

BEFORE
THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

DIRECT TESTIMONY
OF
AARON L. ROTHSCHILD
ACCOUNTING

ON BEHALF OF
THE SOUTH CAROLINA DEPARTMENT OF CONSUMER AFFAIRS
Docket No. 2019-281-S

May 26, 2020

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1 **I. STATEMENT OF QUALIFICATIONS**

2 **Q. PLEASE STATE YOUR NAME, TITLE AND BUSINESS ADDRESS.**

3 **A.** My name is Aaron L. Rothschild. My title is President and my business address is 15 Lake
4 Road, Ridgefield, CT.

5 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

6 **A.** I am President of Rothschild Financial Consulting.

7 **Q. PLEASE STATE YOUR EDUCATIONAL ACHIEVEMENTS AND**
8 **PROFESSIONAL DESIGNATIONS?**

9 **A.** I have a B.A. (1994) degree from Clark University in mathematics and an M.B.A. (1996)
10 from Vanderbilt University.

11 **Q. PLEASE DESCRIBE YOUR BUSINESS EXPERIENCE.**

12 **A.** I provided financial analysis in the telecom industry in the United States and Asia Pacific
13 from 1996 to 2001, investment banking consulting in New York, complex systems science
14 research regarding the power sector at an independent research institute, and I have
15 prepared rate of return testimonies since 2002. My business experience includes providing
16 expert witness services to the California Public Advocates Office to evaluate the financial
17 health, basic operation, wildfire cost recovery, and organizational culture/governance of
18 gas and electric utilities (I.15-08-019), including evaluating bankruptcy restructuring plans
19 for Pacific Gas and Electric. See Exhibit ALR-1 for my resume.

20 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION, OR**
21 **OTHER STATE COMMISSIONS? IF SO, WHICH COMMISSIONS?**

22 **A.** Yes, I have testified before this Commission previously. My expert witness experience
23 includes testifying in over 50 cost of capital proceedings before the following state

1 commissions: California, Colorado, Connecticut, Delaware, Florida, New Jersey,
2 Maryland, North Dakota, Pennsylvania, South Carolina and Vermont. See Exhibit ALR-
3 1 for the list of dockets for each of my testimonies.

4 **Q. ON WHOSE BEHALF ARE YOU PROVIDING THIS TESTIMONY?**

5 **A.** South Carolina Department of Consumer Affairs.

6 **Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS**
7 **PROCEEDING?**

8 **A.** The purpose of my testimony is to provide my recommendations to the Public Service
9 Commission of South Carolina (“Commission”) regarding the following two issues that
10 will impact rates for Palmetto Utilities Inc. (“PUI” or “Company”): (1) the appropriate
11 adjustments to reflect the effect of the Federal Tax Cuts and Jobs Act (“TCJA”), and (2)
12 the appropriate regulatory treatment of the \$18 million acquisition of sewer collection
13 system from the City of Columbia (“City”).

14 **II. SUMMARY OF CONCLUSIONS**

15

16 **Q. PLEASE SUMMARIZE YOUR TESTIMONY**

17 **A.** I recommend the following regarding the TCJA and the treatment of Contributions in Aid
18 of Construction (“CIAC”):

19 1. **TCJA:** Commission order PUI to refund ratepayers the accumulated excess deferred
20 income taxes they collected as a result of the passage of the TCJA. As explained later in
21 my testimony, I recommend the Commission follow IRS requirements regarding
22 normalization and flow-through.

23

- 1 2. **City Sewer Collection System Acquisition:** \$1.29 million of the \$18 million acquisition
2 price be allowed to go into rate base.

