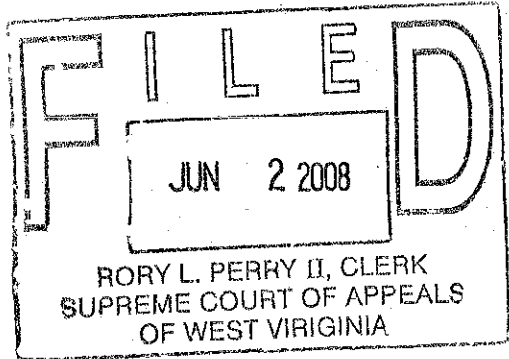


**IN THE SUPREME COURT OF APPEALS  
OF WEST VIRGINIA  
CHARLESTON**



**VALLEY WATER & SEWER SERVICES, INC.,**

**Appellant,**

**v.**

**No. 33899**

**PUBLIC SERVICE COMMISSION OF WEST VIRGINIA  
AND DEERWOOD HOMEOWNERS ASSOCIATION,**

**Appellees.**

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**INITIAL BRIEF OF THE PUBLIC  
SERVICE COMMISSION OF WEST VIRGINIA**

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**PUBLIC SERVICE COMMISSION  
OF WEST VIRGINIA**

**By Counsel,**

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**June 2, 2008**

**TABLE OF CONTENTS**

	<b><u>Page</u></b>
TABLE OF AUTHORITIES .....	i-iv
STATEMENT OF THE CASE .....	2
ASSIGNMENT OF ERROR .....	10
SUMMARY OF ARGUMENT .....	11
STANDARD OF REVIEW .....	11
 INITIAL BRIEF AND NOTE OF ARGUMENT	
<b>I. THE COMMISSION'S ORDER PROPERLY DENIED VALLEY'S SURCHARGE TO PAY BACK EXPENSES TO SES BECAUSE THE EXPENSES WERE OUTSIDE THE HISTORICAL TEST YEAR .....</b>	<b>13</b>
<b>II. THE COMMISSION'S ORDER PROPERLY GRANTED VALLEY'S RATE CASE/ACCOUNTING AND LEGAL EXPENSES BECAUSE THE EVIDENCE SUPPORTED \$10,000 OVER A FIVE (5) YEAR PERIOD OR \$2,000 A YEAR .....</b>	<b>29</b>
CONCLUSION .....	32

## TABLE OF AUTHORITIES

<u>CASES</u>	<u>PAGE</u>
<u>Baltimore &amp; Ohio Railroad v. Public Service Commission,</u> 99 W.Va. 670, 130 S.E. 131 (1925) .....	11
<u>Braxton County Citizens For A Better Environment v. Public</u> <u>Service Comm.,</u> 190 W.Va. 416, 429 S.E.2d 899 (1993) .....	13
<u>Central W.Va. Refuse v. Public Service Commissionn,</u> 190 W. Va. 416, 438 S.E.2d 596 (1993) .....	25
<u>Chesapeake and Potomac Telephone Co. of WV v. Public</u> <u>Service Commission,</u> 171 W.Va. 494, 300 S.E.2d 607 (1982) .....	13,19,25,27
<u>City of Charleston. et al. v. Public Service Commission,</u> 110 W. Va. 245, 159 S.E. 38 (1931) .....	26
<u>Harrison Rural Electrification Association, Inc.v. Public</u> <u>Service Commission and Monongahela Power Company,</u> 190 W.Va. 439, 438 S.E.2d 782 (1993) .....	13,22,23
<u>Monongahela Power Co. v. Public Service Commission,</u> 166 W.Va. 423, 176 S.E.2d 179 (1981) .....	12, 13
<u>Permian Basin Area Rate Cases,</u> 390 U.S. 747 (1968) .....	12
<u>Pittsburgh &amp; West Virginia Gas Company v. The Public Service</u> <u>Commission of West Virginia,</u> 101 W. Va. 63, 132 S.E. 497 (1926) .....	26
<u>Preston Co. Light &amp; Power Co. v. Public Service Commission,</u> 197 F. Supp. 759 (S.D. W.Va. 1969) .....	11,12
<u>State of West Virginia ex rel. The Public Service Commission of</u> <u>West Virginia. v. Town of Fayetteville, Municipal Water Works,</u> 212 W. Va. 427, 573 S.E.2d 338 (2002) .....	26
<u>United Fuel Gas Company v. Public Service Commission,</u> 73 W. Va. 571, 80 S.E. 931 (1914) .....	26
<u>United Fuel Gas Co. v. Public Service Commission,</u> 143 W.Va. 33, 99 S.E.2d 1 (1957) .....	12

Virginia Electric & Power Co., v. Public Service Commission,  
162 W.Va. 202, 242 S.E.2d 698 (1978) .....12,19

Wilhite v. Public Service Commission,  
150 W.Va. 747, 149 S.E.2d 273 (1966) .....12

**COMMISSION ORDER**

Appalachian Power Company, Case No. 79-140-E-42T,  
(Commission Order entered May 27, 1980, and  
Corrective Order entered June 13, 1980) .....21

Arbuckle Public Service District, Case No. 03-0388-PSD-19A,  
(Commission Order entered January 13, 2004) .....28

-i-

Back Creek Valley Utilities, Case No. 95-0621-W-19A,  
(Commission Order entered June 25,1996) .....20

Blacksville Oil & Gas Company, Case No. 79-486-6-42T (Order Modifying  
Hearing Examiner's Recommended Decision entered November 10,1980).. .21,22,25

