

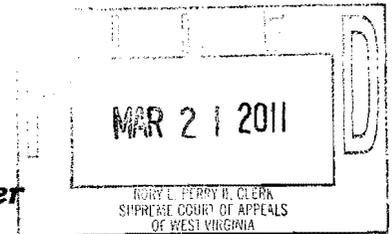
IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

No. 11----

JEFFERSON UTILITIES, INC., *Petitioner*

v.

**THE PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA, *Respondent***



Appeal from a Final Order of the
Public Service Commission of West Virginia
Dated February 18, 2011
Case Nos. 10-0974-W-PC and 10-1329-W-42T

BRIEF OF THE PETITIONER

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I. ASSIGNMENT OF ERRORS

1. The Public Service Commission (“PSC” or “Commission”) erred by rejecting the findings of fact, conclusions of law and recommended decision of its Administrative Law Judge (“ALJ”) without making its own independent findings of fact and conclusions of law, contrary to the applicable standard of review, and by denying the utility rate adjustment requested by Jefferson Utilities, Inc. (“JUI”).

2. The PSC erred by rejecting the affiliated operation and maintenance agreement between JUI and Snyder Environmental Services, Inc. (“SES”) and lease agreements between JUI, SES, and Lee Snyder (“Mr. Snyder”) and Cynthia Snyder (“Ms. Snyder”) including the affiliated operation and maintenance expenses and rental expenses approved by the ALJ, which would allow JUI to recoup its legitimate business expenses through its rate structure.

3. The PSC erred by rejecting the ALJ recommended expenses for JUI’s insurance premiums, rent, rate case expenses, and accumulated depreciation, and by reducing JUI’s incurred expense for officer salary.

II. STATEMENT OF THE CASE

This is an appeal by JUI from a PSC order entered on February 18, 2011, ruling on exceptions to the ALJ’s Recommended Decision dated January 7, 2011, in Case Nos. 10-0974-W-PC and 10-1329-W-42T (“Order”).

The effect of the PSC’s decision was to reduce an annual rate increase of \$310,946 or 22.4 percent recommended by the ALJ, which was still less than

that to which JUI asserts it is entitled, to only 4.4 percent, or \$66,324, Order, at 1, which is manifestly inadequate and unfair.

JUI is a privately held public utility authorized to provide water service to several areas of Jefferson County. JUI Ex. 1, Attachment No. 10, p. 1. SES is a construction, utility and environmental management company headquartered in Kearneysville.

JUI and SES are affiliated companies owned and operated by Mr. Snyder and Ms. Snyder. *Id.* JUI has only one employee, its President, Mr. Snyder. *Tr.* Dec. 1, 2010, at 107. SES performs most operation and maintenance services for JUI and uses SES equipment and vehicles to perform operations, construction, repairs, and maintenance. *Id.* at 149-50.

A. Procedural History

On June 30, 2010, JUI filed Case No. 10-0974-W-PC-42T, a request for increased rates with supporting documentation. JUI Ex. 1. Also included in the filing were two petitions: one requested consent and approval of an affiliated operation and maintenance agreement between JUI and SES (“O&M Agreement”), while the other sought consent and approval of affiliated lease agreements between JUI, Mr. Snyder, Ms. Snyder, and SES, whereby JUI proposed to lease space in a building owned by Mr. and Ms. Snyder (“Snyder Building”) (“Lease Agreements”).¹ *Id.*, Attachment Nos. 10, 11.

¹ Pursuant to W. Va. Code § 24-2-12(f), a public utility must obtain PSC consent and approval prior to entering into an agreement with an affiliate.

The PSC ultimately dismissed the rate case portion of the filing.² Order, July 30, 2010. JUI re-filed its rate case on August 20, 2010, and the matter was docketed by the PSC as Case No. 10-1329-W-42T. JUI Ex. 2. Subsequently, the PSC consolidated JUI's re-filed rate case with the petition for consent and approval case. Order, Oct. 6, 2010. Thus, Case Nos. 10-0974-W-PC and 10-1329-W-42T were processed by the PSC as one proceeding.

Several parties were granted intervenor status in these cases, including the homeowners' associations of the subdivisions of Breckenridge, Deerfield, Gap View, Meadowbrook, Sheridan Estates, and Briar Run ("HOAs"); Citizens for Fair Water, Inc. ("CFW"), the County Commission of Jefferson County, Kay Moore and Scott Tatina. Tr. Dec. 2, 2010, at 9-10.

The ALJ called the cases for hearing on December 1 and 2, 2010, in the City of Ranson. Procedural Order, Nov. 3, 2010. Over the two-day period, evidence was entered into the record by the parties and testimony given by multiple witnesses. Tr. Dec. 1, 2010; Tr. Dec. 2, 2010.

After briefing by the parties, the PSC's ALJ entered her Recommended Decision on January 7, 2011 ("Recommended Decision"), discussed below. Exceptions to the Recommended Decision were filed by JUI, PSC Staff ("Staff"), the HOAs, the CFW, Mr. Tatina, and Ms. Moore on January 24, 2011. On February 3, 2011, JUI filed its reply to the exceptions of others, while on February 4, 2011, the HOAs, the CFW, Mr. Tatina, and Ms. Moore filed their reply to the exceptions of others.

² The matter was redesigned as Case No. 10-0974-W-PC.

B. Recommended Decision

With respect to Jefferson Utilities' petitions for consent and approval, the ALJ approved the O&M Agreement, App. at 78, but not the Lease Agreements, App. at 77. As for rates, several of the ALJ's findings, supported by the evidence, are relevant:

1. The ALJ determined, based upon the evidence, that \$54,270 per year or \$4,522.50 per month, was the appropriate annual rental expense for the Snyder Building, App. at 78;

2. The ALJ determined, based upon the evidence, that \$422,984 per year, or \$35,248 per month, was the appropriate O&M expense for JUI to pay SES under the O&M Agreement flat fee, App. at 78;

3. The ALJ determined, based upon the evidence, that \$18,853 was the appropriate annual insurance premium expense, App. at 43, 71;

4. The ALJ determined, based upon the evidence, that \$11,620 was the appropriate annual utility expense in the Snyder Building, App. at 78;

5. The ALJ determined, based upon the evidence, that \$3,110,524 was the appropriate amount of owners' investment in the Snyder Building, App. at 66-67, 78;

6. The ALJ determined, based upon the evidence, that \$86,926 was the appropriate rate case expense, App. at 79;

7. The ALJ determined, based upon the evidence, that JUI was entitled to accumulated depreciation, i.e., the ALJ adjusted JUI's accumulated depreciation balance to reflect straight-line, rather than accelerated tax

depreciation, which is in accordance with Generally-Accepted Accounting Principles (“GAAP”) and the PSC’s method of calculating depreciation expense, resulting in a \$204,334 addition to JUI’s rate base, App. at 79, 90.³

Thus, JUI substantially prevailed on most of the issues related to the amount of expenses to be applied in calculating its cost of service.

C. PSC Order

The PSC issued its Order on exceptions to the ALJ’s Recommended Decision on February 18, 2011. The PSC ignored virtually all of its ALJ’s findings and conclusions and, instead of substituting its own findings and conclusions, it merely adopted Staff’s recommendations and made no independent findings or conclusions of its own, or, even with respect to some issues, offering any explanation whatsoever for its rejection of the ALJ’s findings and conclusions.

While the ALJ approved the O&M Agreement, the PSC rejected both the O&M Agreement and Lease Agreements, App. at 23, leaving JUI hanging out to dry on its relationship with its landlord and system operator.

In rejecting both, the PSC reasoned, in two sentences, that JUI did not make a “proper showing’ that the O&M Agreement and the Leases with its affiliates meet the statutory test.” App. at 23. Obviously, however, not even the PSC was convinced of this because its Order did not and could not deny

³ Pursuant to a January 12, 2011, Order, the PSC directed Staff to file a “schedule indicating the revenue requirement, or a reconciliation of the dollar difference, on an issue-by-issue basis, between the recommendations filed by Commission Staff and the Recommended Decision.” App. at 93.

approval of the O&M Agreement and Lease Agreements based upon the evidence of record, but rather punted by initiating a general investigation of the proposed O&M Agreement and Leases as well as other issues.⁴ App. at 23.

In other words, at the end of the trial, the jury returned a verdict, but at the same time directed the parties to have additional proceedings on whether its verdict was correct. Respectfully, when JUI met its burden of making a sufficient evidentiary record to warrant approval of the O&M Agreement and the Lease Agreements, the PSC should not have instituted a new far-flung proceeding to give its Staff another bite at the apple while limiting JUI to rates that are not an accurate reflection of its cost structure.

Not only did the PSC refuse to approve the Lease Agreements and, instead, institute a broad new investigatory proceeding, it also rejected the ALJ's recommendation as to rent expense and summarily adopted Staff's calculation of owners' investment and net annual occupancy cost. App. at 24, 95.

Likewise, not only did the PSC refuse to approve the O&M Agreement, it also rejected the ALJ's recommendation and similarly determined without further explanation "the allocation of costs presented by Staff is reasonable and should be allowed in the cost of service determined for JUI" App. at 24.

Despite substantial evidence in the record in support of the ALJ's recommendations, the PSC rejected JUI's actual rate case expense of \$86,926 and, making only a vague reference to a "lack of clarity," adopted the Staff's

⁴ The investigation instituted by the PSC was assigned Case No. 11-0235-W-GI.

recommendation of \$30,000 per year, App. at 25. Finally, the PSC rejected JUI's use of straight-line depreciation for its accumulated depreciation reserve, which was booked according to GAAP and the Uniform System of Accounts for Water Utilities⁵, App. at 27, despite the fact that the PSC always uses straight line depreciation to calculate depreciation expense.

III. SUMMARY OF ARGUMENT

The PSC clearly erred by rejecting the findings of fact, conclusions of law, and recommended decision of ALJ without making its own independent findings and conclusions, contrary to the applicable standard of review, by merely adopting Staff's recommendations and denying the utility rate adjustment requested by JUI.

The PSC should have (1) approved the affiliated O&M Agreement and Lease Agreements, including the affiliated operation and maintenance expenses and rental expenses approved by the ALJ, allowing JUI to recoup its expenses through its rate structure; (2) approved the ALJ-recommended expenses for insurance premiums, building utilities, owners' investment in the Snyder Building, rate case expenses, and accumulated depreciation reserve; and (3) approved JUI's requested amount for officer salary.

Instead, JUI is being required, unlike comparable utilities, to provide services to its customers without being able to recoup its legitimate business

⁵ The PSC's rules provide that all water utilities must maintain "their accounts and records in compliance with the Uniform System of Accounts as promulgated in 1973 by the National Association of Regulatory Utility Commissioners" W. Va. Code R § 150-7-2.5.

expenses through its rate structure, and has suffered a reduction of the 22.4 percent rate increase recommended by the ALJ to a sum of only 4.4 percent approved by the PSC, and is being subjected to an extensive general investigation proceeding.

IV. STATEMENT REGARDING ORAL ARGUMENT AND DECISION

Pursuant to R. App. P. 14(k), “The date for oral argument under Rule 19 or Rule 20 will be set forth in the scheduling order. Unless otherwise provided by order, the petitioner, the Commission and any respondent who filed a brief shall be entitled to present argument.”

V. ARGUMENT

A. Standard of Review.

With respect to the standard of review of PSC orders, this Court recently reiterated:

“The detailed standard for our review of an order of the Public Service Commission contained in Syllabus Point 2 of *Monongahela Power Co. v. Public Service Commission*, 166 W.Va. 423, 276 S.E.2d 179 (1981), may be summarized as follows: (1) whether the Commission exceeded its statutory jurisdiction and powers; (2) whether there is adequate evidence to support the Commission's findings; and, (3) whether the substantive result of the Commission's order is proper.” Syllabus Point 1, *Central West Virginia Refuse, Inc. v. Public Service Commission*, 190 W. Va. 416, 438 S.E.2d 596 (1993).

Syl. pt. 2, *Mountain Communities for Responsible Energy v. Pub. Serv. Comm'n*, 222 W. Va. 481, 665 S.E.2d 315 (2008)(citation omitted).

More specifically, with respect to the scope of review in a rate case, this Court held:

“In reviewing a Public Service Commission order, we will first determine whether the Commission's order, viewed in light of the relevant facts and of the Commission's broad regulatory duties, abused or exceeded its authority. We will examine the manner in which the Commission has employed the methods of regulation which it has itself selected, and must decide whether each of the order's essential elements is supported by substantial evidence. Finally, we will determine whether the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interests, both existing and foreseeable. The court's responsibility is not to supplant the Commission's balance of these interests with one more nearly to its liking, but instead to assure itself that the Commission has given reasoned consideration to each of the pertinent factors.” Syllabus Point 2, *Monongahela Power Co. v. Public Service Commission*, 166 W. Va. 423, 276 S.E.2d 179 (1981).

Syl. pt. 1, *Mountain Communities, supra*.

Where the PSC rejects the recommended decision of its ALJ, as it did in this case, application of these standards of review may warrant reversal of the PSC's order and a directive to adopt such recommended decision. *Community Antenna Serv., Inc. v. Pub. Serv. Comm'n*, 219 W. Va. 425, 633 S.E.2d 779 (2006); *Stowers and Sons Trucking Co., Inc. v. Pub. Serv. Comm'n*, 182 W. Va. 374, 387 S.E.2d 841 (1989).

Likewise, in the instant case, JUI submits that application of the appropriate standards of review warrants reversal of the PSC's order; adoption of the ALJ's recommendations regarding approval of the O&M Agreement and regarding expenses for insurance premiums, building utilities, owners' investment, officer's salary, and accumulated depreciation; and approval of the Lease Agreements.

B. The PSC Erred By Rejecting the Findings of Fact, Conclusions of Law, and Recommended Decision of its ALJ Without Making its Own Independent Findings and Conclusions, Contrary to the Applicable Standard of Review, and Denying the Utility Rate Adjustment Requested by JUI.

Certainly, JUI does not dispute that an ALJ's order in a rate case is only a recommendation and the PSC may reject such recommendation and render its own findings of fact and conclusions of law. The PSC, however, is not free to merely reject an ALJ's recommendations and substitute its own decision that is (1) unsupported by substantial evidence; (2) contrary to the applicable law; and (3) an abuse of discretion which does not allow a utility to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed. In this case, the PSC's decision violates all three principles.

For example, in her 45-page decision, the ALJ carefully reviewed all of the evidence, including the testimony of each witness. App. at 37-81.

With respect to the O&M Agreement, the ALJ found, based upon the evidence, as follows:

Having one O&M agreement for all of the JUI systems is consistent with the unification of the rates and will allow JUI to stop keeping separate books on each of the systems. (I Tr. 263). The old agreements are outdated; under them SES lost substantial money on the work it did for JUI. (I Tr. 264). SES services thirty-nine utility operations other than JUI. (I Tr. 270). The fees SES charges the other utilities are comparable to those it charges JUI. (I Tr. 270). The proposed O&M agreement accurately reflects what SES does for JUI; the old agreements were vague. (I Tr. 270). The flat rate is for the regular duties and the extra charges are for unforeseen duties, such as fixing water line leaks or replacing old lines with new. (I Tr. 271). It is cheaper for SES to provide services to JUI than it would be for JUI to set up an enterprise with its own employees. (I Tr. 272-273). It would take eight people to operate

JUI, which would result in lost effort; for example, if an employee fixes a leak and there is not another leak to fix, he might have nothing to do. (I Tr. 273). Mr. Snyder did not agree that JUI has no incentive to keep rates low, stating that JUI must be efficient in order to pay SES. (I Tr. 274). For the last four years he has returned his salary to JUI. (I Tr. 274). This rate case is crucial; JUI's losses are impairing SES's bond rating and SES's ability to maintain a line of credit. (I Tr. 274-276). He cannot ignore the losses any longer. (I Tr. 275). Mr. Snyder completed his direct testimony by saying to the customers in attendance at the hearing that the costs they had heard about are real, and "pretty much inescapable." (I Tr. 276).

App. at 51. Consequently, the ALJ concluded:

Clearly the eight old agreements (Exhibit C-1) are outdated, if for no other reason than that they require JUI and SES to treat the various JUI systems as separate entities. Staff argues that one problem with the proposed O&M agreement, which continues the format of the old agreements, is that "the actual services and costs to JUI under the flat fee are not functionally measured by SES[.]" Staff continues,

[T]he charges from SES to JUI should be billed only at cost plus return on investment that JUI is authorized to earn. . . . Another problem is that this revised O&M agreement contains an escalator clause, where for each new customer added to the system, the flat fee will be increased . . . to \$14.83 per new customer added. . . . Staff believes the costs to add a new customer would be at a much lower cost than the average cost per customer and should be disallowed.

The undersigned agrees with Staff that an O&M agreement between SES and JUI should be based on actual expenses and that the present format denies transparency. Unfortunately, simply disapproving the proposed O&M agreement would leave the eight old agreements in force, in that no alternative to the format of the proposed O&M agreement has been offered. Accordingly, the format of the proposed O&M agreement will be retained, including the method of calculating the fee for each new customer. However, it will be ordered that the agreement will expire three years after it comes into effect, so that JUI can prepare a more precise, cost-based O&M agreement.

App. at 67, 31.

Rather than analyzing the evidence, however, the PSC simply rejected the ALJ's conclusion as follows:

After consideration of the evidence in this proceeding and the arguments of the various parties, the Commission is not persuaded that JUI has made a "proper showing" that the O&M Agreement and the Leases with its affiliates meet the statutory test. Consequently, the Commission will not grant its prior consent and approval.

App. at 10. Moreover, even though the matters of the O&M Agreement and Lease Agreements had been fully and fairly litigated and all parties had been provided more than an ample opportunity to develop any evidence and raise any legal issues regarding these affiliate agreements, the PSC decided not to decide:

The Commission, by entry of this Order, will resolve the rate filing and simultaneously initiate a general investigation. The general investigation will involve the following issues and concerns. The Commission is concerned with the particular provisions of the O&M Agreement and the Leases and will consider each of those agreements as refiled in the general investigation. In addition, the commission is alarmed by the magnitude of the current rates as well as the level of rate increase requested by JUI. JUI will be required to persuade the Commission that JUI customers are better served by an affiliate furnishing all required services as opposed to JUI employing its own personnel. The Commission will include in the general investigation a further study of JUI's long-term plans to operate and rehabilitate its utility facilities. The Commission has previously approved a \$12 per month surcharge, but desires to receive further details concerning the use of that surcharge revenue and whether the surcharge will fund future capital requirements. Although JUI has stated that it has had discussions regarding private-public agreements, the Commission also wants further details about these discussions and future possibilities of involving public entities.

The Commission will, in the near future, issue a further order establishing procedures in the general investigation.

App. at 10.

The PSC is required by law to make findings of fact and conclusions of law to explain its decisions. W. Va. Code § 24-1-7 (“All orders of the Commission shall set forth separately findings of fact and conclusions of law which findings shall make specific reference to the evidence in the record which supports such findings.”); *see also* Syl. pt. 3., *Mountain Trucking Co. v. Pub. Serv. Comm’n*, 158 W. Va. 958, 216 S.E.2d 566 (1975) (Where an administrative agency is required to find facts or state reasons as a basis for its order, the order must contain findings of facts, rather than conclusory statements, so as to withstand judicial scrutiny).

In this case, however, the PSC made no specific findings of fact in support of its decisions to reject the O&M Agreement and Lease Agreements and to launch a wide-ranging investigation of JUI, nor did it perform any analysis of the ALJ’s detailed factual findings in support of her decisions on the various issues. The PSC’s findings of fact on these and every other issue simply recited the procedural events in the case and restated the positions of the parties on contested issues.

The PSC Order requiring JUI to “persuade” the Commission that JUI customers are better served by SES as opposed to JUI employing its own personnel violates the PSC’s own rules for management audits which put the burden of the audit on Staff or a third party, W. Va. Code R. § 150-7-2.7.d.1, and the order does not allow JUI one dime to pay for meeting this burden. Consequently, the PSC’s decision in this regard was (1) unsupported by

substantial evidence; (2) contrary to the applicable law; and (3) an abuse of discretion because it does not allow JUI to maintain financial integrity, attract necessary capital, and fairly compensate its owners for the risks they have assumed.

Another example of how the PSC simply disregarded the ALJ's recommendation without any support in the evidence or the law concerns the issue of JUI's insurance costs. In the ALJ's decision, she noted:

There is an issue in this case regarding the premiums for insurance on JUI's assets. (I Tr. 68). Mr. Griffith stated that the premiums are billed to SES, although the policies specify assets of JUI. (I Tr. 69). Staff did not allow anything for insurance. (I Tr. 69). Exhibit C-7 shows the total cost of insurance, an actual expense, to be \$44,913 and the amounts thereof attributed to SES and the different JUI water systems; JUI's portion was calculated to be \$18,852.90.

App. at 43. On cross-examination, Staff retreated from its position and agreed with JUI. App. at 63; Tr. Dec. 2, 2010, at 190. Obviously, no utility can operate without insurance coverage and because JUI presented evidence of its insurance costs, and Staff agreed, the ALJ included JUI's insurance expense in her rate calculation. On review by the PSC, however, it simply ignored the issue and, without explanation, calculated JUI's rates as if it has no insurance and no insurance expense.

These are but two examples of how the PSC simply rejected the ALJ's recommendations without any meaningful explanation and, in most cases, simply adopting Staff's arguments, without any substantial evidentiary support. Consequently, JUI submits that, with respect to those ALJ recommendations, this Court should reverse the PSC's decision and order that

the ALJ's recommendations be adopted as the PSC's decision and that JUI's rates should be increased, as of the date of the PSC's order, to the 22.4 percent recommended by the ALJ.

C. The PSC Erred By Rejecting the Affiliated Operation and Maintenance Agreement and Lease Agreements, Including the Affiliated Operation and Maintenance Expenses and Lease Expenses Approved by the ALJ, Which Would Allow JUI to Recoup its Legitimate Business Expenses Through its Rate Structure.

Under W. Va. Code § 24-2-12(f), a utility must obtain PSC approval of agreements with affiliates. When evaluating affiliate agreements, the PSC must consider (1) whether the terms and conditions thereof are reasonable; (2) whether either party is given an undue advantage over the other; and (3) whether the public is adversely affected. *Id.*

In the present case, however, although the PSC acknowledged this test in its order, it failed to discuss or consider the facts and evidence surrounding either the O&M Agreement or the Lease Agreements. Rather, the PSC summarily concluded that JUI did not make the "proper showing that the O&M Agreement and the Leases with its affiliates meet the statutory test in W. Va. Code § 24-2-12." App. at 23. A review of the record, however, demonstrates that the evidence supporting approval of the O&M Agreement and Lease Agreements meets the tests found in W. Va. Code § 24-2-12.

1. O&M Agreement

The eight existing O&M Agreements by which SES operates the company's system were previously approved by the Commission. JUI Ex. 1, Attachment No. 10, p. 2.

The proposed O&M Agreement is very similar to the eight existing agreements in that both have the same fee structure, with a flat rate for recurring duties and a time and materials rate for extraordinary work. *Compare* JUI Ex. 1, Attachment No. 10, Ex. A, *with* JUI Ex. 1, Attachment No. 10, Ex. B.

The differences between the old agreements and new agreement are that there is one agreement instead of eight, Tr. Dec. 1, 2010, at 263; the new agreement has increased the flat rate and added a consumer price index inflator, Id. at 271; and the new agreement specifies in more detail the duties and obligations of both parties, Id. at 270-71.

In light of the similarity between the agreements and the PSC's previous consent and approval, it is difficult to understand why the PSC refused to consent to and approve the O&M Agreement. Clearly, the statute allows approval of the entering into the agreement without approving the terms and conditions affecting rates, which can be deferred until later. Moreover, as determined by the ALJ, there was substantial evidence supporting approval of the O&M Agreement.

First, Mr. Snyder provided detailed testimony on the benefits and need for the O&M Agreement. Indeed, Mr. Snyder testified that it is more cost efficient for SES to operate and maintain JUI's system. Id. at 272. Mr. Snyder also testified that it would be more expensive for ratepayers if JUI were staffed with its own employees instead of contracting for services from SES. Id. at 272-73. Mr. Snyder testified that SES charges JUI the same rates for services

that SES charges non-affiliated customers. Tr. Dec. 2, 2010, at 35. Finally, Mr. Snyder noted that the O&M Agreement is prudent as there is no incentive for SES to overcharge JUI for services because there is no incentive for SES to perform work for which it will never be paid. Tr. Dec. 1, 2010, at 274.

Second, Staff's objection to the O&M Agreement was not well developed as it simply argued that the agreement would have a "detrimental effect" on rates. Staff Ex. 3, p. 1; Tr. Dec. 2, 2010, at 174-75. Of course, taking that argument to its logical extreme, no utility expense should be approved as approval would have a "detrimental effect" on rates.

When pressed at the hearing, Staff witness Pauley argued that JUI has no way of tracking what services and expenses are associated with the flat fee portion of the agreement. Tr. Dec. 2, 2010, at 154-55. This argument fails for three reasons: (1) the O&M Agreement spells out the services to be provided; (2) the O&M Agreement is virtually identical to the existing operation and maintenance agreements previously approved by the PSC; and (3) Staff was able to formulate recommended costs JUI incurred under the agreement.

Staff also could not provide an alternative to the O&M Agreement. Mr. Pauley acknowledged this when asked for his alternate proposal: "No, sir, I don't know exactly how to design the contracts to remedy the situation. That has to be worked out with the company." Tr. Dec. 2, 2010, at 198-99.

Again, the ALJ concluded, "simply disapproving the proposed O&M agreement would leave the eight old agreements in force, in that no alternative to the format of the proposed O&M agreement has been offered. Accordingly,

the format of the proposed O&M agreement will be retained, including the method of calculating the fee for each new customer. However, it will be ordered that the agreement will expire three years after it comes into effect, so that JUI can prepare a more precise, cost-based O&M agreement.” App. at 67.

Respectfully, this Court should reverse the PSC decision and reinstate the ALJ’s recommendation regarding the O&M Agreement.

2. Lease Agreements

Prior to the summer of 2009, SES and JUI operated out of two trailers and a shop/warehouse. Tr. Dec 1, 2010, at 260. In 2009, Mr. and Ms. Snyder constructed a new office building adjoining the shop/warehouse and JUI and SES moved into the Snyder Building. Id. at 260-61. The new building is located on Lots 16 and 17 of the Bardane Industrial Park in Jefferson County. ALJ Ex. 1. Lot 17 is owned by Snyder, LLC, while Lot 16 is owned by Mr. and Ms. Snyder. Id. So that the new building could be leased to Jefferson Utilities, Mr. and Ms. Snyder leased Lot 17 from Snyder, LLC. Id. Mr. and Ms. Snyder leased the new building to JUI, which in turn, subleases the portion of the building not needed for its operations to SES.⁶ Id.

Two payments are made under the Lease Agreements: one payment is made from JUI to Mr. and Ms. Snyder and another is made from SES to JUI, which payment is passed on to Mr. and Ms. Snyder. Id. The legal structure of

⁶ In fact, the building was constructed specifically to provide facilities to meet the needs of JUI. These include a drive-up window for payment, an inside lobby for customers and adequate security for company personnel. Tr. Dec. 1, 2010, at 255, 260.

the Lease Agreements was selected on the basis of professional tax advice. Tr. Dec. 1, 2010, at 261.

Because of the nature of the relationship between JUI and SES, it is efficient and necessary for them to occupy the same office space, i.e., because SES personnel perform most of the operation and maintenance associated with JUI's system it makes sense for both entities to be located in the same building.

Testimony was presented by JUI as to the reasonableness of the Lease Agreements. Its accountant, Mr. Griffith, testified that the Lease Agreements were commercially reasonable, Tr. Dec. 1, 2010, at 89, and that while there were other alternatives, the Lease Agreements provide "a good space for the utility and for the customers to come transact business." Id. at 90.

Staff did not completely oppose the Lease Agreements as it recognized there "needs to be a lease agreement between the affiliates." Tr. Dec. 2, 2010, at 152. Rather, Staff objected to the manner in which the Lease Agreements were structured and made the vague argument that there could "be some financial harm to the ratepayer at some point" Id. at 152-53. Other than this vague objection, Staff neither addressed why the Lease Agreements should not be approved nor proposed an alternative.

The ALJ rejected the Lease Agreements simply because, in the ALJ's opinion, they were complicated:

Indeed, Commission Staff has simply objected to the Lease Agreements and left the Commission to decide what structure is appropriate. As a result, **Commission Staff's objection to proposed Lease Agreements must be rejected.** (JUI IB 14).

However, Staff was clear that it did not like JUI's being the tenant to the owner and SES's being the tenant of JUI; it is clear that Staff found the only reasonable arrangement would be for the owners to rent the lots, with the building, to SES. Mr. Snyder's testimony indicated that he too was uncomfortable with JUI's subleasing to SES; the only justification he could provide was that leasing the lots to JUI would provide a tax benefit (and it was not clear that JUI, rather than SES, would benefit). (See II Tr. 41). That is not a sufficient basis for the proposed complicated leasing structure, particularly since it is clear that SES is the true user of the building on the lots, which houses SES's employees exclusively, and all vacant parts of which are considered to be SES's. In short, it was JUI's burden to show that the agreements were reasonable, and it did not do so.

App. at 66 (emphasis supplied). So, even though the ALJ found Staff's superficial objection to be without merit, but simply because Staff "did not like" an arrangement made by JUI and SES with the advice of its accountant because of the tax advantages, which would benefit JUI's customers, the ALJ refused to recommend approval of the Lease Agreements.

Respectfully, because JUI's evidence was not rebutted regarding the reasonableness of the Lease Agreements, this Court should approve those agreements and remand to the PSC with directions to include JUI's expenses from those agreements in its rate calculations. *United Fuel Gas Co. v. Pub. Serv. Comm'n*, 154 W. Va. 221, 174 S.E.2d 304 (1969) ("The Public Utility Commission is not a super board of directors for the public utility companies of the State and it has no right of management of them. Its sole power is to see that in the matter of rates, service and facilities, their treatment of the public is fair").

3. General Investigation

Strangely, instead of deciding the case based upon the evidence presented, the PSC decided to “initiate a general investigation of the proposed O&M Agreement and Leases” and a host of other unrelated subjects. App. at 23.

The PSC provided no insight, reasoning, or authority for initiating a general investigation of matters that were the subject of a two-day evidentiary hearing, a thorough and well reasoned recommended decision by the ALJ, and extensive briefing by the parties, nor any explanation why it shifted the burden of the investigation to JUI while denying it any funds to participate.

Respectfully, JUI should not be required to incur the burden and expense attendant to twice litigating the same issues, nor to defending a broad general investigation on a number of other subjects.

D. The PSC Erred By Rejecting the ALJ Recommended Expenses for JUI’s Insurance Premiums, Rent, Rate Case Expense, and Accumulated Depreciation, and By Reducing JUI’s Expense for Officer Salary.

The PSC erred by failing to approve ALJ recommended expenses for JUI’s insurance premiums, rent, rate case expense, and accumulated depreciation.

1. Insurance Premiums

JUI’s rate request included an \$18,853 figure for an insurance expense. JUI Ex. 2, Attachment No. 3, at 7. The expense pays to insure various utility assets of the Company. Tr. Dec. 1, 2010, at 69. A breakdown of the utility assets covered by the insurance premium and a copy of the declaration pages were placed into evidence by JUI. JUI Ex. 7.

Staff did not include the \$18,853 insurance premium expense in its recommended cost of service, see Staff Ex. 2, although at the hearing Mr. Pauley conceded that the amount should be allowed, Tr. Dec. 2, 2010, at 190.

There being no dispute between JUI and Staff regarding the insurance premium expense, the ALJ included an \$18,853 annual expense in the JUI's cost of service for insurance premiums. App. at 43. Yet, in the PSC's Order, without discussion, it denied JUI any insurance expense.⁷

As the evidence provided by JUI in support of the \$18,853 insurance premium expense was not rebutted and because the PSC failed to make a specific finding regarding the expense, the expense should be allowed in JUI's cost of service.

2. Rent

Because JUI and SES both occupy the Snyder Building, it is necessary to calculate and apportion a fair rental. JUI and Staff both followed the same method, which is to calculate a fair annual return on owners' investment, add building expenses, and then apportion the result between JUI and SES.

In the matter of owners' investment, JUI presented a detailed list of costs associated with the construction of the Snyder Building, which totaled \$3,118,524. JUI Ex. 4. Staff presented a less detailed list that totaled

⁷ While the PSC's order did not specifically address the insurance premium expense, it clearly denied the expense. The O&M expense approved by the PSC totaled \$959,161, App. at 36, which is the amount Staff recommended, App. at 24. As noted previously, Staff did not include the \$18,853 insurance premium expense in its recommended cost of service. See Staff Ex. 2. So by adopting the \$959,161 operation and maintenance expense recommended by Staff, the PSC clearly did not allow the \$18,853 insurance premium expense.

\$2,411,704. The ALJ considered the evidence of both parties and found the proper amount to be \$3,110,524, which was JUI's total less a duplicative \$8,000 appraisal. App. at 66-67, 78.

The PSC rejected the ALJ's finding regarding owners' investment and adopted Staff's position, without further discussion, as "reasonable." App. at 24. There was no discussion as to why Staff's amount was "reasonable" or why the actual costs incurred by the owners were ignored. The PSC simply noted Staff's objection to JUI's proposed number and then summarily found Staff's calculation to be reasonable. Thus, the \$3,110,524 owners' investment amount approved by the ALJ should be reinstated as the evidence supported the finding, and the PSC failed to discuss the findings required to support its decision.

The second element of rent is building expenses. JUI presented evidence that during the test year the Snyder Building incurred actual utility expenses of \$11,712. JUI Ex. 3; Tr. Dec. 1, 2011, at 59-60. Staff did not include utility expenses associated with the leased building. Staff Ex. 3, DLP-4.

The ALJ included JUI's share of the Snyder Building's utility expenses in JUI's cost of service. App. at 78. The ALJ reasoned that the \$11,712 was proper and noted that Staff provided no explanation for why the amount should not be approved. App. at 78.

Similar to the foregoing discussion regarding the insurance expenses, the PSC's Order contains no discussion or finding regarding the utility expenses. Utility expenses were clearly denied because the total operation and

maintenance expense adopted by the PSC, which amount represents what was recommended by Staff, does not include an amount for utility expenses. Thus, the PSC again denied, without a finding of fact or conclusion of law, an expense amount that was actually incurred and supported by unrebutted evidence.

Because JUI provided unrebutted evidence in support of its utility expenses and because the PSC failed to make a specific finding regarding the expense, the \$11,712 expense approved by the ALJ should be allowed in the JUI's cost of service.

The final piece of the rent calculation is to apportion the expenses and annual return on investment between SES and JUI.

JUI presented a detailed study of the space occupied by employees who performed duties for SES and how much of their time was so devoted. JUI Ex. 3. JUI calculated that 22.9% of the office was used for JUI business. *Id.*

Staff presented an estimate of 10.3% based on its "observations", which may or may not have included actually asking employees how much time they spent on JUI business, *Tr. Dec. 2, 2010, at 190-91*, and certainly did not include talking to Mr. Snyder, *id.*, at 193. Staff testified that it reduced JUI's occupancy study numbers based on "[m]y experience with utilities and their rates." *Id.* at 192. The ALJ found the evidence conflicting, and split the difference, allocating 16.6% of the Snyder Building to JUI. *App. at 41-42.*

With no substantive discussion, the PSC found the ALJ's decision to split the difference "not supported by the evidence" and again went with the Staff, finding that Staff's 10.3% was "more reasonable." *App. at 24.* The

preponderance of the evidence clearly supports JUI's position on rent, or at least the ALJ's. Accordingly, the PSC's Order should be reversed on this point.

3. Rate Case Expense

JUI experienced substantial professional services expenses during the test year. Its filing sought to recover these expenses, as well as the expected cost of the rate case, spread over five years at \$81,886 per year. JUI Ex. 10. The ALJ allowed recovery of both of these items. App. at 33, 79. The PSC denied recovery of the outside services expenses, reasoning only that allowance would imply that they were "normal expenses," App. at 25, and that due to a "lack of clarity" in JUI's case and the Recommended Decision, the PSC would use the Staff's allowance, \$30,000. There was no finding by the PSC that JUI's costs were unreasonable.

The PSC's refusal to allow JUI to recover its test year outside services costs, while virtually guaranteeing that it will continue to incur outside services costs defending the PSC's broad general investigation, is unreasonable, contrary to the evidence and arbitrary.

4. Depreciation

Depreciation is an allowance for the consumption of capital. *Lindheimer v. Illinois Bell Tel. Co.*, 292 U.S. 151 (1934).

Per IRS regulations, JUI claims accelerated depreciation for income tax purposes and records depreciation expense and accumulated depreciation on its books using this accelerated method. For ratemaking purposes, the PSC calculates depreciation expense using the straight line method following the

Uniform System of Accounts for Water Utilities. Accelerated depreciation expense is usually larger than straight line expense.

In previous cases, JUI had adjusted its depreciation expense claim to conform to the PSC's mandated straight line method, but mistakenly had not adjusted its reserve, continuing to reflect the reserve accumulated under the accelerated method. This overstated its reserve for depreciation and understated its net plant compared to a calculation based on straight line depreciation. Tr. Dec. 1, 2010, at 75-79. In this case, JUI calculated both depreciation expense and the depreciation reserve based on the straight line method. Id. at 75-76. The Staff and the PSC however, allowed depreciation **expense** calculated on the straight line method, but refused to adjust the **reserve** to reflect the straight line method, the PSC reasoning, essentially, that JUI was bound by the mistake it had always made. Id. at 78; App. at 26-27.

By refusing to calculate the depreciation reserve using the straight line method as it did to calculate the depreciation expense, the PSC used inconsistent and conflicting methods. Because the PSC-mandated accumulated reserve for depreciation (using accelerated depreciation) is building faster than the expenses allowed, this inconsistency will result in the JUI's plant investment being completely depreciated (in the PSC's view) before JUI has recovered sufficient funds to provide for the consumption of its capital. The PSC's refusal to rectify this situation is reversible error.

5. Officer Salary

Mr. Snyder's salary expense was one of the more contentious matters in these proceedings. JUI booked and claimed \$55,000 salary expense for its president and only employee. JUI Ex. 2, Attachment No. 3, at 7.

Staff, on the other hand, recommended a paltry \$15,000 be allowed for Mr. Snyder's salary. Staff Ex. 2, at 4. In arriving at its salary recommendation, Staff was somewhat confused by how Mr. Snyder's salary was handled in a previous rate case:

I kind of misread from the prior case where they had actually removed the entire \$55,000, but . . . when the case was settled they added back \$15,000 and allowed \$40,000. And I had it turned around different so the \$15,000 doesn't actually match the description.

Tr. Dec. 2, 2010, at 132. Undaunted by his admitted confusion, however, Mr. Pauley did not alter his recommendation: "We're sticking to the \$15,000 even though the descriptions were wrong." *Id.* at 133. Of course, this makes a mockery of the fact-finding process.

Likewise, the ALJ's recommendation was contrary to the evidence. Indeed, the ALJ recommended that Mr. Snyder receive NO compensation for his work as JUI's president and only employee. App. at 78-79. In reaching her finding, the ALJ found that the record supported a finding that Mr. Snyder should not be considered an employee of the Company. App. at 78-79. Also, the ALJ speculated that because Mr. Snyder may receive profits from JUI, App. at 68, a salary expense was not warranted. ***It should be noted, however, that JUI has never made a profit.*** Tr. Dec. 1, 2010, at 244-45.

The findings by the ALJ with respect to Mr. Snyder's entitlement to no compensation, however, were rejected by the PSC. App. at 24. Specifically, the PSC found that Staff did not adequately support its proposed reduction in Mr. Snyder's salary, but that JUI did not adequately support its figure either. App. at 24. Instead, the PSC allowed \$40,000 in JUI's cost of service for Mr. Snyder's salary, the amount approved in the last JUI case.

Contrary to the PSC's finding, JUI did adequately support its \$55,000 salary amount for Mr. Snyder. Specifically, three witnesses testified regarding the amount of time and effort devoted by Mr. Snyder to JUI.

First, Mr. Womack testified that for the year 2009, Mr. Snyder spend 1,966 hours working on matters related to the management and operation of JUI. Tr. Dec. 1, 2010, at 145.

Second, Mr. Snyder testified that his daily duties include the following: (1) handling of customer complaints; (2) preparation of alternate extension agreements; (3) attending county water advisory board meetings; and (4) meeting with housing developers. Id. at 252-54. Mr. Snyder also testified that he devotes almost 2,000 hours a year to matters related to JUI. Id. at 234; see also Tr. Dec. 1, 2010, at 279.

Finally, Mr. Griffith testified that Mr. Snyder devotes a considerable amount of time and expertise to the management of the Company. Id. at 68.

The foregoing evidence amply demonstrates that Mr. Snyder spends a tremendous amount of time managing Jefferson Utilities. The record is void of any evidence calling into question the substantial amount of time Mr. Snyder

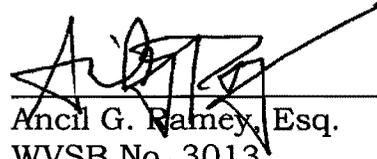
devotes to managing Jefferson Utilities. Thus, the PSC's \$40,000 salary amount was not supported by substantial evidence, contrary to the evidence, and should be overturned.

VI. CONCLUSION

JUI respectfully requests the following relief: (1) the PSC's decision to deny approval of the O&M Agreement, contrary to the ALJ's recommendation, be reversed and the PSC ordered to adopt the ALJ's recommendation; (2) the PSC's decision to reject the ALJ's recommendations regarding insurance premiums, rent, rate case, and accumulated depreciation expenses be reversed and the PSC ordered to adopt the ALJ's recommendations; (3) the PSC's decision to deny approval of the Lease Agreements be reversed and the PSC ordered to recalculate JUI's rates based upon the expenses incurred by JUI pursuant to such agreements; (4) the PSC's decision to reduce the salary for JUI's sole employee be reversed and the PSC ordered to recalculate JUI's rates based upon the salary actually booked; and (5) either the PSC's decision to reduce the ALJ's recommended rate increase from 22.4 percent to only 4.4 percent be reversed and the PSC ordered to adopt the ALJ's recommendation or, in the alternative, the PSC be ordered to recalculate JUI's rates based upon this Court's rulings on the errors alleged by JUI.

JEFFERSON UTILITIES, INC.

By Counsel

A handwritten signature in black ink, appearing to read 'Ancil G. Ramey', is written over a horizontal line.

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CERTIFICATE OF SERVICE

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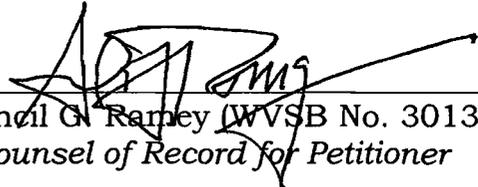
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