3 **III. TAX CUTS AND JOBS ACT**

4
5 **Q. WHY ARE DEFERRED TAXES AN ISSUE IN THIS CASE?**

- 6 **A.** Starting on January 1, 2018, the maximum corporate income tax rate was lowered from 35
7 percent to 21 percent. The provision for deferred income taxes charged to ratepayers in
8 PUI's last rate case was based on a provision for deferred income taxes using the 35 percent
9 rates of the old law. Therefore, ratepayers continued to pay for a provision for deferred
10 taxes at the 35 percent rate. Because of this, within the spirit of the use of normalization
11 accounting, ratepayers are entitled to the benefits of the deferred taxes they were paying.
12 These excess taxes ratepayers paid since the January 1, 2018 tax law change would truly
13 be "phantom" tax payments if ratepayers were to permanently lose the benefit of these
14 taxes in excess of the statutory rate that the company actually paid.

15 **Q. DOES THE COMPANY DISPUTE THAT THE CORPORATE INCOME TAX**
16 **RATE WAS LOWERED TO 21 PERCENT SINCE ITS RATES WERE**
17 **ESTABLISHED?**

- 18 **A.** No. However, company witness Mr. Walsh states on page 6 of his direct testimony that he
19 believes returning the payments made by ratepayers at the higher tax rate, even after the
20 rate had been changed, would constitute retroactive ratemaking. He also believes that
21 adjusting for the change in the income tax expense constitutes retroactive ratemaking. He
22 proposes the company simply keep the excess payments and return none of them to
23 ratepayers.

1 **Q. SHOULD THE COMPANY BE ALLOWED TO KEEP THOSE EXCESS**
2 **PAYMENTS?**

3 **A.** No. As stated below, refunding consumers excess deferred income taxes (“EDIT”) is not
4 retroactive ratemaking because the utility company does not own these funds. Looking at
5 the long history of this issue shows that the very existence of the provision for deferred
6 taxes was a compromise between what companies wanted and the flow through accounting
7 that ratepayers preferred. Denying consumers the portion of the tradeoff that helps them
8 would be unfair and unreasonable.

9 **Q. WHAT ARE DEFERRED INCOME TAXES?**

10 **A.** Deferred income taxes are the difference between the current income tax expense that a
11 company records on its income statement, and the income taxes it actually has to pay on
12 the income earned in that period. When the income tax expense recorded on the income
13 statement is larger than the income tax payment a company is currently liable to pay, the
14 company gets the use of the difference between the per books income tax expense and the
15 current actual expense.

16 Typically, deferred income taxes occur because the tax law permits a company to
17 depreciate its assets for tax purposes more rapidly than what the company’s accounting
18 system records for depreciation expense. The accounting depreciation expense is intended
19 to charge to expenses the original cost of an asset over the best estimate of its useful life.
20 The tax basis depreciation expense is based on whatever the taxing authority permits.
21 Typically, the depreciation rate allowed for tax purposes is higher than the per books
22 depreciation expense rate because of some combination of the use of a depreciation life
23 shorter than its expected actual life, or because of accelerated depreciation methods

1 permitted for tax purposes that compute depreciation expense higher in the early part of an
2 asset's life than if a straight-line method of depreciation were used. This results in
3 ratepayers paying more in taxes than the utility is actually paying the IRS in the early years
4 of the asset's useful life and less after the asset is fully depreciated.

5 **Q. IS THE PER TAXES DEPRECIATION EXPENSE ALWAYS HIGHER THAN**
6 **THE PER BOOKS DEPRECIATION EXPENSE?**

7 **A.** No. While income tax computations often permit a depreciation expense that is higher
8 than the depreciation expense a company records on its books for operating expense
9 purposes during the earlier part of the life of an asset, the per tax depreciation expense
10 eventually becomes lower than the per books depreciation expense. For any one specific
11 asset, once the asset becomes old enough, the tax depreciation rate becomes less than the
12 per books depreciation rate. When that happens, at least with respect to that one specific
13 asset, the income taxes paid currently will become higher than the per books income tax
14 expense.