Boone-Raleigh Public Service District, Case No. 06-1472-PSWD-PC,  
(Commission Order entered January 23, 2007) .....28

City of Cameron, Case No. 03-0724-W-MA,  
(Commission Order entered October 17, 2003) ..... 29

City of Huntington, Case No. 04-0949-S-MA,  
(Commission Order entered September 4, 2007) ..... 28

Greenbrier County Public Service District No. 2,  
Case No. 07-0072-PSD-42T, (Commission Order entered August 29, 2007).. .21

Huntington Sanitary Board, Case No. 05-0624-S-CN,  
(Commission Order entered November 17, 2005) ..... 28

Lubeck Public Service District, Case No. 03-1473-PWD-CN,  
(Commission Order entered June 14, 2005) ..... 28

Monongahela Power Co., Case No. 89-532-E-P,  
(Commission Order entered March 16, 1992).. ..... 25

Morgan Sanitation & Recycling Corp., Case No. 98-1339-SWF-CN  
(Reopened), (Commission Order entered May 11, 2000) ..... 25

<u>Putnam Public Service District</u> , Case No. 03-0303-PWD-42T, (Commission Order entered January 27, 2004) .....	28
<u>Putnam Public Service District</u> , Case No. 06-1291-PWD-T, (Commission Order entered December 4, 2006) .....	28
<u>South Putnam Public Service District</u> , Case No. 05-0660-PWD-CN, (Commission Order entered January 10, 2006) .....	28
<u>Southern Public Service Company</u> , Case Nos. 81-233-G-42T, 81-234-G-42T, 81-235-G-42T(Commission Order Modifying Hearing Examiner’s Decision).	23,24
<u>Union Oil &amp; Gas, Inc.</u> , Case No. 06-0410-G-42T, (Commission Order entered January 11, 2007). .....	20
<u>West Virginia-American Water Company</u> , Case Nos. 92-0113-W-PC and 92-0250-W-42T (Commission Order entered May 19, 1994). .....	17
<u>West Virginia-American Water Company</u> , Case No. 94-0138-W-42T, (Commission Order entered December 22, 1994) .....	17
<u>West Virginia Water Development Authority v. City of Huntington</u> , Case No. 03-1678-S-C, (Commission Order entered September 4, 2007) ....	28

**STATUTES**

<u>West Virginia Code §24-1-9</u> .....	22
<u>West Virginia Code §24-2-3</u> .....	25
<u>West Virginia Code §24-2-11</u> .....	2,4
<u>West Virginia Code §24-5-1</u> .....	11

**PUBLIC SERVICE COMMISSION RULES AND REGULATIONS**

150 CSR § 1 <u>RULES OF PRACTICE AND PROCEDURE</u> (2004). .....	3
150 CSR § 2 <u>RULES FOR THE CONSTRUCTION AND FILING OF TARIFFS</u> (2002). .....	4,14

**OTHER**

National Association of Regulatory Utility Commissioners (NARUC)  
Rate Case and Audit Manual (Summer 2003)..... 14,15

**TREATISE**

The Regulation of Public Utilities Theory and Practice, (2d ed. 1988),  
by Charles F. Phillips, Jr. .... 15,17

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**Appellees.**

---

**INITIAL BRIEF OF THE PUBLIC  
SERVICE COMMISSION OF WEST VIRGINIA  
FOR THE ENTRY OF ITS ORDERS  
OF SEPTEMBER 28, AND OCTOBER 30, 2007,  
IN CASE NO. 07-0448-W-42T-CN**

---

**TO THE HONORABLE JUSTICES OF THE SUPREME COURT OF APPEALS OF  
WEST VIRGINIA:**

The Appellee, the Public Service Commission of West Virginia ("Commission" or "PSC"), hereby submits for filing with this Honorable Court this Initial Brief for the entry of its Orders of September 28, and October 30, 2007, in Case No. 07-0448-W-42T-CN.

## STATEMENT OF THE CASE

On March 21, 2007, Valley Water & Sewer Services, Inc., (Valley), filed a Rule 42T application to increase its rates and charges for providing current water service unrelated to the project. The proposed non-project rate increase is 57.6%. In this case, Valley also filed an application for a certificate of convenience and necessity to construct a new water storage tank to serve its approximately eighty-four (84) customers in Berkeley County pursuant to West Virginia Code §24-2-11. The certificate application proposed an additional project-related rate increase of approximately 32.6%. This increase is over and above the non-project rate increase of 57.6%. Valley estimated that construction will cost approximately \$250,000 for the new tank. Valley proposed that the construction will be financed with a bank loan.

In Case No. 01-1343-W-C, Valley was ordered to file for a certificate of convenience and necessity to build the tank prior to June 1, 2004, under the terms of the settlement of the first complaint case. Valley admitted that it did not comply with the settlement agreement in the first complaint case. Valley justified the failure because it believed that the then-current President of the Association told him that the Deerwood Homeowners Association, Inc. (Association) could live with the leaking tank as long as the rates were not increased. (Tr. 33, 38 ) . In the above-stated complaint, Valley never petitioned the Commission to obtain an extension of time to build the tank in order to not violate the settlement agreement.

In Case No. 06-0508-W-C, the Association filed a second complaint. Valley was ordered again to file a certificate of convenience and necessity to replace its water tank which led to the current general rate case and certificate case. (Tr. 10).

By its Notice of Filing Order entered on March 29, 2007, the Commission ordered Valley to give notice of the increased non-project rates and the certificate filing with the additional increased project rates to construct the new water storage tank to serve the Deerwood Subdivision in Berkeley County, by publishing a copy of the Notice of Filing once in a newspaper, duly qualified by the Secretary of State, published and of general circulation in Berkeley County, making due return to the Commission of proper certification of publication immediately thereafter. The Notice provided that anyone desiring to protest or intervene should file a written protest or notice of intervention within thirty (30) days following the date of publication, unless otherwise modified by Commission Order. The Notice of Filing Order warned that failure to timely protest or intervene could affect a protestant's or intervenor's right to protest aspects of the certificate case, including any associated rate increases, or to participate in future proceedings. The Notice also stated that all protests or requests to intervene should briefly indicate the reason for the protest or intervention. Requests to intervene also had to comply with the Commission's rules on intervention set forth in the Commission's Rules of Practice and Procedure (2004), 150 C.S.R. 1 (Procedural Rules). Finally, the Order stated that, if no protests were received within the thirty-day period, the Commission could waive formal hearing and grant the

application based on the evidence submitted with the application and the Commission's review thereof.

On April 10, 2007, Valley filed a letter certifying that the Certificate of Posting, Publication, and Separate Mailing of Notice to its Customers to comply with the notice requirements in the Commission's Rules for the Construction and Filing of Tariffs (2002), 150 C.S.R. § 2 (Tariff Rules).

On April 13, 2007, Staff Attorney Ronald E. Robertson, Jr., filed the Initial Joint Staff Memorandum stating that the Commission Staff was reviewing the non-project rate case and the certificate project case and would file a final recommendation upon completion of the review.

On April 24, 2007, the Commission suspended the use of the non-project related rates and charges until August 30, 2007; referred the proceeding to the Division of Administrative Law Judges (ALJ) with a decision due date of on or before July 17, 2007, on the issue of the non-project related rates, and a decision due date of on or before October 17, 2007, on the application for a certificate of convenience and necessity; and directed Commission Staff to file its report regarding the non-project related rates on or before May 29, 2007.

On May 10, 2007, Valley filed the affidavit of publication evidencing that the Notice of Filing had been published on April 6 and 13, 2007, in The Journal, a newspaper of general circulation in Berkeley County to comply with West Virginia Code §24-2-11. There were no protests filed.

On May 29, 2007, Staff filed its Final Non-Project Staff Report recommending a 17.4% across-the-board increase to Valley's current rates and approval for a 9.16% rate of return.

By Procedural Order issued on June 11, 2007 by the ALJ, the matter was set for hearing on July 11, 2007, in Martinsburg, West Virginia, for the purpose of addressing both the non-project-related rate increase and the project-related rates increase. Valley was directed to publish a Notice of Hearing, once a week for two consecutive weeks, and to provide the affidavit of publication to the Commission at the hearing. Staff was already directed to file its report regarding the project-related rates on or before June 21, 2007.

On June 15, 2007, Valley filed a Motion to toll the statutory decision deadline and to extend the ALJ's decision due date.

By Commission Order dated June 26, 2007, the Commission tolled the statutory period for thirty-two (32) days, from August 30, 2007, until October 1, 2007 and extended the ALJ's decision due date for thirty (30) days, from July 17, 2007, until August 16, 2007.

On July 9, 2007, the Association petitioned to intervene in the proceeding. By Procedural Order issued July 10, 2007, the Association was granted party status by the ALJ.

On July 9, 2007, Staff filed a Further Final Non-Project Staff Report recommending 18.7% across-the-board increase to Valley's per book rates and Staff's non-project recommended rates would generate a net operating income of \$6,994, a cash flow surplus of \$817 and provide a 9.15% rate of return.

On July 10, 2007, Staff filed its Final Project Staff Report recommending an additional 43.8% across-the-board increase to Valley's per book rates for constructing the new tank and Staff's project recommended rates would generate a net operating income of \$24,8644, a cash flow surplus of \$8,170 and provide a 8.54% rate of return. Staff further recommended that: 1) Valley certificate application to construct the new water storage tank be approved subject to receiving a construction permit from the West Virginia Health Department; 2) the bank loan from the City National Bank in the amount of \$220,000 at an initial interest rate of 8% for a period of ten (10) years be approved; and 3) Valley explore the possibility of transferring its system to another utility, i.e. Berkeley County Public Service Water District.

On July 10, 2007, Valley published the Notice of the July 11, 2007, Public Hearing in The Journal, a newspaper published and generally circulated in Berkeley County, West Virginia, that described the new tank project and stated Valley's combined non-project and project requested rates.

On July 11, 2007, the hearing was held as scheduled in Martinsburg, West Virginia. E. Dandridge McDonald, Esquire, appeared on behalf of Valley. Kenneth J. Ford, Esquire, appeared on behalf of the Association. Ronald E. Robertson, Jr., Esquire, appeared on behalf of Commission Staff.

On July 17, 2007, a transcript of the July 11, 2007, hearing, consisting of 182 pages of testimony and 9 exhibits were filed.

On August 18, 2007, the ALJ issued a Recommended Decision that:

- adopted a Commission-approved rate of return for a similar water utility as an adequate method of establishing a rate of return for Valley given its small number of customers. The rate of return in this should be the same as approved by the Commission for the Beckley Water Company in Case No. 06-0373-W-42T, which was 8.84%;
- the rate case expense allowed by Commission Staff \$10,000 over a five (5) period or \$2,000 per year is reasonable and should be used to develop rates in this case. Valley was requested rate case expense of \$40,389 over three (3) years or \$13,463 per year. Valley's efforts to collect expenses which were not incurred for this case and which were not part of the test year must be rejected;
- given all the circumstances, it is not reasonable for the Commission to attempt to force the stockholder of Valley to make a major infusion of equity capital in Valley and approved the tank financing and 100% recovery of the cost of financing from the ratepayers:
- rejected to place into rate base money that Valley owes to Snyder Environmental Services (SES), an affiliate of Valley, for O&M services because to place the debt into rate base would be improper rate making. The ALJ stated that it would create an added burden upon ratepayers which would never go away and old services do not depreciate;
- did not ignore the legitimate operational debt owed by Valley to SES and approved a surcharge to be added to the tariff which spreads the debt owed to SES for O&M services over a period of twenty-five (25) years;
- denied the Association any discount on rates based simply on Valley's failure to construct the new tank in a more timely fashion;

- granted the certificate and approved the need of the project to construct the new water storage tank subject to receiving a construction permit from the West Virginia Health Department;
- approved the proposed financing of a bank loan of \$220,000 with an interest rate of 8% for ten years as reasonable;
- approved the pre-project rates attached as Appendix A as reasonable, just, based primarily on the cost of providing service and should be approved for all service rendered after the suspension period
- approved the post-project rates attached as Appendix B as reasonable, just, based primarily on the cost of providing service and should be approved for all service rendered after the substantial completion of the project; and
- required Valley to explore the possibility of transferring its system to another utility given all the circumstances of this case, including the very high rates and small customer base.

On August 31, 2007, Staff filed exceptions to the ALJ's August 18, 2007, Recommended Decision stating that Conclusions of Law No. 3-Financing the Tank should not be paid 100% by the ratepayers, and Nos. 5 and 6-Surcharge to Repay Valley's Debt Owed to SES should not be approved over a period of twenty-five (25) years.

On September 10, 2007, Valley filed a response to Staff's exceptions stating that Conclusions of Law Nos. 3, 5, and 6 were correct. In its response, the Utility requested that the Commission alter the Administrative Law Judge's (ALJ) decision to disallow \$40,389

in legal and accounting expenses incurred in Case No. 06-0508-S-C and the present case. Valley again requested that these expenses be amortized over a period of three years (3) at \$13,463 per year.

In its September 28, 2007, Order, the Commission: 1) adopted the ALJ's Recommended Decision conclusion of law 3- Financing the Tank which required the ratepayers to pay for 100% of the tank financing; 2) did not adopt conclusions of law 5 and 6-Surcharge to Repay Valley's Debt Owed to SES of the ALJ's Recommended Decision because the debt sought to be recovered by the surcharge was debt incurred outside of the historical test year; therefore, should not be included in determining rates and charges in the present case; 3) denied Valley's exception concerning recovery of attorney and accounting expenses because Valley provided no compelling argument to overturn or alter the ALJ's Recommended Decision on this issue; 4) required Staff to file a petition with the Commission requesting a general investigation of Valley. Staff may include in its petition the issues Staff deems appropriate; however, at a minimum, the petition should include a request to investigate the long-term viability of Valley, its relationship to Snyder Environmental Services, Inc., the opportunities and alternatives for the transfer of ownership, and whether receivership is appropriate; and 5) required Valley to file quarterly status reports in this case, beginning on October 15, 2007, regarding the status of the possible sale of Valley to another utility in the area.

On October 9, 2007, Valley filed a Petition for Reconsideration for the Commission to reconsider its rulings on three (3) issues: 1) the disallowance of a surcharge to recoup

expenses from SES incurred by Valley prior to the test year; 2) the requirement of the Commission's Staff to request a general investigation into Valley; and 3) the upholding of the ALJ's Recommended Decision concerning recoupment of only \$10,000 over five (5) years rate case/accounting and legal expenses for this case and Case No. 06-0508-S-C.

On October 15, 2007, Staff filed a Response to Valley's Petition for Reconsideration concurring with September 28, 2007 Commission Final Order.

On October 30, 2007, the Commission Order upheld its earlier September 28, 2007, Order, except that Conclusion of Law Number 4 and the fifth ordering paragraph are stricken therefrom. To be clear, the fifth ordering paragraph of the September 28, 2007 Order, which is stricken pursuant to this Order, stated as follows:

IT IS FURTHER ORDERED that Staff shall file a petition with the Commission requesting a general investigation into the viability of the Utility. The petition shall be consistent with the directive given to Staff in the Discussion and Conclusion of Law sections of this Order.

On November 28, 2007, the Petitioner filed its Petition for Appeal of the Commission's September 28, and October 30, 2007, Orders which was docketed as No. 073622. On April 2, 2008, this Honorable Court issued an order that granted Valley's Petition for Appeal.

#### **ASSIGNMENT OF ERROR**

THE PUBLIC SERVICE COMMISSION ERRED AND EXCEEDED ITS STATUTORY AUTHORITY BY DENYING A SURCHARGE FOR THE DEBT OWED BY VALLEY TO SES AND REFUSED TO AWARD HIGHER RATE CASE/ACCOUNTING AND LEGAL EXPENSES THAT VALLEY REQUESTED

## SUMMARY OF ARGUMENT

The Commission's September 28, and October 30, 2007, Orders properly ruled, under basic ratemaking principles, that the \$79,230 debt to Snyder Environmental Services, Inc. (SES) was outside the historical test year, not extraordinary and should be disallowed. These Commission's Orders also correctly held in establishing the rate case/accounting and legal expenses at \$10,000 over 5 years because any higher amount was outside the historical test year and should be disallowed under basic ratemaking principles. Both the surcharge and a higher amount of rate case/accounting and legal expenses constitute retroactive ratemaking.

## STANDARD OF REVIEW

The authority for review of a Final Order of the Public Service Commission by the Supreme Court of Appeals of West Virginia is set forth in West Virginia Code §24-5-1, which provides in part:

[A]ny party feeling aggrieved by the entry of a final order by the commission, affecting him or it, may present a petition in writing to the supreme court of appeals, or to a judge thereof in vacation, within thirty (30) days after the entry of such order, praying for the suspension of such final order.

In the process of reviewing a Commission Order, this Court is guided by the well established principle that the Order will not be disturbed upon appeal unless such findings are arbitrary, unjust, contrary to the evidence or without evidence to support them, Baltimore & Ohio Railroad v. Public Service Commission, 99 W.Va. 670, 130 S.E. 131 (1925), or unless the decision is based upon a mistake of law or misapplies legal principles. Preston

Co. Light & Power Co. v. Public Service Commission, 197 F. Supp. 759 (S.D. W.Va. 1969); United Fuel Gas Company v. Public Service Commission, 143 W.Va. 33, 99 S.E.2d 1 (1957); Wilhite v. Public Service Commission, 150 W.Va. 747, 149 S.E.2d 273 (1966); Virginia Electric & Power Co., v. Public Service Commission, 162 W.Va. 202, 242 S.E.2d 698 (1978).

[R]eview by the Supreme Court of Appeals, while not calling for an independent judgment as to both law and facts, does provide a review in regard to the evidentiary support for the findings of the Commission as well as the correctness of the legal principles applied and conclusions reached by the Commission. [Preston Co. Light & Power Co. v. Public Service Commission, supra, at 766.]

Several years ago this Court reconsidered the standard of review to be applied in Monongahela Power Company v. Public Service Commission, 166 W.Va. 423, 176 S.E.2d 179 (1981). In Monongahela Power, this Court adopted the comprehensive standard of review applied by many states and set forth in Permian Basin Area Rate Cases, 390 U.S. 747 (1968).

After discussing the merits of the more comprehensive standard of review in Permian Basin, this Court adopted the Permian Basin three-pronged analysis as follows:

The first is a rather broad inquiry centering on whether the Commission abused or exceeded its statutory jurisdiction and powers. The second step relates to an analysis of the Commission methodology and a determination of whether there is adequate evidence to support the Commission's findings. The third analysis looks to the substantive result of the Commission's Order to see if it has arrived at a proper determination. [Monongahela Power, 176 S.E.2d at 183.]

It should be noted that although the Court reviewed a Commission rate case decision in Monongahela Power, the same standard of review would apply to the Commission's ruling in a certificate of convenience and necessity case.

Similarly, in C & P Telephone Company v. Public Service Commission, 171 W.Va. 494, 300 S.E.2d 607 (1982), the West Virginia Supreme Court of Appeals began by reiterating the three-pronged standard of review established in the Monongahela Power case, supra, and went on to hold generally that: "The Court's responsibility is not to supplant the Commission's balance of 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." Op cit. at 611.

Furthermore, the C&P case affirmed the Supreme Court's holding "that this Court will not substitute our judgment for that of the Commission on controverted evidence". Id. p. 611.

In Braxton County Citizens for a Better Environment v. The Public Service Commission of West Virginia, 429 S.E.2d 899 (1993) and in Harrison Rural Electrification Association, Inc. v. The Public Service Commission of West Virginia, 438 S.E.2d 782, 190 W.Va. 439 (1993), this Court reaffirmed the use of the standard of review set forth in the Monongahela Power case.

#### **INITIAL BRIEF AND NOTE OF ARGUMENT**

- I. **THE COMMISSION'S ORDER PROPERLY DENIED VALLEY'S SURCHARGE TO PAY BACK EXPENSES TO SES BECAUSE THE EXPENSES WERE OUTSIDE THE HISTORICAL TEST YEAR AND WERE NOT EXTRAORDINARY.**

In this proceeding, the Appellants have challenged several long established, universally recognized rate making principles, including reliance upon a historic test year, and disregarding out of period expense. When filing a rate case before the Public Service Commission, every public utility is required by rule to support its need for a rate increase by an actual audited or finally closed experience for the most recent twelve (12) month period ending on a calendar quarter available. "Each utility, at the time it files a tariff or application for initial rates or changes in rates shall present the proposed tariff, schedules and exhibits upon which it intends to rely in support of its application or filing." Tariff Rule 19.1, Rules for the Construction and Filing of Tariffs, 150 C.S.R. § 2.

"TEST PERIOD: Actual or finally closed experience for the most recent twelve (12) month period ending on a calendar quarter available shall be used in preparing Statement A to G, inclusive." Tariff Rule 19.2. Statement A, Schedule 2 requires the public utility to provide operating expenses for the historic test period. Expenses are required to be shown by account number and classifications set out in the applicable uniform system of accounts prescribed by the Commission. Tariff Rule 19.3.b. This requirement that a proposed rate increase be based upon actual experience of a historic test year is a basic rate making principle. The principle is recognized by the National Association of Regulatory Utility Commissioners (NARUC) in their Rate Case and Audit Manual (NARUC Audit Manual), which was prepared by the NARUC Staff Committee on Accounting and Finance, dated Summer 2003.

Some states use an average historic test year, others use a year-end test year, and others use projected, future test period. Yet, this difference does not

generally change the nature or importance of the test year, nor does it change the basic list of elements that are included in the rate base or the operating income statement.

NARUC Audit Manual, p. 4.

The test year is a period of measurement for a recent, consecutive twelve-month period consisting of a full year of operations where data is readily available. NARUC Audit Manual, p. 10. The NARUC Manual specifically directs the auditor to the test year when reviewing operating expenses such as the ones at issue in this proceeding. "In reviewing operating expenses, the auditor may wish to begin by again turning to the historical analysis of expenses that was prepared during the preliminary procedures and the analysis of the month by month test year data." NARUC Audit Manual, p. 35.

The use of a historic test period, usually the most recent twelve month period for which complete data are available, is recognized by one of the most widely recognized experts in the field of utility regulation, Charles F. Phillips, Jr. See Charles F. Phillips, Jr., The Regulation of Public Utilities Theory and Practice, pp. 187-188 (2d ed. 1988).

The historic test year used in this proceeding included operating and maintenance expenses associated with Valley Water & Sewer Services, Inc.'s contract with its affiliate, Snyder Environmental Services, but only insofar as those expenses affected the earnings posture of Valley during the test year and would continue to affect Valley's earnings posture in the future. The contract expenses were not considered because they were out of period. In its Order on Exceptions filed on October 30, 2007, the Commission both found as a finding of fact that it was being asked to consider out of period expenses, but concluded as

a matter of law that it would be unfair to utility ratepayers to allow the recovery of those out of period expenses. (See Finding of Fact 1 and Conclusion of Law 2.).

While the Commission clearly stated in its October 30, 2007 Order on page 4 that “[i]t would be unfair to penalize the Utility’s customers at this late date by requiring them to pay for expenses incurred in the distant past about which the Utility knew, but failed to attempt to recoup in a timely manner,” the Commission did not further elaborate. Out of period expenses are disallowed for several reasons. Inclusion of out of period expenses: (1) requires retroactive rate making, a process outside the legislative prospective rate making authorization of the Commission; (2) mismatches revenue with expense in the rate design process; (3) mismatches the current customer universe with expenses incurred to serve prior customer universes; (4) shifts all of the risk from management decisions not to timely pursue recovery of utility costs to the utility ratepayers and away from the decision makers responsible for the decision not to timely pursue recovery but to allow an expense to unreasonably accrue; (5) makes it more difficult for the Commission’s Staff to verify the expenditures during the audit process; and (6) can unnecessarily produce “rate shock” or significant increases in utility customer billings. For all of these reasons, expenses occurring outside the test year are routinely disregarded in the rate making process.

In this case, Valley’s management made decisions regarding the accrual of the contractual expenses being incurred during its continuing relationship with its affiliate. It is a matter of record that Valley’s management has received a tax benefit from the writing off of a portion of the accrued expense. (See ALJ’s August 16, 2007, Recommended

Decision, p. 8.). In a rate proceeding, “[m]anagement’s function is to set the level of expenses; the commission’s duty is to determine what expense burden the ratepayer must bear.” Phillips, The Regulation of Public Utilities Theory and Practice, *supra*, p. 246.

Also, under Rule 42 of the Commission’s Rules for the Construction of and Filing of Tariffs (2002) 150 CSR § 2 (Tariff Rules), a utility filing for a rate increase is required to provide financial information regarding what is known as the historical test-year. The historical test year provides the Commission with an understanding of what the utility’s financial condition is for the purpose of determining whether the utility’s requested rate increase is reasonable. West Virginia-American Water Company, Case No. 94-0138-W-42T (Commission Order entered December 22, 1994 at page 55). Because it is difficult to predict how a utility’s financial condition will change, the Commission in the past has limited information regarding the utility’s financial condition to the historical test-year, unless an adjustment to the test year financial information that a utility or any other party to the proceeding is proposing is known and measurable and does not violate the basic principal of matching test year rate base and test year expense units to test year revenue units.

Furthermore, since average test year plant balances, by definition, satisfy the matching principal, in the past, adjustments to rate base are not considered unless they can be demonstrated as being non-revenue producing and non-expense reducing. *Id.* and West Virginia-American Water Company, Case Nos. 92-0113-W-PC and 92-0250-W-42T (Commission order entered May 19, 1992 at p. 2 and at conclusion of law no. 3 at p. 4).

Thus, allowing a recovery of an expense not incurred within the historical test year is a perilous path for the Commission to pursue. If a utility needed higher rates to address extraordinary expenses, the utility should have filed a rate case sooner. Valley's management voluntarily choose not to file rate cases any sooner in order to recover these expenses.

In its September 28, 2007, Order, the Commission stated on p. 4 that:

The Commission understands that the Utility should be able to recover its costs; however, basic ratemaking principles must be followed by any utility operating in this State. Nothing has prevented the Utility from seeking recovery of this item in more timely and earlier rate proceedings, Rule 42 of the Commission's Rules for the Construction and Filing of Tariffs (Tariff Rules) requires a utility filing for a rate increase to provide financial information regarding the historical test year, the most recent 12 month period ending on a calendar quarter. The Commission typically limits information regarding a utility's financial condition to the historical test year and does not allow adjustments outside of the test year. The Commission finds no reason to deviate from that course in the present case.

Proper management of Valley would have resulted in periodic rate cases to recover on-going revenue shortfalls. To allow lengthy accruals results in: (1) rate shock; (2) a decreased ability for the Commission to review and confirm that the expenses are ordinary and reasonable; (3) an inability for the Commission to match test year expenses with test year revenues during a historic test year; and (4) a mismatch of customer base with cost of service. To allow utilities to defer filing rate cases indefinitely (or as in this case for four years) violates the traditional rate making mechanisms of using a historic test year and disallowing out-of-period expenses. Valley's past due expenses owed to SES were clearly outside the test year. The ongoing recovery of the "current expense" for the Valley/SES expenses was included in the Commission's approved rate structure.

In VEPCO v. Public Service Commission of W. Va., 162 W. Va. 202, 248 S.E.2d 322 (1978), this Honorable Court held that under "*W. Va. Code, 24-2-3 [1923]* authorizes only prospective and not retroactive changes in a utility's rate structure". The Court reaffirmed its decision in C & P Tel. Co. V. Public Service Commission of W. Va., 171 W. Va. 494, 300 S.E.2d 607 (1982), that it is inherent in the statute establishing the general power of the Public Service Commission to "fix reasonable rates ... to be followed in the future."

In its earlier decisions of September 28 and October 30, 2007, the Commission adhered to this statute (West Virginia Code §24-2-3) by not allowing retroactive ratemaking which denied Valley's recovery of the \$79,230 past debt (accrued between 2000 and 2005) owed to SES.

Therefore, the Commission maintained its long-standing ratemaking policy regarding the historical test year and did not allow a surcharge for the recovery of debt incurred prior to the test year to be included in determining rates in the current case; which was also retroactive ratemaking.

As a part of the current rate case, Valley requested that \$79,230 owed to SES be placed into the rate base. The Commission noted that the debt accrued between 2000 and 2005 and had been written off by SES for tax purposes; however, SES and Valley maintained that the debt was collectible. (Tr. pp. 19 and 67). The Commission reasoned that even if the debt was technically collectible, SES has received some benefit in writing off Valley's debt. (Commission's October 30, 2007, Order Discussion at p. 2). Valley had the

opportunity in previous years to file for a rate review and have the \$79,230 in unpaid expenses recognized in the appropriate time frames, but did not choose to do so. Valley had a duty to manage this utility in a manner so that the unpaid bills did not accumulate. Valley should not be compensated for its inaction.

On October 9, 2007, Valley requested the Commission to reconsider its decision in the September 28, 2007, Order to disallow expenses for services provided by SES that were incurred prior to the test year. Valley stated that it had only one rate case, Case No. 03-1127-W-42T, prior to the present case. The Utility implies in its arguments to this Honorable Court that it did not seek to recover the SES expenses in the 2003 rate case because the rate increase afforded by the Commission at that time was a substantial increase to Valley's customers and was relatively high compared to other water utilities at the time. Valley argues that the Commission held, in Back Creek Valley Utilities, Case No. 95-0621-W-19A (Order entered June 25, 1996), that after considering the most recent year of actual costs, Staff then considers "whether there are any extraordinary items which should require adjustments to the actual costs." Id. at 3.

The Appellant's, as well as the Administrative Law Judge's, contentions that Valley's out of period expenses should be treated as recoverable extraordinary expenses should be addressed. Extraordinary expense is a term of art in the regulatory community usually used to refer to single, large expenses incurred for a short period of time and which are not usually incurred as a part of a utility's regular operation and maintenance. Major repairs to a gas transmission line is one example. See Union Oil & Gas, Inc., Case No. 06-0410-G-42T,

January 11, 2007; and Greenbrier County Public Service District No. 2, Case No. 07-0072-PSD-42T, August 29, 2007, for other lesser non-recurring expenses. In Case No. 79-140-E-42T, Appalachian Power Company, May 27, 1980, the Commission approved recovery of ice-storm damage and fire damage. "Extraordinary expenses" as a term or art has not been expanded to include the accrual of a public utility's regular operation and maintenance expenses over an extraordinarily long period of time as Valley seeks in this proceeding.

In Blacksville Oil & Gas Company, Case No. 79-486-6-42T (Order Modifying Hearing Examiner's Recommended Decision entered November 10, 1980), the Commission was confronted with addressing whether a debt which was clearly utility-related, but incurred outside the test year, could be recovered from the customers through the rate proceeding pending before the Commission. While the Commission ultimately concluded in the Blacksville Oil & Gas Company case that the utility could not recover the extraordinary utility-related debt incurred outside the historical test year, the Commission provided a good summary of when the Commission may consider allowing a utility to recover extraordinary past unrecovered costs:

That is not to say that there are no circumstances in which the Commission might provide a means by which extraordinary past unrecovered costs could not be recovered, although such circumstances will be rare and such mechanisms are to be very carefully circumscribed.

For example, we might reasonably consider providing a mechanism for recovery of such costs in those instances (a) in which a clearly extraordinary, unforeseeable and unforeseen cost is clearly unrecovered []; (b) in which the underrecovery could lead to the utility's bankruptcy or severe financial harm []; (c) in which the cost or debt is clearly identifiable; and (d) in which the cost or debt is not barred by the statutes of limitations.

Blacksville Oil & Gas Company at p. 6. The Commission stated that none of the above conditions existed in the Blacksville Oil & Gas Company case. Likewise, there was no evidence presented by Valley in the current case that any of the above-stated conditions exist. Valley's \$79,230 past due payables owed to SES were for the operation and maintenance of Valley's water system and were not extraordinary. No where in the record did Valley prove through testimony nor any exhibits at hearing that the \$79,230 past due payables were extraordinary. Therefore, the Commission rightfully denied the Administrative Law Judge's allowance of a surcharge to recover this past due debt owed to SES.

In Harrison Rural Electrification Association, Inc. v. Public Service Commission and Monongahela Power Company, 190 W. Va. 439, 438 S.E.2d 782 (1993), this Honorable Court ruled that the Commission may designate employees to conduct hearings, but the ultimate authority to renders decisions remains with the Commission. West Virginia Code § 24-1-9 states in part:

(d) In all proceedings in which exceptions have been filed to a recommended order, the commission, before issuing its final order, may afford the parties an opportunity for oral argument. When exceptions are filed, as herein provided, it shall be the duty of the commission to consider the same and if sufficient reason appears therefor, to grant such review or make such order or hold or authorize such further hearing or proceeding as may be necessary or proper to carry out the purposes of this chapter. The commission, after review, upon the whole record, or as supplemented by a further hearing, shall decide the matter in controversy and make appropriate order thereon.

(e) When no exceptions are filed within the time specified, such recommended order shall become the order of the commission five days following the expiration of the period for filing exceptions unless the order is stayed or postponed by the commission: Provided, That the commission may, on its own motion before such order becomes the order of the commission, review any such matter and take action thereon as if exceptions thereto had been filed.

At Page 787 of Harrison Rural Electrification Association, Inc., this Court stated that: An ALJ's decision is a recommendation to the PSC, which "may, on its own motion . . . . review any such matter and take action thereon . . . ." West Virginia Code §24-1-9 [1979]. This Honorable Court further held that the PSC's authority to review internal decisions of its employees is not similar to the review procedures outlined in the Administrative Act, § 29A-5-4(g); therefore, the jurisdiction conferred by the legislature on the PSC in this section will not be limited.

Under the above-stated statute and sound rate making principles, the Commission correctly denied the ALJ's August 18, 2007, Recommended Decision approving Valley's surcharge; Valley's operation and maintenance debt due to SES accrued between the years 2000 and 2005 which was outside the historical test year ended September 30, 2006, and this debt was not extraordinary.

Moreover, adopting the Administrative Law Judge's allowance of a surcharge so that Valley can recover unpaid expenses outside of the historical test year would be effectively granting rates on a cash flow methodology. Valley is private utility, and its rates should be granted on a rate of return methodology. In Southern Public Service Company, Case Nos. 81-233-G-42T, 81-234-G-42T, 81-235-G-42T (Commission Order Modifying Hearing Examiner's Decision) the Commission at p. 6 stated: "Ordinarily, once a reasonable return on rate base is established it should not be arbitrarily altered to provide additional cash to the Company to fund extensive construction or renovation projects or an excessive debt." The Commission explained that:

Using a cash flow approach in determining a particular utility's revenue requirement generally involves an examination of the Company's debt service requirements and funds required for capital improvements as well as operating revenue deductions of a cash nature. Depreciation and other expenses not of a cash nature are not considered. The return on average rate base which results from the utilization of this methodology is merely a fall out number (primarily the difference between a company's debt service requirements and allowance for depreciation and amortization). The primary consideration in a cash flow analysis is whether the rates being approved are sufficient to generate cash for operating expenses and needed capital improvements. . . . Looking only at cash needs may result in unreasonable low earnings and insufficient internal cash generation to fund depreciation requirements during periods of low construction activity. Such a situation could seriously jeopardize a utility's capability to obtain capital from normal processes. This is further exasperated in the case of relatively small privately owned utilities which generally do not have access to capital markets through the issuance of stock or bonds.

Id. at p. 5. Private utilities primarily focus on the rate of return. Thus, absent unusual circumstances, the Commission does not grant rates under a cash flow methodology for private utilities. While in the Southern Public Service Company case, the Commission allowed the utility to charge a surcharge for a short time period as a "customer contribution in aid of construction", similar facts do not exist which supports Valley to collect a surcharge for a long period of years (for twenty-five years) for expenses incurred outside of the historical test year in addition to earning a rate of return. Finally, imposing the surcharge for the expenses which occurred outside of the test year is retroactive ratemaking because it allows Valley to recover these outside expenses from future ratepayers.

Valley had the opportunity in previous years to file for a rate review and have the \$79,230 in unpaid expenses recognized in the appropriate time frames, but did not choose to do so. Valley also had a duty to manage its finances in a manner that the unpaid bills did

not accumulate. There is no evidence in the current case that any of the circumstances outlined in Blacksville Oil & Gas Company which would warrant the recovery of extraordinary past unrecovered costs outside of the historical test year exist. SES also wrote the debt off as uncollectible and enjoyed the benefits of reduced business and/or personal taxes of Mr. Snyder, Valley's President, due to the write off.

The Commission did not consider its decision in Back Creek to require it to approve the surcharge in this case. First, Administrative agencies performing regulatory actions are not normally bound by *stare decisis*. See, Monongahela Power Co., Case No. 89-532-E-P, March 16, 1992, Order; Morgan Sanitation & