-0- utility plant balances through 2003.

3. The Utility's balance sheet as of June 30, 2004 shows over $4 million of plant suddenly appearing. The plant values were derived from an engineering study that used bids, county plats and other documentation. The supporting accounting entries debit plant and erroneously credit "paid in capital" when CIAC should have been credited. (Exhibit CEL-R1)

of $1.75 million

4. The purchase price paid to International Paper suggests only the reimbursement of the newly constructed elevated water tank and well number 3, and not any payment for system plant. Furthermore, the purchase price is in an amount far lower than the total claimed plant values transferred to CK Materials. (Exhibit CEL-R6).

Q: ARE THERE OTHER OBSERVATIONS THAT YOU HAVE WITH MR. GAUSTELLA'S REBUTTAL TESTIMONY?

A: Yes, he did not address the under-depreciated plant or DIUC's failure to comply with NARUC and GAAP in its recording of Accumulated Depreciation.

Q: WHAT WOULD BE THE EFFECT IF THE COMMISSION DOES NOT REMOVE DONATED PLANT FROM RATE BASE OR REDUCE RATE BASE TO REFLECT ACTUAL PLANT UTILIZATION, BUT DOES ADJUST TEST YEAR DATA TO ACCURATELY REFLECT ACCUMULATED DEPRECIATION?

A: The Commission should then adjust DIUC's asserted test year data to include the accumulated depreciation necessary to comply with NARUC and GAAP. Table 1 below reflects those adjustments. Mr. Lanier presents the computation of the resulting revenue requirement in his Surrebuttal Testimony.

TABLE 1

INCREASE RATE BASE AND DEPRECIATION EXPENSE TO REFLECT NARUC/GAAP STRAIGHT LINE

	Water	Sewer
Accumulated Depreciation	($848,164)	($1,430,015)
Depreciation Expense	$39,880	$51,148
CIAC Increase	($5,757)	($3,029)

Q: DOES THIS CONCLUDE YOUR SURREBUTTAL?

A: Yes.

BY MR. PRINGLE:

Q Well, let's move, then, to Mr. Lanier. Would you state your full name and business address?

A [LANIER] Yes. My name is Lynn Lanier. My business address is –

CHAIRMAN WHITFIELD: Mr. Lanier, could you cut that mic on?

WITNESS LANIER: Sorry [indicating].

CHAIRMAN WHITFIELD: There we go.

WITNESS LANIER: My name is Lynn Lanier. My business address is 1850 Parkway Place, Marietta, Georgia.

BY MR. PRINGLE:

Q By whom are you employed and in what capacity?

A [LANIER] I'm employed by GDS Associates. I'm now an executive consultant, and I'm a semi-retired former principal in the firm.

Q Okay. Tell the Commission a little bit about your educational and professional background.

A [LANIER] Certainly. I hold a degree in Industrial Management from the Georgia Institute of Technology. I have been a rate expert/analyst for approaching 40 years.

Q Okay. Have you ever testified before a public utility commission?

A [LANIER] Yes, numerous times.
Q All right. How many times, if you can estimate?
A [LANIER] Probably 10, 15, 20 times, something like that.
Q Okay. Typically – have you obtained any other designations or educational degrees of any type?
A [LANIER] I haven't.
Q Okay. What do you typically do in your work, or have you done in your career, at GDS?
A [LANIER] Well, with respect to rate-related work - and I do other things, but with respect to rate-related work - most of my responsibility is in the development of the revenue requirements based on the information obtained by me or provided by the company, or in situations like this, obtained based on a company's filing and other information that we might obtain through discovery. My role would then be to determine whatever the revenue requirements need to be, design the rates associated with that, propose that – depending on who I'm working for – to the client or take a position similar to what I have done in this case.
Q Okay. Did you testify in the previous part of this case?
A [LANIER] I did.
Q Okay. A little bit more particularly, when you have been called upon to work, say, for an intervenor or

someone other than an applicant in a rate case, what kind of documents have you reviewed in the course of your responsibilities, or in performing your responsibilities?

A [LANIER] Well, obviously, the first thing we look at is the Application that has been filed by the company, and whatever information they provided. We then try to determine any additional information that we think may be needed to support either the company's position or the position that we believe is justified, based on what our findings are with respect to the Application.

Q Okay. Do you review balance sheets?

A [LANIER] Absolutely.

Q Do you review income statements?

A [LANIER] Yes.

Q Do you review statements of cash flows?

A [LANIER] Yes.

Q Do you review various other statements of - do you review depreciation schedules?

A [LANIER] Yes.

Q Okay. Do you typically review the series and sets of documents that this Commission typically sees in a water and sewer rate case?

A [LANIER] Yes, we do.

Q Okay. And, indeed, did you also offer testimony in the

2011 DIUC rate case?

A [LANIER] I did.

Q Okay. So you've been before this Commission in two dockets previous to the testimony you're offering today?

A [LANIER] I also testified in a Kiawah Island docket several years ago.

Q Okay. What did you do in that case?

A [LANIER] My role was similar to what it is in this case, which was to examine the applicant's Application and file testimony on behalf of property owners.

Q Okay. And do you recall whether you've ever been officially designated as an expert before any particular commission?

A [LANIER] Well, I haven't ever been designated as not one.

[Laughter]

Q Okay.

A [LANIER] And I have testified in many, and my testimony has always been accepted and has never been denied.

Q Okay. And your attempt to testify has never been excluded by a regulatory commission?

A [LANIER] No.

MR. PRINGLE: To the extent, you know, following the trajectory of things, I'd like to offer Mr. Lanier – to the extent necessary – to

give his opinions in the designation as a, if the term is, "expert" in the review of rate-case filings and for the purposes of offering opinions on the various revenue requirements and other factors that go into the determination of just and reasonable rates under Title 58. If there's a word for that, I'll take anybody's suggestion about what that expert is called, but that's, I think, the idea.

Okay. And I sort of paused, in case, at this point – I guess maybe this will come when I start to offer the testimony.

CHAIRMAN WHITFIELD: Well, I – okay, go ahead.

MR. PRINGLE: Yeah.

BY MR. PRINGLE:

Q Mr. Lanier, did you cause to be prefiled direct testimony in this case, consisting of 25 pages in question-and-answer format?

A [LANIER] Yes, I did.

Q Do you have any additions, deletions, or changes to make to the body of the testimony, at this time?

A [LANIER] No, I do not.

Q Okay. Pull that microphone so you can get in front of it.

A [LANIER] [Indicating.]

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

A [LANIER] Yes, they would.

MR. PRINGLE: Okay. At this time, I'd like to ask that Mr. Lanier's prefiled direct testimony be read into the record as if given orally from the stand.

CHAIRMAN WHITFIELD: Mr. Walker?

MR. WALKER: Mr. Chairman, thank you. The Applicant objects for the same grounds as we objected to Mr. Loy. This witness's testimony is primarily based on the impermissible conclusions, speculations, and hearsay of Mr. Loy, so we renew our objection, and it's hearsay within hearsay within hearsay – a wheel within a wheel – and we think it's inadmissible, and under the Public Service Commission Rules, the Rules of Evidence apply. Thank you.

MR. PRINGLE: If I could, just quickly – and I do realize that there's sort of been a previous ruling here, but I do want to make clear very, very quickly that – addressing the hearsay within hearsay, which I like the metaphor – I mean, it doesn't apply here. But the documents that are

being involved and reviewed are ones that this Commission is very used to seeing in terms not only of their authenticity (a) because they've been provided in previous dockets before this Commission and been considered by this Commission in connection with that, and then, you know, therefore have become parts of records in cases pursuant both to Commission Rule and to the processes in those; or they are largely self-authenticating documents, such as these, that we're not actually, you know, requesting some question about whether they are what they say they are; and then, further, just to the 10-K, and I only wish that Mr. Maybank were here, because we had an argument in a previous docket about 10-Ks, but I think those type of things and their authentication speaks for itself, and they are often used in Commission proceedings for these particular purposes. But I won't belabor the point.

CHAIRMAN WHITFIELD: And thank you for the last.

I'm going to give you one more bite at the apple, Mr. Walker, and we're going to decide right now.

MR. WALKER: Well, the only other thing I

would say, just to not take any more of your time, is that we'd make the same objection on the exhibits he's getting ready to offer, just so you don't have to look to me a second time. But I have nothing more to add and won't burden you with more argument. Thank you.

CHAIRMAN WHITFIELD: We're going to overrule your objection, Mr. Walker, and we find Mr. Lanier certainly, by our standards with what we're accustomed to, to give his opinion in this case and his testimony. So, with that said, Mr. Lanier's testimony will be entered into the record as if given orally from the stand.

[See pgs 359-383 ~ Rehrg. direct]

MR. PRINGLE: Thank you, Mr. Chairman.