15 **Q. HOW IS THE DIFFERENCE BETWEEN THE PER BOOKS INCOME TAX**
16 **EXPENSE AND THE ACTUAL YEAR'S TAX PAYMENT REFLECTED FOR PER**
17 **BOOK PURPOSES?**

18 **A.** The difference between the per books income tax expense and the actual "per tax" income
19 tax expense is recorded on the income statement as a provision for deferred income taxes.
20 This provision for deferred income taxes is not really a current expense. It is an income
21 tax expense the company will have to pay sometime in the future. To properly
22 communicate to investors that the company has this ongoing liability to make these higher

1 income tax expenses in the future, the income statement provisions for income taxes are
2 accumulated on a company's balance sheet as an accumulated provision for income taxes.

3 **Q. WHAT IS THE RATEMAKING TREATMENT FOR DEFERRED INCOME**
4 **TAXES?**

5 **A.** Several decades ago, there was disagreement on how to treat income tax expense for
6 ratemaking purposes. Some jurisdictions would "flow through" the tax benefit of the lower
7 actual income tax expense directly to ratepayers within the rate case. This method, called
8 "flow through" immediately gave the tax timing benefit to ratepayers. Other jurisdictions
9 used "normalization" instead of "flow through," where the per books income tax amount
10 was charged to ratepayers and any accumulated provision for deferred taxes was subtracted
11 from rate base. Then, in 1986, there was a change in the income tax law that required
12 utility ratemaking to use the normalization method, or lose the benefit of lower taxes.
13 Utility commissions responded by abandoning "flow through" in exchange for the
14 currently used "normalization" method. People who argued in favor of "flow through"
15 accounting for the tax timing benefit typically referred to the provision for deferred income
16 taxes as "phantom taxes." Once the tax law was changed, however, all realized that it was
17 better for ratepayers to allow the company to have the tax savings so long as the provision
18 for deferred taxes was accumulated on the balance sheet of the company. Since the
19 provision for deferred taxes is a standard rate base deduction, ratepayers still benefited
20 from the tax savings, albeit more slowly than if "flow through" accounting had been used.

21 **Q. PLEASE SUMMARIZE MR. WALSH'S RECOMMENDATION THAT**
22 **CONSUMERS SHOULD NOT BE GIVEN A REFUND FOR THE PORTION OF**

1 **RATES COLLECTED WHICH INCLUDED INCOME TAXES AT THE HIGHER**
2 **TAX RATES PREVAILING PRIOR TO THE EFFECTIVE DATE OF THE TCJA.**

3 **A.** Mr. Walsh claims that ratepayers should not be given a refund as result of the TCJA for
4 two reasons. First, Mr. Walsh claims that refunding consumers “constitutes impermissible
5 retroactive ratemaking.”¹ Second, he claims that such a refund would constitute single
6 issue ratemaking. In particular, Mr. Walsh claims that “it is improper to consider the
7 lawfulness of a public utility’s rates at a given point in time by reference to a single expense
8 and without consideration of whether the public utility is earning in excess of an authorized
9 return or margin.”²

10 **Q.** **PLEASE RESPOND TO MR. WALSH’S RECOMMENDATION.**

11 **A.** Mr. Walsh is correct that after-the-fact rate adjustments, referred to as “retroactive
12 ratemaking” should not be permitted. He is not correct, however, that refunding consumers
13 for paying PUI more than the company will have to pay the IRS is retroactive ratemaking.

14 Cost of service regulation is prospective in nature. In other words, a utility
15 company’s revenue requirement is authorized based on projections during a rate case
16 proceeding. A utility’s actual revenues between rate cases will never match its authorized
17 revenue requirement exactly. A utility is given the opportunity to earn its allowed rate of
18 return, but it is not given a guarantee. If a utility is able to increase its earnings and rate of
19 return, through efficient management or good luck, it is entitled to the higher returns. On
20 the other hand, if costs turn out to be higher than expected, because of poor management
21 or bad luck, the utility company may earn less than its authorized return.³ Regulators

¹ Mr. Walsh’s Direct Testimony, page 6, lines 22-23.

² Ibid. lines 28-31.

³ Cost recovery for storm damage is an exception.

1 typically do not adjust rates up or down based on retroactive conditions to make actual
2 returns equal to their authorized rate of return. Regulators typically do not refund
3 consumers for earnings above their authorized rate of return because it would violate
4 investors expectation that utility rates will remain the same until they are changed
5 prospectively in their next rate case.

6 However, retroactive ratemaking, should not apply to the cumulative amount of
7 taxes that has been collected from ratepayers but has not yet been paid to the IRS because
8 the intent was that these funds would be returned to ratepayers. These funds were put into
9 a liability account on the balance sheet because they are for the benefit of ratepayers, not
10 investors. These funds collected from ratepayers are called accumulated deferred income
11 taxes (ADIT)⁴. PUI cannot use ADIT to pay investors dividends because they are not
12 earnings. These funds do not impact PUI's rate of return directly and PUI certainly does
13 not own these funds. Refunding money that was set aside for consumes does not constitute
14 retroactive ratemaking.

15 **Q. PLEASE COMMENT ON DECISIONS MADE BY OTHER UTILITY**
16 **COMMISIONS REGARDING REFUNDING EXCESS INCOME TAXES**
17 **COLLECTED.**

18 **A.** My recommendation to return the additional ADIT to consumers as a result of the TCJA
19 is consistent with the all the decisions I have seen in states around the country. For
20 example, on December 4, 2019, the Public Utilities Commission of Ohio agreed to allow
21 Dominion Energy Ohio to create a credit on gas customer bills to reflect the impact that
22 the Tax Cuts and Jobs Act (TCJA) of 2017 had on its tax rates (Case 18-1908-GA-UNC).

⁴ ADIT is removed from rate base. Deferred taxes are added to rate base as they are paid to the IRS in future years.

1 The company will return to customers normalized excess deferred income tax (EDIT)
2 estimated to be approximately \$181 million over about 6 years.⁵

3 **Q. HOW DO YOU PROPOSE RATEPAYERS BE PAID BACK THESE EXCESS**
4 **TAXES THAT WERE BUILT INTO THE RATES THEY PAID?**

5 It is undeniable that consumers should receive the benefit of EDIT. I am recommending
6 the following:

- 7 1. Protected EDIT⁶ should be included in ADIT
- 8 2. Unprotected EDIT should be included in ADIT or flowed-through in current rates.

9 It could be reasonable for the Commission to use the portion of the EDIT which is
10 available for flow-through (Unprotected EDIT) to reduce current rates instead of remaining
11 part of ADIT. Current ratepayers are often burdened with paying for plant being included
12 in rate base that will primarily benefit future ratepayers.

13

14 **IV. ACQUISITION OF THE CITY'S SEWER COLLECTION SYSTEM**

15

16 **Q. PLEASE EXPLAIN THE PURPOSE OF YOUR TESTIMONY REGARDING THE**
17 **REGULATORY TREATMENT OF THE \$18 MILLION ACQUISITION OF THE**
18 **CITY OF COLUMBIA'S SEWER COLLECTION SYSTEM.**

19 **A.** The purpose of this section of my testimony is to recommend how much of the \$18 million
20 acquisition price paid by Palmetto Richland County ("PRC") in 2013 should be allowed in
21 PUI's rate base. The criteria I use for determining this amount starts and ends with just and

⁵ <https://www.puco.ohio.gov/media-room/media-releases/puco-approves-dominion-tax-cut-rate-reductions/>

⁶ For benefits given to ratepayers, Protected EDIT must be normalized while Unprotected EDIT can be normalized or flowed-through.

1 reasonable rates. Regulatory principles require CIAC to be accounted for and not be
2 allowed in PUI's rate base. Setting rates as if CIAC funds were an investment made by
3 PUI or the City is unfair to the consumers who made those contributions and to existing
4 consumers who would be asked to cover those costs once again.

5 PUI claims that the \$18 million acquisition price was based on an arms-length
6 negotiation.⁷ In general, when one party purchases the assets of another, the buyer wants
7 the price to be as low as possible and the seller wants the price to be as high as possible.
8 This type of negotiation most often leads to a competitive price. In contrast, when an
9 investor owned utility ("IOU") purchases a municipality, there is an incentive for collusion
10 because both sides stand to benefit from a higher purchase price – all at the expense of the
11 consumer. The higher the price, the bigger the check received by the municipality. The
12 higher the price, the greater the IOU's rate base.

13 Considering that PUI and the City both stand to benefit from a higher acquisition
14 price at the expense of consumers, it is concerning that PUI's valuation study was
15 completed after the acquisition price was determined. These are the specifics regarding the
16 timing of the transaction:

- 17 1. **June 6, 2012 - Asset Purchase Agreement (APA) signed for \$18 million.**
- 18 2. July 6, 2012 - PRC filed application.
- 19 3. December 21, 2012 - PSC approved the acquisition.
- 20 4. **February 28, 2013 – Tangibl determined Original Cost Less Depression =**
21 **\$18,016,906.**

⁷ Mr. Walsh's Direct Testimony, page 5, lines 9-13.

1 The after the fact valuation study happened to be the same as the acquisition price
2 agreed to before the study (\$18 million). Company witness Mr. Daday states, “though
3 similar in amount, the purchase price played no role in the calculation.”⁸ I agree with Mr.
4 Daday that the fact that these numbers are almost identical is worth noting.

5 **Q. HOW MUCH OF THE \$18 MILLION ACQUISITION PRICE SHOULD GO INTO**
6 **RATE BASE?**

7 **A.** GDS Associates, Inc. identified \$1.29 million of plant book values known to be non-
8 contributed in the City’s accounting records.⁹ PUI has the burden of proof and the fact that
9 the City kept poor accounting records does not justify PUI, or the City, taking ownership
10 of the CIAC. In my opinion it is not just and reasonable for consumers to forfeit their
11 CIAC unless legislation allows such a practice and if the Commission determines it is in
12 the public interest. For example, a number of states around the country have determined
13 that it is in the public interest to allow IOUs to put the acquisition price into rate base
14 instead of the original cost less depreciation. To my knowledge there is no legislation in
15 South Carolina that allows IOUs to deviate from original cost ratemaking when they
16 purchase a municipal system.

17 As explained below, the Commission has the authority to make regulatory decisions
18 based on their determination of just and reasonable rates. The Uniform System of Accounts
19 (“USOA”) are guidelines to improve the effectiveness of regulation; they should be
20 followed only if the Commission determines these guidelines result in just and reasonable
21 rates. Regardless of what the Commission decides in this proceeding concerning the

⁸ Mr. Daday’s Direct Testimony, page 7, lines 4-6.

⁹ GDS Associates, Inc., The Analysis and Determination of the Value of Donated Assets for Palmetto Utilities Inc.’s Palmetto of Richland County, LLC Service Area, page 8. Exhibit ALR-7.

1 regulatory treatment of the \$18 million acquisition of the City's sewer collection system,
2 the Commission can use this opportunity to establish expectations for future acquisitions
3 of municipal water and wastewater systems. In my opinion, these expectations should
4 include that consumers will be treated fairly, and their CIAC will not be taken from them.

5 **Q. PLEASE EXPLAIN THE PERCENTAGE OF THE \$18 MILLION ACQUISITION**
6 **PRICE PUI IS REQUESTING BE PUT INTO RATE BASE AND THEIR**
7 **JUSTIFICATION.**

8 **A.** PUI's primary position is that the entire \$18 million acquisition price should be allowed in
9 rate base. Their justification for this position includes the following: (1) The amount paid
10 by the first utility to own an asset (\$18 million) is the original cost, (2) the amount of CIAC
11 is unknowable because the City kept poor accounting records,¹⁰ and (3) most of CIAC was
12 used to build assets (e.g., City's Metro WWTP) not purchased by PRC.¹¹

13 Alternatively, Mr. Daday states that "if the Commission were to determine that the
14 USOA did not apply to the City,"¹² \$17.1 million of the \$18 million acquisition price
15 should be allowed in rate base.

16 The amount paid by the first utility to own an asset (\$18 million) is the original cost

17 Mr. Walsh's justification for recommending inclusion of the entire \$18 million is
18 based on his reading of USOA Instruction 18. He quotes this instruction as saying "... all
19 amounts included in the accounts for utility plant acquired as an operating unit or system,
20 shall be stated at the cost incurred by the person who first devoted the property to utility

¹⁰ See APB Exhibit 2: "City accounting records were ill-kept and grossly incomplete"

¹¹ Mr. Daday's Direct Testimony, Page 7, lines 11-12.

¹² Ibid. Page 6, lines 10-15.

1 service.”¹³ He then claims that the City is not a utility, so in his opinion the acquisition
2 should be recorded as the cost paid by PUI.¹⁴

3 Most of CIAC was used to build assets (e.g., City’s Metro WWTP) not purchased by PRC
4 PUI argues that reducing allowable rate base for CIAC applied to plant expansion is not
5 warranted for the following reasons:

- 6 1. The amount of plant expansion fees is unknowable.
- 7 2. Expansion fees were used to recover cost of capacity for an asset PRC did not
8 purchase - the City’s Metro wastewater treatment plant.
- 9 3. The City’s expansion fee was not cost based – The city used these funds as a slush
10 fund.
- 11 4. Under PSC of South Carolina regulation, the ‘plant’ component of a tap fee
12 involves recovery of only a portion of the cost of a utility’s WWTP.

13 Mr. Daday does not reduce rate base to account for CIAC allocated to the City’s
14 wastewater treatment plant. He states that cash CIAC (City “Expansion Fee”) “paid by
15 customers was specifically for ‘plant expansion’” and PRC did not purchase these assets.¹⁵
16 Mr. Daday refers to Mr. Walker’s testimony for greater clarification regarding why this
17 CIAC should not be excluded from rate base. Mr. Walker argues that the regulatory
18 principle of “used and useful” requires that CIAC allocated to treatment facilities not be
19 excluded from rate base because PRC did not purchase the City’s Metro WWTP treatment
20 plant.¹⁶

¹³ Mr. Walsh’s Direct Testimony, page 3, lines 10-13.

¹⁴ Ibid. page 4, line 7.

¹⁵ Mr. Daday’s Direct Testimony, Page 7, lines 12-14.

¹⁶ Gannett Fleming, Opinion on the Probable Value of Customer Contribution in Aid of Construction Related to the Acquisition of Some Wastewater Assets Owned and Operated by the City of Columbia, South Carolina, August 2018, page 8.

1 **Q. PLEASE EXPLAIN WHY THE FUNDS DONATED BY DEVELOPERS AND**
2 **CUSTOMERS SHOULD NOT BE PLACED INTO RATE BASE.**

3 **A.** The appropriate amount that should be included in PUI's rate base is no more than the
4 amount that would be appropriate to add to rate base if the acquired entity was a regulated
5 utility. Any other treatment would be extremely unfair to ratepayers. Original cost
6 ratemaking is based on the principle that items added to rate base that are used and useful
7 and have been prudently incurred at a reasonable cost should be added to rate base in an
8 amount equal to the depreciated original cost, with appropriate adjustments for assets
9 acquired by Contributions in Aid of Construction and deferred income taxes. Consistently
10 applying this procedure is extremely important for at least two reasons.

11 1) **DEPRECIATED ORIGINAL COST DECLINES.** When items are first placed into
12 service, rates are high because there is not any accumulated provision for depreciation
13 as of yet. As assets get older, the accumulated provision for depreciation gets larger
14 and larger, making the rate base associated with that asset get smaller and smaller.
15 This procedure causes the charge associated with rate base that is collected from
16 ratepayers to be high in the early years of the life of an asset, but low in the later years.
17 It would be unfair to ratepayers to deny them the benefit of the lower depreciated cost
18 rate base of an asset later in its life after they have been paying for years based on the
19 less depreciated cost earlier in its life. If commissions failed to protect ratepayers from
20 being able to keep this benefit they earned by paying higher rates in the early years of
21 the life of an asset, it would be unfairly taken away.

22 2) **MARKET TO BOOK RATIO PROFIT AMPLIFICATION.** In financial markets, the
23 common stock of most public utilities trades at a price meaningfully in excess of book

1 value most of the time. This means that a company who wishes to acquire a utility
2 company would often be required to pay some amount in excess of its original cost
3 book value. If the acquisition cost became a substitute for the true depreciated original
4 cost of the assets eligible for inclusion in rate base, the mere fact that the acquisition
5 took place would result in an increased charge to ratepayers. This incremental cost is
6 unjustified because it violates original cost ratemaking procedures in a way that is
7 inherently unfair to ratepayers. If such an unfair approach were approved, it would
8 make a fiasco out of rate regulation. One utility could pay a premium for acquiring
9 another, making its rate base higher and allowing it to charge higher rates. Then
10 another company could come along and pay yet another acquisition premium, etc.
11 Each iteration would make rates higher and higher.

12 **Q. PLEASE EXPLAIN WHY YOU RECOMMEND THAT IF THE COMMISSION**
13 **DECIDES IT IS IN THE PUBLIC INTEREST TO ALLOW A PORTION OF THE**
14 **DONATED PLANT, IT SHOULD CLEARLY EXPLAIN HOW FUTURE CASES**
15 **WILL BE TREATED TO MINIMIZE REGULATORY UNCERTAINTY.**

16 **A.** In this case, both the City of Columbia and PUI are in a position to benefit from a higher
17 sales price at the expense of consumers. There is potential for abuse when a regulated utility
18 purchases an asset from a municipality in general. The Commission should ensure that
19 consumers' interests are protected when an IOU proposes purchasing a municipality
20 system.

21 **Q. PLEASE EXPLAIN WHY THE APPROPRIATE PORTION OF THE \$18**
22 **MILLION ACQUISITION PRICE THAT WILL GO INTO RATE BASE SHOULD**
23 **(1) BE JUST AND REASONABLE AND (2) ESTABLISH EXPECTATIONS**

1 **REGARDING THE REGULATORY TREATMENT OF MUNICIPAL ASSETS IN**
2 **FUTURE ACQUISITIONS.**

3 **A.** The USOA provides detailed accounting instructions to assist effective utility regulation.
4 Commissions have the authority to set rates based on their own accounting system if they
5 determine it is necessary to deviate from USOA to set just and reasonable rates. This
6 flexibility is consistent with Supreme Court opinions. In FPC v. Hope Natural Gas the court
7 states “Under the statutory standard of ‘just and reasonable’ it is the result reached not the
8 method employed which is controlling...”.¹⁷ The USOA is a starting point, a default system
9 available, so commissions around the country do not have to waste time re-inventing the
10 rate setting accounting wheel.

11 Gary Walsh does not recognize the authority granted to this Commission to set just
12 and reasonable rates. He states that the Commission must put the entire \$18 million
13 acquisition price into rate base because of accounting rules, leaving no room for flexibility.
14 He claims that USOA rules make the original cost of the sewer collection system irrelevant
15 because the utility assets PRC purchased from the City in 2013 did not meet the USOA
16 definition of a utility.¹⁸ According to Mr. Walsh, USOA Instruction 18 requires that the
17 accounts for utility plant “shall be stated at the cost incurred by the person who first devoted
18 the property to utility service.”¹⁹

19 See Appendix A for a more in-depth discussion of the purpose of accounting
20 systems, USOA and rate making.

21

¹⁷ FPC v. Hope Natural Gas, 320U.S. at 602, 605

¹⁸ Mr. Walsh’s Direct Testimony, page 4, lines 20-22.

¹⁹ Mr. Walsh’s Direct Testimony, Page 3, lines 12-13.

1 **V. PUI’S REQUEST TO LIMITED SERVICE INTERRUPTION LIABILITY**

2

3 **Q. PLEASE RESPOND TO PUI’S REQUEST TO LIMIT THEIR LIABILITY**
4 **REGARDING SERVICE INTERRUPTIONS.**

5 **A.** It is my understanding that under South Carolina regulation PUI’s only obligation is to
6 resume service as quickly as possible. Limiting the Company’s liability is not a benefit to
7 customers.

8

9 **VI. CONCLUSION**

10

11 **Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS IN THIS CASE.**

12 **A.** **A.** I recommend the following:

13 1. **TCJA:** Commission order PUI to refund ratepayers the accumulated excess deferred
14 income taxes they collected as a result of the passage of the TCJA.

15 3. **City Sewer Collection System Acquisition:** \$1.29 million of the \$18 million acquisition
16 price be allowed to go into rate base.

17 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

18 **A.** Yes.

19

APPENDIX A: UNIFORM SYSTEM OF ACCOUNTS

Accounting is a system of rules, procedures and principles that help measure the economics (e.g. profits, losses) of companies, including regulated utilities. Accounting data is used by management, investors, government and regulators to make decisions. For most companies accounting data is a report card, an output. For regulated utilities, however, accounting can influence the economics.

Filing Requirements - IOUs

Utilities have multiple filing requirements, including those required by the Securities and Exchange Commission (SEC) and regulators (states and federal). The SEC requires utilities to file accounting information in accordance with Generally Accepted Accounting Principles (GAAP). The Federal Energy Regulatory Commission (FERC) require utilities, under their jurisdiction, to file accounting information based on FERC Uniform System of Accounts (USOA).

Both USOA and GAAP (for utilities through Accounting Standards Codification ASC 980 – Regulated Operations) were developed with the prevailing cost-of-service model in mind for utilities. State regulators have the authority to set rates based on different accounting rules than GAAP if they determine that doing so is in the public interest. In practice, GAAP and USOA accounting requirements are usually the same.

GAAP

GAAP is governed by the Financial Accounting Standards Board (FASB). The purpose of GAAP, established by the Financial Accounting Standards Board (FASB), is to provide investors with uniform financial information so they can make informed decisions. It is up to

1 utility commissions, not FASB, to decide how to determine just and reasonable utility rates.
2 For example, ASC 980 requires that when certain regulatory actions (e.g., cost disallowance)
3 are probable and estimable, the estimated amount must be recognized as a loss. This
4 requirement helps investors understand the financial condition of a utility company so they can
5 decide how much the shares of the company are worth and if they would like to buy them or
6 not. If a utility does not comply with GAAP, they are subject to fines and possibly criminal
7 charges. Companies are allowed to provide investors “non-GAAP” financials in their investor
8 presentations, but they are required to show investors how they made the calculations and how
9 the results compare to results that are consistent with GAAP.

10 USOA

11 The USOA impacts the rates that utilities will charge their consumers, revenues, expenses,
12 earnings and ultimately their share price. The purpose of USOA, created by the Federal Energy
13 Regulatory Commission (FERC) in 1937, is to increase regulators’ capacity to provide
14 effective regulation. The USOA “...provides detailed descriptions of the activities for which
15 the financial impacts are to be included in each account.” For example, the USOA provides
16 instructions for the types of expenditures included in the costs of an electric plant. These
17 instructions provide the consistency needed for regulators to monitor utility performance, but
18 the USOA’s impacts are more consequential than record-keeping. The USOA impacts rates.

19 Utility Commission Authority

20 Utility commissions do not have the authority to change GAAP. They do have the
21 authority to change the USOA, however, if they determine it is in the public interest. Most
22 state regulators require utilities to file in a format consistent with FERC USOA. State

- 1 regulators can require their utilities to file based on their own system of accounts and change
- 2 what costs go into rates.