BY MR. PRINGLE:

Q Mr. Lanier, do you also have - you'll have to keep me straight on this - seven exhibits attached to your testimony? Is it seven?

A [LANIER] I do.

Q Okay. Did you prepare those exhibits?

A [LANIER] I did.

Q Okay. Do you have any revisions to make to those exhibits?

A [LANIER] No, I do not.

Q Okay. Is that on the surrebuttal that we have a change to make to an exhibit?

A [Nodding head.]

MR. PRINGLE: Okay. All right. With that I'd like to ask that Mr. Lanier's exhibits to his direct testimony, which I believe consist of LML-R1 through LML-R7, be made the next hearing exhibit.

CHAIRMAN WHITFIELD: Before I do that, Mr. Butler does have a question for you, Mr. Pringle.

MR. PRINGLE: Okay. Sure.

MR. BUTLER: Yes, thank you, Mr. Chairman.

Mr. Pringle, we noticed that, in terms of the exhibits for Mr. Lanier, there doesn't seem to be an -R1 or -R2. They seem to be reserved for future use. We do have Exhibits -R3 through -R7.

BY MR. PRINGLE:

Q Were there any additional exhibits, Mr. Lanier?

A [LANIER] No.

MR. PRINGLE: Okay.

MR. BUTLER: So the intent is to put into the evidence the exhibits as submitted, which I believe are -R3 through -R7.

MR. PRINGLE: Oh, okay, you're right, because I mischaracterized by saying -R1. Yes, you're absolutely right: -R3 through -R7.

MR. BUTLER: Thank you, sir.

MR. PRINGLE: Okay.

CHAIRMAN WHITFIELD: All right. And – well, he hasn't objected yet.

MR. WALKER: I tried to make it ongoing.

CHAIRMAN WHITFIELD: Ongoing.

MR. PRINGLE: Continuing.

CHAIRMAN WHITFIELD: Okay, I'm sorry.

MR. WALKER: And just so I don't have to stand up again, I'd also object to the surrebuttal and any exhibits with that. I just – if I could have a running objection?

CHAIRMAN WHITFIELD: Running objection, you got it. Yes, sir.

MR. WALKER: Thank you.

CHAIRMAN WHITFIELD: We noted your objection to Mr. Lanier's surrebuttal. Mr. Lanier's Exhibits LML-R3 through -R7 will be entered into the record as Hearing Exhibit No. 6.

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

MR. PRINGLE: All right.

BY MR. PRINGLE:

Q And, Mr. Lanier, did you prepare surrebuttal testimony in connection with this case?

CHAIRMAN WHITFIELD: And I'll also note that Mr. Walker's objection to those exhibits has also been overruled.

MR. PRINGLE: Thank you, Mr. Chairman.

BY MR. PRINGLE:

Q Did you also cause to be prefiled surrebuttal testimony consisting of eight pages in question-and-answer format?

A [LANIER] I did.

Q Do you have any additions, deletions, or changes to make to the body of that testimony?

A [LANIER] I have one addition to make.

Q Okay.

A [LANIER] On my Exhibit LML-8, on Schedule C-4, on the far right-hand side there was a box, and it did not print when the exhibit was printed. And in that box, there should be the number "61.2 percent" as the change in the revenue requirement. If you look at Schedules W-4 and S-4, you'll see the box beside the number, and that box should have appeared on this exhibit but it did not.

MR. PRINGLE: Ms. Wheat, if you could turn the overhead on, I'll show the Commissioners exactly what we're talking about.

BY MR. PRINGLE:

Q And, Mr. Lanier, if I put this box here [indicating] and

then what would I put in that box?

A [LANIER] Sixty-one point two [61.2] percent.

Q Absent the bad handwriting, does that represent what the exhibit – how it should read?

A [LANIER] It does.

MR. PRINGLE: Okay. I'd like to ask that Mr. Lanier's surrebuttal testimony, the body of the testimony, be read into the record as if given orally from the stand. And, further, I'd like to ask that Mr. Lanier's exhibit, as revised, become the next hearing exhibit, and that would be LML-R8.

CHAIRMAN WHITFIELD: Mr. Lanier's surrebuttal testimony will be entered into the record.

[See pgs 385-392 ~ Rehrg. surrebuttal]

And his Exhibit LML-8, as revised, will be entered in as Hearing Exhibit No. 7. And we are noting Mr. Walker's objection, and Mr. Walker's objection has also been overruled, on both.

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

MR. PRINGLE: Thank you, Mr. Chairman.

BY MR. PRINGLE:

Q Mr. Lanier, have you prepared a summary of your direct and surrebuttal testimony?

A [LANIER] I have.

Q Please present it, if you would.

A [LANIER] Certainly.

Commissioners, in my direct testimony, I stated that the purpose of my testimony was to incorporate the plant, accumulated depreciation, CIAC, and utilization adjustments and expense adjustments from Mr. Loy's testimony. I also recommend revenue requirements based on Mr. Loy's recommended changes to rate base and expenses.

I pointed out that DIUC's representations about financial distress were overstated, and I demonstrated that the DIUC proposed rates are unreasonably high compared to other water and sewer providers in the area.

As to the content of my testimony, first of all, I presented revenue requirements based on Mr. Loy's recommendations to reduce plant and rate base by changing the paid-in-capital to CIAC and that that would result in an overall revenue-requirements increase of about 20 percent. I then presented an alternate revenue requirements based on Mr. Loy's recommendations to reduce rate base by reducing the plant investment for the utilization for the unutilized investment and that that would result in an overall revenue requirement of about 25 percent.

In my revenue requirements, I utilized the revenue

and expense adjustments that had been recommended by ORS in the first phase, except for power costs and I had used my own number for that. The company did not challenge ORS' adjustments, except for outside management fees and bad-debt expense, so I used those numbers in my revenue requirements.

I addressed bad-debt expense and showed that ORS sought and received information from DIUC in the first case that indicated clearly that the test-year, bad-debt expense was not indicative of future bad-debt expense, and so I accepted the company's bad-debt expense adjustment that they had made in their Application, which was a reduction of about $90,000. I believe my adjustment is consistent with the Supreme Court's Opinion on that particular issue.

As you know, property tax was also a major issue that was addressed by the Supreme Court. I have proposed the property tax allowances be reduced, consistent with proposed reductions in rate base, but I also acknowledge that DIUC is obligated to pay some back property taxes for prior years and that some of that likely cannot be changed at this point. So I have recommended that the difference between what would be recovered in the rates approved by the Commission, in this case, and what DIUC is obligated to pay, based on

the back taxes, be established as a regulatory asset and that the company request an amortization of such difference to revenue with a surcharge to rates as approved by the Commission. That would be the means of allowing the company to recover the property taxes that it's obligated to pay.

In my revenue requirements, I have utilized the capital structure and rate of return proposed by ORS and adopted by the Commission in its Order from the first hearing. I have attempted to demonstrate that the picture of financial distress presented by Mr. Guastella is not accurate and is overstated. And, specifically, I show that there is more cash flow and that the debt service coverage from the loan agreement was not correct, and that the debt service coverage is, in fact, met.

I have also presented a comparison of DIUC's proposed water and sewer rates to the rates of area water and sewer providers that shows that DIUC's proposed rates would be extremely high compared to other area providers. In my surrebuttal testimony, with respect to that, Mr. Guastella challenged three aspects of my testimony. He challenged the debt service coverage ratio in the SunTrust loan agreement in regard to the financial distress of DIUC. He also challenged

my rate comparisons from my direct testimony, and he challenged my management fee adjustments.

In regard to the debt service coverage ratio, I showed that the required ratio from the SunTrust loan agreement clearly says that the minimum is 1.2 to 1.0, such that the minimum is 1.0, not 1.2 as claimed by Mr. Guastella. Since Mr. Guastella challenged my use of some local publicly owned water and sewer companies in the comparison of rates, I provided a comparison of the DIUC proposed rates with the current rates of two local investor-owned water and sewer utilities that are regulated by this Commission, which are Kiawah Island Utility Company and Harbor Island Utility Company. Both of these companies were referenced by ORS for comparison purposes in their witnesses' testimony, and showed that even when comparing to these companies, the DIUC proposed rates are much higher.

I also address the reasonableness of the disallowance by ORS of the much higher rate-case expenses now claimed by Mr. Guastella.

And, finally, based on the surrebuttal testimony of Mr. Loy where he presents an alternate adjustment to rate base, based on the critique of his testimony by Mr. Guastella, I presented an alternate revenue-requirements analysis that shows an overall revenue-requirements

increase of 61.2 percent that I referred to earlier. This is not my recommendation, but it is provided as an alternative.

Q Does that complete your summary?

A [LANIER] It does.

MR. PRINGLE: All right.

[PURSUANT TO PREVIOUS INSTRUCTION, THE PREFILED REHEARING DIRECT TESTIMONY OF LYNN M. LANIER FOLLOWS AT PGS 359-383

DAUFUSKIE ISLAND UTILITY COMPANY, INC.

DOCKET NO. 2014-346-WS

PRE-FILED TESTIMONY OF LYNN M. LANIER

BEFORE THE SOUTH CAROLINA PUBLIC SERVICE COMMISSION

[Prepared for De Novo Hearing]

Testimony Prepared: November 16, 2017

Hearing Date: December 5, 2017

Q: PLEASE STATE YOUR NAME, EMPLOYER AND BUSINESS ADDRESS.

A. My name is Lynn M. Lanier and I am employed by GDS Associates, Inc. ("GDS"), a utility consulting and engineering firm with its principal offices in Marietta, GA. Until 12/31/16 I was a Principal in the Firm, but am now semi-retired and am an Executive Consultant. My business address is 1850 Parkway Place, Suite 800, Marietta, GA 30067.

Q. ARE YOU THE SAME LYNN M. LANIER, WHO TESTIFIED IN THE HEARING BEFORE THE PSC ON THIS MATTER ON OCTOBER 28, 2015?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS MATTER?

A. The purpose of my testimony is to:

- Incorporate the rate base adjustments and expense adjustments proposed by my colleague Mr. Charles Loy into our view of Daufuskie Island Utility Company, Inc.'s (DIUC's or "the Company's) revenue requirements;

- Recommend alternative revenue requirements and overall revenue impacts, including appropriate operating expense levels,
- Demonstrate that the representations made by the Company as to its financial distress are inaccurate and overstated, and finally,
- Demonstrate that by comparison to other water and sewer utility service providers in the area, the Company's proposed rates are unreasonably high.

Q. WHAT IS THE OVERALL EFFECT OF YOUR PROPOSED ADJUSTMENTS ON THE COMPANY'S REVENUE REQUIREMENT AND INCREASE OVER PRESENT REVENUES?

A. As I will outline in detail, in the balance of this testimony, I have determined that, based on Mr. Loy's recommendation for applying "paid-in capital" to "CIAC", the increase in the Company's overall revenue requirement for the combined water and sewer systems is $219,993, which would represent an increase over present adjusted revenues of 20.5%. For the Water System, the increase in revenue requirements would be $169,694 or a 31.3% increase, and for the Sewer System, the revenue requirement increase would be $50,298 or an increase of 9.5%. Under Mr. Loy's alternative recommendation of applying utilization factors to the Company's plant balances to remove the unutilized plant, the overall increase in revenue requirements for the combined water and sewer systems would be $269,499, representing an increase over present revenues of 25.1%. For the Water System, the increase in revenue requirement would be $160,779, representing an increase of 29.6%, and for the Sewer System, the increase in revenue requirement would be $108,719, representing an increase of 20.5%.

Q. ARE YOU AWARE OF THE S.C. SUPREME COURT'S DECISION ADDRESSING THE COMPANY'S APPEAL OF THE COMMISSION'S RULING IN THIS MATTER?

A. Yes, I am.

Q. HAVE YOU REVIEWED THE DIRECT TESTIMONY OF MR. GUASTELLA AND MR. WHITE, FILED OCTOBER 18TH FOR THE REHEARING OF THIS MATTER BEFORE THE COMMISSION?

A. Yes, I have.

Q. AND DO YOU AGREE WITH THE TESTIMONY OF MR. GUASTELLA AND MR. WHITE?

A. No, I do not.

Q: WHAT ARE YOUR DISAGREEMENTS?

A: As outlined in his rehearing testimony, my colleague, Mr. Loy, has recommended adjustments to the Company's proposed Rate Base. I have incorporated those changes into my proposed revenue requirements calculation, along with my proposed adjustments to power cost, bad debt expense, and property taxes, along with adjustments to revenues and expenses made by ORS and reflected in Ivana Gearheart's testimony and the Settlement Agreement, from the first hearing, and determined that the overall revenue requirement for the combined water and wastewater systems of the Company is $1,293,571, representing an overall increase in existing revenues of 20.5%. This increase is significantly less than the 108.9% increase sought in the Company's original application and the 125.7% increase that Mr. Guastella asserts, in his rehearing direct testimony, could now be justified.

Q. WHAT CHANGES ARE YOU PROPOSING TO THE COMPANY'S RATE BASE?

A. In his testimony, Mr. Loy proposed three adjustments to the Company's Rate Base: 1) recording donated Property Plant and Equipment as a Contribution in Aid of Construction (CIAC) instead of "Paid-in Capital"; 2) recording accumulated depreciation expense appropriately for the Net Plant of the Company; and (alternatively) 3) reducing the Company's Plant to reflect that percentage of Plant that is actually "used and useful" by the Company.

Q. DESCRIBE THE PROCESS BY WHICH THE COMPANY ADDED CERTAIN PROPERTY, PLANT AND EQUIPMENT TO ITS BALANCE SHEET.

A. In Haig Point Utility Company's (the predecessor in name to DIUC) 2005 rate case, the Company proposed adjustments to add $4,339,598 to Property, Plant, and Equipment to the balance sheet, which was described in the accompanying note as

> "To tie to Thomas & Hutton property schedule ($1,711,549 water and $2,628,049 sewer)." [See Exhibit CEL-R1 to Mr. Loy's Direct Testimony]

As Mr. Loy noted in his testimony, this is the first time that Property, Plant, and Equipment had appeared on the Company's balance sheet. The Company then proposed an offsetting adjustment on the Liabilities and Equities side of the balance sheet of "Paid in Capital" in the amount of $4,635,782 [Also, see Exhibit CEL-R1 to Mr. Loy's Direct Testimony], which, according to the notes on the Company's exhibit, states

> "To record plant and equipment and other adjustments to paid in capital."

Q. WHY WAS BOOKING THE ADJUSTMENT TO "PAID-IN CAPITAL" AN ERROR?

A. As stated by Mr. Loy in his testimony, the adjustment to "Paid in Capital" was erroneous and, instead, the offsetting adjustment should have been booked as "Contributions in Aid of Construction (CIAC)", because the plant was donated to HPUC by Haig Point, Inc.. The effect of booking the offsetting adjustment to CIAC is a credit to the liability side of the Company's balance sheet to reflect the appropriate offset to the donated Property Plant and Equipment entry made on the asset side of the balance sheet. If this had been properly booked, as of June 30, 2004, the CIAC would have completely off-set the donated plant in Rate Base. This erroneous transaction has been continued on the Company's books all the way up to the present, although the rate base calculations were challenged by ORS in the 2005 rate case, by ORS and intervenors in the 2012 rate case, and in this current rate case.

Q. WHAT IS THE EFFECT ON RATE BASE ASSOCIATED WITH MR. LOY'S PROPOSED CHANGES?

A. As shown on Schedule C-2 of my **Exhibit LML-R3**, the Rate Base would be reduced from $6,934,861 for the combined systems to $2,304,944. For the Water System, the Rate Base would be reduced from $3,144,900 to $1,379,638, and for the Sewer System, the Rate Base would be reduced from $3,789,961 to $925,306.

Q: HAS MR. LOY PROPOSED ANY ADJUSTMENTS TO DIUC'S DEPRECIATION EXPENSE AND ACCUMULATED DEPRECIATION?

A. Yes. Mr. Loy has also demonstrated that the Company incorrectly calculated depreciation expense and accumulated depreciation on its Property Plant and Equipment and that the Company has greatly under-depreciated its plant investment. His proposed changes would increase the accumulated depreciation, thus reducing the Company's Net Plant

value, as used in the Rate Base Calculation. This is shown on my Schedules C-1, C-2, W-1, W-2, and S-1 and S-2.

Q: HAS MR. LOY PROPOSED ANY ADJUSTMENTS RELATED TO WHETHER DIUC's PLANT INVESTMENT IS "USED AND USEFUL"?

Yes. Mr. Loy has demonstrated in his testimony, as an alternative to the accounting adjustment to reclassify paid-in capital to CIAC, that a substantial portion of the Company's Plant Investment is not used and useful, and therefore, an adjustment should be made to remove from Rate Base the portion of the Company's investment that is not used and useful.

Q. WHAT ARE YOU PROPOSING AS TO THE COMPANY'S EXPENSES TO BE INCLUDED IN THE REVENUE REQUIREMENT?

A. In its Application, the Company asserted that its combined water and sewer Operating Expenses for the year ended 12/31/14 were $1,037,747, and proposed adjustments of $334,186, resulting in Total Operating Expenses (Pro Forma) of $1,365,076. Notable in this large adjustment of 32.2% to Operating Expenses, were an increase in electric power cost of $51,281, a "decrease" in bad debt expense of $90,905, an increase of $113,655 for amortization expense, and an increase of $188,092 for property taxes. In my direct testimony for the first hearing in this matter, I was critical of the overall increase in the Company's operating expenses and of the Company's Management Agreement with Guastella & Associates (GA), and I specifically recommended a decrease in the Company's Electric Power Cost adjustment of $34,841, based the information provided by the Company.

In her testimony, ORS witness Ivana Gearheart, proposed adjustments to the Company's expenses of $64,311 for the combined system and $19,375 for the Water System and $44,936 for the Sewer system. In the Settlement Agreement between ORS and Intervenors, ORS changed its adjustment for bad debt expense, to accept the Company's adjustment in its filing of a decrease of $90,905. As reflected on Settlement Exhibit ICG-3, this resulted in a decrease in operating expenses for the combined system of $26,883, and $26,314 for the Water System and $569 for the Sewer System.

In the Company's direct testimony for the rehearing, the Company accepted all of the ORS adjustments to expenses, except for the outside management services and bad debt expense from the Settlement Agreement, and depreciation, Amortization, and Property Tax Expense, which is related to back property taxes, and the current Property tax amount.

In my proposed revenue requirements, as shown on Schedules C-4, W-4, and S-4 of my **Exhibit LML-R3**, I have incorporated the expense adjustments proposed by ORS and accepted by the Company. However, in addition, I have also used the bad debt expense adjustment included by the Company in its Application, and also made adjustments to the Depreciation Expense, Amortization Expense (including the amount associated with back property taxes) and the Property Tax amount, to reflect the taxes that should be expected, based on the adjusted Rate Base.

Q. WHAT IS THE BASIS FOR YOUR ADJUSTMENT TO BAD DEBT EXPENSE, WHEREIN YOU ACCEPTED THE BAD DEBT EXPENSE AS FILED BY THE COMPANY IN ITS APPLICATION?

A. In the Company's application from Schedule A-4, I calculated the Bad Debt Expense to be an extremely high 10.1% of revenue, excluding "Misc. Other Revenues". Such a rate of bad debt expense is unheard of and simply cannot be justified. This amount is also far in excess of what the Company proposed in its 2012 rate case of $25,423, which ORS then adjusted down to $9,332 (ORS Witness C. Stutz, Audit Exhibit CAS-1, Page 1 of 2). In its Application, the Company, properly in my opinion, reduced the bad debt expense by $90,905 to a much more reasonable amount of $14,762, which results in a bad debt expense rate of 1.4% of adjusted test year revenues (excluding misc. other revenues), a much more reasonable level. Surprisingly, ORS witness Gearheart adjusted the bad debt expense back to the Company's actual test year expense of $105,667, making only a minor adjustment of $284,

> "Adjustment 4(j) – ORS proposes to adjust bad debt expense at a rate of 0.5% applied to pro forma revenues. ORS computed total bad debt expense of ($105,384), less the per book amount of ($105,668), for a total adjustment of ($284)."

Furthermore, in her Audit Exhibit ICG-4 (p. 3 of 9), item 11 (4(j), she described the bad debt adjustment as

> "To adjust bad debt expense to reflect test period revenue write-off percentages applied to ORS pro forma revenues under present rates."

Q: DID ORS WITNESS GEARHEART CALCULATE BAD DEBT EXPENSE AT A RATE OF 0.5% APPLIED TO PRO FORMA REVENUES?

A. She did not. Even though a rate of 0.5% applied to revenues would be an appropriate rate for bad debt expense, Ms. Gearheart instead applied a rate of 9.816% [DIUC's per book bad debt expense ($105,668) as a percentage of its annual revenue ($1,076,463)] multiplied by the ORS pro forma adjusted revenues of $1,073,577, to arrive at a figure of $105,384.

Q. WHAT WAS THE BASIS OF THE COMPANY'S ADJUSTMENT OF A DECREASE OF $90,905 TO BAD DEBT EXPENSE?

A. My recollection is that at some point, Mr. Guastella was asked this question and he responded something to the effect that the Company had adjusted the Bad Debt expense down in an effort to achieve a more balanced level of expenses, for the purpose of the Application. However, the Company's intent was clear in providing its response to ORS Water/Wastewater Department July 23, 2015 Requests, item 6.2, where the Company stated,

> "The test-year bad debts reflect the write-off of accounts that were well past due, in most cases in excess of one year, or delinquent amounts adjusted out of receivables for charges judged to be uncollectible (ex., unpaid late charges on otherwise satisfied accounts). This was done in an attempt to "clean-up" the receivables account and improve the management of customer billing records. **The pro forma bad debt expense in the rate application does not reflect the test-year levels, but instead reflects a reasonable forecasted level of expense. (bold for emphasis added)** In the future, the customer receivables, delinquent based on a receivables aging, will be recorded in the reserve "Provision

> for Uncollectible" account and written-off as a bad debt. Any subsequent payment received on an amount written-off will reduce both the uncollectible reserve and bad debt expense."

I think it's pretty clear that the test year booked amount was not a realistic amount for the purpose of establishing revenue requirements and I think the Company recognized that and made an adjustment to reflect a reasonable level of bad debt expense for future years. In researching this matter further, I went back to the 2012 Rate Case and the testimony or ORS witness Christina Stutz, dated May 3, 2012. On page 7, lines 13-18 of her testimony, she states,

> "Adjustment 18 – ORS proposes to adjust bad debt expense at a rate of 0.5% applied to pro forma metered revenues of $414,335 and a rate of 2.50% applied to pro forma availability billing revenues of $290,416. The Applicant's factors were considered reasonable by the ORS Water and Wastewater Department. ORS computed total bad debt expense of $9,332, less the per book amount of $25,423, for a total adjustment of ($16,091)."

Two important observations can be made from Ms. Stutz's testimony from the 2012 rate case. 1) ORS determined that the total combined system bad debt expense should have been only $9,332 on pro forma revenues of $714,996, representing a composite rate of 1.31%. 2) ORS believed in 2012 that appropriate rates for bad debt expense should be 0.5% for rate revenues and 2.5% for availability billings.

As shown in Table 1, below, I then applied the 0.5% and 2.5% rates to the Company's Pro Forma Present Rate revenues from its application and calculated exactly the amounts that the Company used in the Application, $6,676 for the Water System and $8,086 for the Sewer System.

Table 1

DIUC Bad Debt Expense Calculation and Adjustment Per Application			
	Combined	**Water**	**Sewer**
Rate Revenue	$580,779	$324,389	$256,390
Bad Debt Rate		0.500%	0.500%
Bad Debt Expense	$2,904	$1,622	$1,282
Availability Revenue	$474,327	$202,156	$272,171
Bad Debt Rate		2.500%	2.500%
Bad Debt Expense	$11,858	$5,054	$6,804
Total	$14,762	$6,676	$8,086
DIUC Per Books	$105,668	$52,834	$52,834
Difference (DIUC Adjustment)	($90,906)	($46,158)	($44,748)

This, combined with the ORS adjusted bad debt expense of $9,332 on pro forma adjusted revenues of $714,996, leads to the obvious conclusion that ORS believed that the appropriate level of bad debt expense was on the order of a 1.3% composite rate, and secondly, and more importantly, reveals that the Company very intentionally calculated an adjusted bad debt rate in its Application, based EXACTLY on the rates used by Ms. Stutz in the 2012 rate case. I can only conclude that the Company believed that in its Application, ORS would absolutely not accept a bad debt expense of $105,667 or almost 10% of revenues, a rate almost 8 times the 1.3% rate from the 2012 rate case. Thus, in my direct testimony for the first hearing in this case, I accepted the Company's bad debt

expense of -$90,905, resulting in a very reasonable rate of 1.36% of adjusted present revenue. My Exhibit **LML-R3**, attached hereto, also reflects that adjustment.

Q. ARE YOU AWARE OF WHAT THE SUPREME COURT SAID IN ITS DECISION ON THE APPEAL OF DIUC, IN THIS MATTER, WITH RESPECT TO BAD DEBT EXPENSE?

A. Yes, I am. In its opinion, the Court stated that

> "the Commission's decision to allow a bad debt expense of $30,852 is unsupported by the evidence in the record." (underling added for emphasis).

Notably, the Court did not provide any specific direction to the Commission in remanding the matter back to the Commission for further consideration, but basically said that whatever the Commission decides on bad expense, should be based on the evidence in the record.

Q. SO, WHAT IS YOUR CONCLUSION IN REGARD TO THE APPROPRIATE LEVEL OF BAD DEBT EXPENSE.

A. While I am reluctant to be critical of ORS, on this particular item I believe that ORS failed to fully analyze the Company's actual test year bad debt expense and failed to consider the prudency of the amount of $105,667, an amount representing almost 10% of revenues. In both the 2012 rate case and in this one, ORS first said that the bad debt expense should be 0.5% of revenue and then, in this case, computed an amount almost 20 times that rate. Furthermore, from the Company's history, going back to the 2012 rate case, ORS had information and knew what the Company's historical bad debt expense rate was and should reasonably be, and it is not almost 10%. Perhaps more importantly, if the Company, in its application, very intentionally adjusted its bad debt expense down

to a level that even it believed to be more reasonable and more acceptable to ORS, why should ORS take it upon itself to adjust the bad debt expense back to the Company's actual booked amount, an amount that is clearly beyond any reasonable level of bad debt expense. So, in my determination of revenue requirements, I am proposing exactly what the Company included in its Application, 0.5% on water and sewer rate revenues and 2.5% on water and sewer availability revenues, reflecting a somewhat greater difficulty in collecting availability billings vs metered water and sewer service, that may be disconnected to coerce payment.

Q. WHAT ARE YOUR RECOMMENDATIONS WITH RESPECT TO THE OTHER OPERATING EXPENSES OF THE COMPANY?

A. With the exception of outside management services and bad debt expense, the Company did not challenge the ORS proposed O&M Expense Adjustments in its direct testimony for the rehearing. Thus, with one exception, I have accepted all of the ORS operating expense adjustments in my determination of overall revenue requirements. The exception is the adjustment for power cost. In my analysis, as shown in my direct testimony for the first hearing in this matter, I determined that the Company's adjustment for power cost should be reduced by $34,841, whereas ORS recommended a decrease of only $14,744. While I understand how ORS arrived at its proposed adjustment, I believe that my analysis is more thorough and that my proposed adjustment of -$34,841 is more accurate and appropriate and, therefore, I have used my adjustment for power cost.

Q. WHAT IS YOUR PROPOSAL FOR DEPRECIATION AND AMORTIZATION EXPENSES?

A. In his testimony, Mr. Loy addressed depreciation and amortization expense, as it relates to the DIUC utility plant and the amortization CIAC. For convenience, I have provided a summary of his depreciation and amortization adjustments, in the table, below. I have utilized the depreciation adjustments provided in my revenue requirements analysis. My Amortization Expense of $93,532, reflected on my Schedule C-4, includes the Amortization of the recalculated back property taxes (discussed below) and the rate case amortization expenses (See Schedule C-5, **Exhibit LML-R3**, item L-4)

Q. WHAT ARE YOU PROPOSING FOR PROPERTY TAX EXPENSES?

A. In the Company's Application and as reflected in the testimony of the Company's witnesses, the Company claims that in August 2012 it was notified by the South Carolina Department of Revenue (DOR) and Beaufort County, that it owed property taxes, based on its personal property assets for the years 2009, 2010, 2011, 2012, 2013, and 2014. The DOR and Beaufort agreed to abate the taxes for 2009 and 2010, leaving a total back tax amount of $526,844. This was based on information that had been obtained by DOR from DIUC's annual report to the PSC. As shown by the assessment reports from DOR, DIUC's personal property assets had been assessed at the rate of 10.5%, resulting in tax valuations upon which Beaufort County had levied taxes. The Company states that it entered into negotiations with Beaufort County in an effort to reduce the amount of tax owed on its personal property assets, which the Company had not been paying prior to 2014. As a result, Beaufort County agreed to forego the tax for 2009 and 2010, and allow the Company to pay the amounts owed for 2011-2014, on an installment basis over eight (8) years. The amount for 2015 was determined to be $192,302, resulting in an adjustment in property tax from $4,209 actual for 2014 of $188,092. Thus, in its

Application and testimony, the Company proposed an adjustment in Amortization Expense of $113,655, to amortize the back taxes owed to Beaufort County over a period of 8 years, to match the agreed upon payment plan with Beaufort County.

As shown on the calculations of the Assessments by DOR, the Assessment is determined, as follows (See DIUC ORS 1.81 Attachment C – DOR Rev. Asses. 2012, 2013, and 2014):

Total South Carolina Net Utility Plant		$_____
Less: Adjustments		
S.C. Licensed Vehicles (Net)	$_____	
S.C. CWIP	$_____	
S.C. CIAC (Net)	**$_____**	
S.C. Intangible Plant	$_____	
South Carolina Taxable Value		$_____
South Carolina Assessment Ratio		10.5%
South Carolina Proposed Assessment		$_____

From this calculation, it is clearly evident that CIAC is netted from the South Carolina Net Utility Plant (Gross Plant less Accumulated Depreciation), in arriving at the assessed value. As Mr. Loy has demonstrated in his testimony, the Company should have booked the $4,635,782 amount booked to Paid in Capital in the 2005 Rate Case, to CIAC. Had it done so, the Taxable Values of the Company's plant would be much lower, which would have resulted in much lower assessments in 2011, 2012, 2013, 2014, and a lower assessment in 2015. In addition, Mr. Loy's corrected Accumulated Depreciation for each year would have reduced the Company's Net Utility Plant Amount in each year,

including the test year, 2014, and future years. Finally, Mr. Loy's alternative adjustment to set aside a portion of the Company's plant investment as "not used and useful" has the effect of further reducing the Company's Net Utility Plant for DOR tax assessment purposes. Thus, based on his proposed adjustments to the Company's booked plant values for CIAC, for greater accumulated depreciation, and removal of plant that is not used and useful, the Company's Property Tax Assessments would have been much lower and the taxes levied by Beaufort County would have been much lower. In his testimony and exhibits, Mr. Loy recalculated the assessments for each year, based on his recommended changes. Information supplied to me by Mr. Loy is summarized in the Table 2, below.

Table 2

	2011	2012	2013	2014
Estimated Property Taxes With CIAC				
Net Plant	$4,703,358	$4,552,231	$4,526,446	$5,165,934
Net CIAC	($3,076,679)	($3,016,352)	($2,957,207)	($2,899,223)
Taxable Base	$1,626,679	$1,535,879	$1,569,239	$2,266,711
Assessment Ratio	10.5%	10.5%	10.5%	10.5%
Milliage Rate	0.197540	0.200850	0.240033	0.248790
Tax Due	$33,740	$32,391	$39,550	$59,213
Total Back Taxes			$164,894	
Total Annual Tax				$59,213

Based on his recommended changes, the Tax Assessment from 2014, which is the basis for the tax in 2015, would decrease from $192,302 to $59,213 and the tax amount from 2011 – 2014 would decrease from a total of $526,844 to $$164,894.

In determining revenue requirements for the Company, based on the 2014 Test Year, adjusted, the Adjusted Property tax for the test year should be $59,213 and the Amortization of the back-property taxes should be $20,612, per year.

Q. SINCE DOR HAS ALREADY RENDERED ASSESSMENTS AND BEAUFORT COUNTY HAS LEVIED TAXES, BASED ON THE ASSESSMENTS FOR THE YEARS 2012 FORWARD, ISN'T THE COMPANY OBLIGATED TO PAY THE TAXES OWED FOR PREVIOUS YEARS, EVEN IF THE COMPANY IS ABLE TO LOWER ITS ASSESSMENT FOR THE CURRENT AND FUTURE YEARS?

A. I have investigated this issue with the DOR and was advised by DOR that South Carolina Code Section Title 12, Section 12-54-85 is applicable to this section. Section F(1) is the operative language, as follows:

> *"(F)(1) Except as provided un subsection (D), claims for credit or refund must be filed within three years from the time the return was filed, or two years from the date the tax was paid, whichever is later. ... "*

Based on this code section, DIUC should be able to apply for and receive a refund of taxes paid. DIUC should be able to file an amended return for a reduction in its property taxes for 2017 (based on 2016 year-end plant balances) and also file amended returns for 2016 and 2015, to reduce the tax owed for those two years. It is likely that DIUC will be unable to achieve any relief or reduction for the 2011-2014 personal property tax, since it has been more than two years since taxes for those years were paid. However, the Amortization Expense included in revenue requirements should reflect the property taxes that the Company should be paying, based on the adjustments in plant and CIAC proposed by Mr. Loy. With respect to the difference between what the Commission authorizes for property tax in this matter, I recommend that the Commission establish a regulatory asset for DIUC that would represent the difference between what the Company

is liable for and the amounts that would be collected through the rates approved by the Commission, and authorize a special rate surcharge, to be amortized over a period of 8 years, and which would be extinguished at the end of such period. Based on the belief that the Commission will issue an order is this matter before the end of December 2017, once the order is issued, the Company should immediately file amended returns with the DOR and Beaufort County to obtain refunds or credits for 2015 and 2016 and to obtain a lower assessment and property tax amount for 2017 and future years.

It should also be noted, as addressed the Commission's No. 2015-846 from the first hearing, that DIUC has gone back to the Department of Revenue and Beaufort County on several occasions to request changes in its tax assessment and its tax billings, so there is every reason to believe that the Company can achieve some relief from its property tax burden if its Net Plant Investment and Rate Base are reduced by the Commission to the levels recommended by Mr. Loy and reflected in my testimony.

Q. ARE YOU AWARE OF WHAT THE COURT SAID WITH RESPECT TO THE RECOVERY OF PERSONAL PROPERTY TAX EXPENSE?

A. Yes, I am. In the Court's opinion, it stated,

> "the Commission's suggestion that DIUC may be able to reduce its tax liability by renegotiating with Beaufort County in the future is purely speculative, especially in light of Wall's testimony indicating the County would not be willing to amend the terms of the settlement agreement. Therefore, we would reverse the Commission's adoption of ORS's property tax expense adjustment."

The Court's decision was related to the disallowance by ORS of plant associated with the elevated storage tank on property not owned by DIUC. We did not make that same argument in the first hearing or in this hearing. Our proposed

adjustment to property taxes is based on changes in net plant values, as proposed by Mr. Loy, and therefore, it seems entirely reasonable that the on-going property taxes should be based on such net plant values. Therefore, I do not feel that my above recommendation is contrary to the Court's decision as it is based on an entirely different set of facts and I have also provided a mechanism for DIUC to recover any property taxes it is obligated to pay, that are in excess of what would be recovered through the Commission approved rates.

Q. IN YOUR DETERMINATION OF REVENUE REQUIREMENTS, HAVE YOU MADE ANY ADJUSTMENTS TO THE COMPANY'S REVENUES?

A. Yes. ORS proposed adjustments to the Company's revenues which the Company has accepted and, therefore, I have incorporated those revenue adjustments into my revenue requirements analysis. Those adjustments were relatively insignificant and amounted to a negative $2,885 in annual revenue.

Q. BASED ON MR. LOY'S PROPOSED ADJUSTMENTS TO RATE BASE AND YOUR ADJUSTMENTS TO REVENUES AND EXPENSES, WHAT IS YOUR RECOMMENDED REVENUE REQUIREMENT?

A. Based on revisions to my Exhibit 3, now referenced as **Exhibit LML-R3**, from my direct testimony in the first hearing in this matter, I have made revisions per this testimony for Plant Investment, Rate Base, and revenue and expense adjustments, as I have outlined above. With respect to the Rate of Return, since I believe that ORS testimony on Rate of Return, Return on Equity, and the Long-Term Debt rate are consistent with what I proposed in my direct testimony for the first hearing and which the Commission adopted in its Order No. 2015-846, I have adopted and used the ORS recommended ROE and Long-term debt rates of 9.31% and 5.29% respectively, for calculating the overall Rate of

Return to be applied to Rate Base. Using a capital structure of 46% debt and 54% equity, as approved by the Commission in its Order (See my **Exhibit LML-R3**, Schedules C-3, W-3, and S-3), the weighted cost of capital is 7.46% to be applied to the Rate Base. I have calculated revenue requirements for the Water and Sewer Systems separately and for the Combined System. As shown on my **Exhibit LML-R3**, Schedule C-4, the overall revenue requirement for the combined systems is $1,293,571, representing an increase of $219,993 and 20.5% over Pro Forma Adjusted Present Revenue. For the Water System, the revenue requirement is $712,166, representing an increase of $169,694 over adjusted present revenues and a 31.3% increase over Pro Forma Adjusted Present Revenues. And for the Sewer System, the revenue requirement is $581,403, representing an increase of $50,298 over adjusted present revenues and a 9.5% increase over Pro Forma Adjusted Present Revenues.

Q. IN HIS TESTIMONY, MR. LOY ACTUALLY PRESENTED TWO RATE BASE OPTIONS, ONE THAT REFLECTED THE SHIFTING OF "PAID IN CAPITAL" TO "CIAC", WHICH YOU HAVE ADDRESSED ABOVE, AND ONE THAT REFLECTED THE APPLICATION OF UTILIZATION FACTORS TO PLANT INSTEAD OF THE SHIFT OF PAID IN CAPITAL TO CIAC. HAVE YOU DEVELOPED REVENUE REQUIREMENTS BASED ON THIS ALTERNATIVE?

A. Yes, but since the Rate Base changes very little between the two alternatives, there is actually not much change in the revenue requirements. I have provided another version of my revenue requirements model as **Exhibit LML-R4**, in which I have removed the adjustments to paid in capital and CIAC and instead applied the utilization adjustment provided by Mr. Loy in his Table 8. Without going into all the detail that I did with respect to **Exhibit LML-R3**, the net effect on revenue requirements under this scenario is

an overall increase in the revenue requirement of 25.1%% and for the Water System, 29.6%, and for the Sewer System, 20.5% (See Schedules C-4, W-4, and S-4).

Q. IN HIS DIRECT TESTIMONY FOR THE REHEARING OF THIS CASE, MR. GUASTELLA HAS INCLUDED AS ATTACHMENT A TO HIS TESTIMONY, A STATEMENT ENTITLED "IMPACT OF COMMISSION'S ORDER ACCEPTING ORS/POA SETTLEMENT," WHICH PURPORTS TO DEMONSTRATE THAT THE RATES AND CHARGES ALLOWED, PER THE COMMISSION'S ORDER, ARE INSUFFICIENT TO ALLOW DIUC TO MEET CASH FLOW REQUIREMENTS AND INSUFFICIENT TO MEET THE FINANCIAL TESTS IN THE LOAN COVENANTS WITH SUNTRUST BANK. HAVE YOU REVIEWED THIS STATEMENT, MR. GUASTELLA'S ASSERTIONS, AND DO YOU AGREE WITH THEM?

A. I have reviewed Mr. Guastella's testimony, his ATTACHMENT A, and Loan Covenants attached to his testimony as Exhibit JFG-R1. I first reproduced Mr. Guastella's Exhibit JFG-R2 and recalculated the numbers to assure accuracy (See **Exhibit LML-R5**). I disagree somewhat with his calculations. Specifically, there is an amortization component of the property tax expense, that provides cash. There is also an amortization of rate case expense that provides cash. I also believe that that there may be a deferral associated with income tax, if not current, then in the future that would provide cash for DSC coverage, so I think the cash flow calculation is somewhat erroneous, and that if corrections are made, the cash flow becomes positive. I was unable to fully document the debt service on the $2.75 million term loan and the Line of Credit, but I believe the $278,124 annual amount is reasonably accurate. However, I feel that the representations made, as to the calculations are not accurate. On Exhibit JFG-R2, Mr. Guastella calculated a Debt Service Coverage (DSC) Ratio of 1.03 and claims that it does not pass

the SunTrust Bank loan covenant test. He also calculated a Debt to EBITDA ratio of 9.26 and claims that it also does not pass the SunTrust Bank load covenant test.

In reviewing the SunTrust Loan Covenants included with this testimony, under "Debt Service Coverage Ratio" on page 2 of 5, the agreement states that

> "The Debt Service Coverage Ratio of the Borrower shall not at the end of each fiscal year be less than 1.2 to 1.0."

While this is rather strangely written, it appears that the minimum DSC is 1.0. Mr. Guastella's Exhibit JFG-R2 shows that the calculated DSC is 1.03, which I would interpret to mean that it passes the test of 1.0. Exhibit JFG-R2 indicates a minimum DSC of 1.5, but that is not reflected in the loan covenants. There is also no reference in the SunTrust Bank Loan Covenants provided by Mr. Guastella in his testimony to a Debt to EBITDA ratio, so the reference to a ratio of 6.0 or less is meaningless, even if the ratio calculated fails the test. These are material misrepresentations and Mr. Guastella should make corrections for the Commission's consideration. Furthermore, in his calculations of Net Income, Depreciation, Amortization, and Interest in the DSC calculation, I believe he fails to include the amortization portions of the property tax expense, the rate case expense, and any deferred income tax, such that the DSC calculation is somewhat understated. This would also affect the Debt to EBITDA ratio.

So, my conclusion is that JFG-R2 is not entirely accurate and is not conclusive that the SunTrust Bank Loan Covenants would not be met under the revenues allowed by the Commissions original order. In any case though, my revenue requirements analysis, as

reflected on my Exhibit **LML-R6**, indicates that the revenues would be sufficient to meet cash flow requirements and meet the loan covenant requirements of SunTrust Bank.

Q. IS THERE ANYTHING ELSE THAT YOU HAVE REVIEWED THAT WOULD INDICATE THE REASONABLENESS OR UNREASONABLENESS OF THE COMPANY'S PROPOSED OVERALL RATE INCREASE OF 108.9%?

A. Yes. I recently obtained a rate comparison from the Beaufort Jasper Water & Sewer Authority (BJWSA) that contains the rates and availability charges of water and sewer utility service providers in the Lowcountry area of South Carolina and particularly in the immediate vicinity of Daufuskie Island. To the survey data, I added the rates and charges, currently being charged by DIUC under bond, and compared those rates to the rates from the survey respondents. The survey, as received from the BJWSA, with the addition of the DIUC rates, in attached as **Exhibit LML-R7**. As clearly shown, the sum of water and sewer rates, based on the rates and charges that DIUC is asking the Commission to approve in this case, and which amount to a 108.9% overall revenue increase, results in rates that are higher than the highest rates shown in the survey and much higher than the survey average. While it may be expected that the costs of providing water and sewer services on Daufuskie Island may be greater than in some nearby areas, for a variety of reasons, I do not believe such differences justify rates 124% higher than the average rates in the general area.

Q. WHAT IS YOUR OVERALL CONCLUSION AND RECOMMENDATION AS TO THE RATES AND CHARGES THAT THE COMMISSION SHOULD AUTHORIZE DIUC TO COLLECT, PURSUANT TO THE COMPANY'S APPLICATION IN THIS CASE?

A. My view is that the Company's expenses are excessive and that its expectation for an equity return are equally excessive and that the revenue increases and the rates and charges that the Company would need to charge to cover its excessive expenses and provide the desired return, represent an insensitivity to the interests and concerns of its customers and also ignore the potential impact on the future development of the Island caused by excessively high water and sewer charges and availability fees. As I have stated previously in my direct testimony in this case and the 2012 case, I believe the Commission should provide rate relief to DIUC sufficient to provide the Company an opportunity to earn a "reasonable" return, but not at the cost of a 108.9% rate increase. The Company should also be encouraged by the Commission to seek greater efficiencies in its operations and to also pursue Strategic Alternatives to its continued operation, including sale to or merger with other entities.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

END OF DIRECT TESTIMONY

LIST OF EXHIBITS TO ACCOMPANY TESTIMONY

EXHIBIT LML-R1 – [Reserved]

EXHIBIT LML-R2 – [Reserved]

EXHIBIT LML-R3 – LML Revenue Requirements Schedules (Donated Plant)

EXHIBIT LML-R4 – LML Revenue Requirements Schedules (Utilization Factors)

EXHIBIT LML-R5 – Reproduction of Exhibit JFG-R2

EXHIBIT LML-R6 – Cash Flow from Exhibit LML-R3

EXHIBIT LML-R7 – Comparison of Water and Sewer Rates

[PURSUANT TO PREVIOUS INSTRUCTION, THE PREFILED REHEARING SURREBUTTAL TESTIMONY OF LYNN M. LANIER FOLLOWS AT PGS 385-392]

DAUFUSKIE ISLAND UTILITY COMPANY, INC.

DOCKET NO. 2014-346-WS

PRE-FILED SURREBUTTAL TESTIMONY OF LYNN M. LANIER

BEFORE THE SOUTH CAROLINA PUBLIC SERVICE COMMISSION

[Prepared for De Novo Hearing]

Testimony Prepared: December 5, 2017

Q: PLEASE STATE YOUR NAME, EMPLOYER AND BUSINESS ADDRESS.

A. My name is Lynn M. Lanier and I am employed by GDS Associates, Inc. ("GDS"), a utility consulting and engineering firm with its principal offices in Marietta, GA. Until 12/31/16 I was a Principal in the Firm, but am now semi-retired and am an Executive Consultant. My business address is 1850 Parkway Place, Suite 800, Marietta, GA 30067.

Q. ARE YOU THE SAME LYNN M. LANIER, WHO TESTIFIED IN THE HEARING BEFORE THE PSC ON THIS MATTER ON OCTOBER 28, 2015 AND WHO ALSO PROVIDED REHEARING DIRECT TESTIMONY IN THIS MATTER?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS MATTER?

A. The purpose of my testimony is to:

- Rebut certain aspects of the rebuttal testimony of DIUC witness Guastella; and
- Provide a third Revenue Requirements analysis, based on my colleague, Mr. Loy's surrebuttal testimony.

Q. WHAT ARE YOUR DISAGREEMENTS WITH THE REBUTTAL TESTIMOY OF DIUC WITNESS JOHN GUASTELLA?

A. I have several, specifically in regard to the Debt Service Coverage Ratio (per the SunTrust Loan Agreement, the Rate Comparisons, and Rate Case Expense and Management Fee adjustments.

Q. WHAT ARE YOUR CONCERNS ABOUT DEBT SERVICE COVERAGE RATIO FROM THE SUNTRUST LOAN AGREEMENT?

A. Mr. Guastella provided the SunTrust Loan Agreement with his rehearing direct testimony as Exhibit JFG-R1. In his rehearing direct testimony, he erroneously showed on his exhibit JFG-R2 that the required Debt Service Coverage (DSC) Ratio was 1.5. In his rebuttal testimony, he now says that the required DSC is 1.2, yet the Suntrust Loan Agreement, Section III(A) states "shall not at the end of each fiscal year be less than 1.2 to 1.0." So I see no way to interpret that other than the minimum is 1.0. If DSC is going to be a test of adequate revenue in this case, in terms of satisfying the Loan Agreement Requirements, the correct ratio must be used and the DSC must be calculated properly with non-cash expenses, such as amortization expense, where previous expenses have

been paid and are now being recovered through amortization expense, included in the coverage amounts.

Q. WHAT CONCERNS TO YOU HAVE ABOUT MR. GUASTELLA'S REBUTTAL TESTIMONY REGARDING THE RATE COMPARISONS?

A. On the last page of his testimony (page 22, beginning on line16), he states, "Second, the comparisons shown on Exhibit LML-R7 are not valid because they do not make the necessary adjustments for the significant differences between an investor-owned utility such as DIUC and municipal utilities; as such, they are not relevant to the Commission's analysis in this case." I beg to differ. From the consumer's perspective, the consumer does not care about the type of entity that may be providing utility services to him. He only cares whether the rates he is paying are reasonably comparable to the rates charged by other utility service providers in the area. Some refer to this as "yard-stick" competition and I believe regulators are and should be concerned about rate comparability. In fact, the Commission maintains, on its website, a comparison of water and sewer rates of all the water and sewer utilities it regulates. When a comparison of rates from various utility service providers indicates a provider's rates are significantly higher than all the other provides, it does definitely beg the question and to why, and what may be amiss with that provider.

But if Mr. Guastella feels that only a comparison with rates of investor owned water and sewer companies in the area are valid comparisons, let's look at those. In her rehearing testimony, ORS witness Dawn Hipp identified Kiawah Island Utility Company (KIUC) and Harbor Island Utility Company (HIUC) as similarly situated investor owned water

and sewer companies, and utilized them for comparison purposes. KIUC and HIUC both received rate increases in 2017 from this Commission and, thus, their rates can be considered current. Based on the rates as reflected in the Commission's final orders and also a Commission order that authorized a small wholesale water cost pass-through for HIUC, I have calculated the charges for water and sewer at 6,000 gallons per month for both, as shown in **Table 1**, below. I have then shown a comparison of the DIUC proposed rates, and calculated the differences and percent differences.

TABLE 1

Comparison of DIUC Proposed Rates vs Present KIUC and HIUC Rates

		Kiawah Island Utility Company (KIUC)	Harbor Island Utility Company (HIUC)	Daufuskie Island Utility Company (DIUC)	Difference DIUC Proposed vs KIUC		Difference DIUC Proposed vs HIUC	
Line No.	Description	Current Approved Rates	Current Approved Rates	DIUC Proposed Rates	Amount	%	Amount	%
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
1	Water							
2	Base Charge	$34.29	$32.09	$49.77	$15.48	45.1%	$17.68	55.1%
3	Usage Charge (per 1,000 gal)	$4.05	$5.47	$4.41	$0.36	8.9%	($1.06)	-19.4%
4	Sewer							
5	Base Charge	$26.20	$59.24	$72.73	$46.53	177.6%	$13.49	22.8%
6	Usage Charge (per 1,000 gal)	$0.69	$0.00	$2.38	$1.69	244.9%	$2.38	#DIV/0!
	Monthly Charges							
7	Water Charge	$58.59	$64.91	$76.23	$17.64	30.1%	$11.32	17.4%
8	Sewer Charge	$30.34	$59.24	$87.01	$56.67	186.8%	$27.77	46.9%
9	Total Water and Sewer Charge	$88.93	$124.15	$163.24	$74.31	83.6%	$39.09	31.5%

As shown, the proposed DIUC rates for combined water and sewer charges would be 83.6% above the KIUC rates and 31.5% above the HIUC rates. These are dramatic differences and while it may be expected that the DIUC rates might be somewhat higher

than the KIUC and HIUC rates, the differences between the DIUC proposed rates and the KIUC and HIUC rates are difficult to understand. I believe this Commission must seriously consider such large differences in authorizing any increase in rates to DIUC.

Q. IN YOUR DIRECT REHEARING TESTIMONY, DID YOU ADOPT THE RATE CASE AND MANAGEMENT FEE ADJUSTMENTS PROPOSED BY ORS IN THE FIRST HEARING AND ALSO ADOPTED BY MR. SULLIVAN IN HIS REHEARING DIRECT TESTIMONY?

A. Yes I did.

Q. IN HIS REBUTTAL TESTIMONY, MR. GUASTELLA CHALLENGED, AT LENGTH, THE ORS PROPOSED ADJUSTMENTS TO RATE CASE AND MANAGEMENT FEES. HAVE YOU REVIEWED THE CRITERIA UTILIZED BY ORS TO VERIFY DIUC'S REQUESTED RATE CASE EXPENSES?

A. Yes.

Q. DO YOU AGREE THAT THOSE CRITERIA ARE REASONABLE?

A. Yes.

Q. BASED UPON THE ORS REVIEW OF DIUC'S RATE CASE EXPENSES AND APPLICATION OF THE VERIFICATION CRITERIA, ARE THE ADJUSTMENTS RECOMMENDED BY ORS APPROPRIATE?

A. Yes. Additionally, in view of the impact of rate case expenses on the authorized rates, it also seems entirely appropriate for the Commission to authorize a longer period for

amortization of such expenses, as recommended by ORS witness Sullivan. As reflected in his rebuttal testimony on page 9, lines 3-5 and on page 10, lines 19-20, Mr. Guastella apparently believes that any cost he claims DIUC incurred should be recoverable in rates. That is not the regulatory standard, though. Only those costs "prudently" incurred and supported by adequate documentation are eligible for recovery in rates. Based upon these bedrock principles of ratemaking, Ms. Hipp's decision to exclude those expenses is reasonable.

Q. HAVE YOU CONSIDERED THE EFFECT OF MR. LOY'S PRESENTATION IN HIS SURREBUTTAL TESTIMONY OF MAKING ONLY THE REQUIRED ADJUSTMENT IN DIUC'S DEPRECIATION EXPENSE, TO PROVIDE FOR STRAIGHT LINE DEPRECIATION OF DIUC ASSETS?

A. Yes I have. I have attached hereto, my Exhibit LML-R8, which is the revenue requirements calculation for the water and sewer systems and the combined system. I have made the adjustment suggested by Mr. Loy for Accumulated Depreciation and Depreciation Expense based on NARUC prescribed Straight-Line depreciation and the result is that the resulting increase in the overall revenue requirement for the Combined Systems would be $657,331, representing an increase over present revenues of 61.2%, and an increase in Water System revenue requirements of $353,134 or 65.1% over present revenues, and an increase in Sewer System revenue requirements of $304,196, representing an increase of 57.3%. This change is based on a higher Rate Base, increased depreciation and amortization expense, and larger return amount. Also, because property taxes change from the Company's current assessment from the DOR and tax billings

from Beaufort County, please refer to may rehearing direct testimony, where I suggested that the Commission consider establishing a regulatory asset for the difference between what DIUC is able to achieve in reducing its property tax costs, and the amounts allowed in rates, per this proceeding, and allow the Company a surcharge to rates for the difference, based on an appropriate amortization period. This should be dependent, though, on DIUC providing evidence of its good faith efforts to amend assessments and tax billings, and the results achieved.

Q. ARE YOU RECOMMENDING THIS TO THE COMMISSION?

A. No. My primary recommendation is reflected on Exhibit LML-R3 in my rehearing direct testimony. This is merely presented to provide another alternative to the Commission, based on the surrebuttal testimony of my colleague Mr. Loy, in response to the critique of his rehearing direct testimony by Mr. Guastella and Mr. White, in their rebuttal testimonies.

Q. DO YOU HAVE ANY DISAGREEMENTS ANY ASPECTS OF THE REBUTTAL TESTIMONY OF GARY WHITE?

A. No.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

END OF DIRECT TESTIMONY

1 **LIST OF EXHIBITS TO ACCOMPANY TESTIMONY**

2

3 **EXHIBIT LML-R8 – Revenue Requirements – Straight-Line Depreciation on Assets**

MR. PRINGLE: Mr. Commissioner, we tender the panel for questions from the other parties and from the Commissioners.

CHAIRMAN WHITFIELD: Okay. Thank you, Mr. Pringle.

Office of Regulatory Staff, Mr. Nelson. Would you like –

MR. NELSON: I've got a few questions.

CHAIRMAN WHITFIELD: – for the Intervenors to go first? I mean, I'm sorry, the company?

MR. WALKER: No, we're delighted for ORS to go first. That's fine.

MR. NELSON: I've got just a few short questions.

CROSS EXAMINATION

BY MR. NELSON:

Q Mr. Loy, I want to go to you, first, if I could please. there's a couple of terms that you used, and I think it's on page 19 and 20 of your direct. I'm a little – and this is to explain things for me, and maybe the Commission, as well. You use the terms both "used-and-useful" and you also use the term "system utilization." Is that one and the same, or is there a difference between those two things? And if there is, could you explain it?

A [LOY] Yeah, in the way I used them on that page, they're one and the same.
Q All right. So if you're talking but used-and-useful or utilization of the plant, we're pretty much talking about the same issue?
A [LOY] Yeah.
Q Okay, thank you. Mr. Lanier, two short ones for you, I think. In your direct testimony, you have an Exhibit LML-R7 and then you also have a Table 1, which is on page four of your surrebuttal testimony. Both of those appear to be comparisons of rates of other utilities. Do you have an opinion – I mean, because I didn't hear it in the testimony. Do you have an opinion as to why the rates of Daufuskie are different - differ significantly from those of the others that you've provided as exhibits to your testimony?
A [LANIER] Well, rates are always a function of the operating expenses required to operate the utility, plus the return or the margin that's added to that. And in this particular case, the concerns that I would have would relate to the level of operating expenses; and, secondly, with the return on rate base. And our position is that the rate base is overstated, and so, therefore, if you apply any rate of return value to an inflated rate base, you're going to get a larger number

in terms of the return.

So it's a combination of the factors of the operating expenses, the rate base, the return on the rate base, and the return percentage that's allowed on the rate base.

Q One other thing, then. When you – these other companies that you've used, could you tell me how current were the rates that you were using for those companies, or where did you obtain them from?

A [LANIER] I obtained those from the orders that this Commission rendered earlier this year for both Kiawah and Harbor Island.

Q All the recommendations that you've made would produce a rate, obviously, somewhat less than what has been asked for by the utility here. Did you believe that the rates that would fall out from your recommendations would still be sufficient to service the debt of the utility?

A [LANIER] I do.

MR. NELSON: No further questions. Thank you.

CHAIRMAN WHITFIELD: Mr. Nelson, ORS is done?

MR. NELSON: Yes, sir.

CHAIRMAN WHITFIELD: I think we're going to take a brief recess, for just a few minutes, maybe about 10 minutes. We'll start back at quarter to three.

[WHEREUPON, a recess was taken from 2:40 to 2:50 p.m.]

CHAIRMAN WHITFIELD: Be seated. I'll call this hearing back to order, and I do have one piece of housekeeping I need to do. I need to properly enter Mr. Loy's direct testimony into the record. So Mr. Loy's direct testimony will be entered into the record as if given orally from the stand.

And with that, since ORS is through, I'm going to turn it over to Mr. Gressette and Mr. Walker.

MR. WALKER: Thank you, Mr. Chairman.

CROSS EXAMINATION

BY MR. WALKER:

Q Mr. Loy, I'd like to start with you. You would agree that the utility itself is not the developer, correct?

A [LOY] Yes.

Q They're separate entities, correct?

A [LOY] Yeah. I mean, the developer doesn't even exist anymore, so –

Q Right. And we've heard a lot of testimony about capacity and utilization. It did make sense for this developer to install the mains and the facilities, as well as the sewage treatment plant, at one time, did it not, from a cost standpoint?

A [LOY] I have no idea what their plans were, how they

came - how they made the decision that they should build the size of system that they did. Typically, what I'll see is they'll build different sections. And as they sell them, they'll add on. So I have no idea why they decided what they did.

Q If they decided to offer all these lots at one time, they would have to have the public water and sewer, to serve them, available, correct?

A [LOY] Yeah, I guess if they offered them all at the same time, they would. Yeah.

Q And it would certainly make sense, for something like the sewage plant, to have the capacity to serve, not knowing the absorption rate of the lots but to observe what – excuse me – to serve what could be built out?

A [LOY] Yeah, but what – from what I've seen, what I understand, they can do sewage treatment plants, and build them in phases, and –

Q And I'm not asking you what you might've done.

MR. BEACH: Mr. Chairman. I'm sorry.

MR. PRINGLE: Go ahead. I think that Mr. Loy answered the question and was explaining his answer, and I think he probably needs to be allowed to finish that sentence, then Mr. Walker can ask the next question.

WITNESS LOY: From my understanding, you can -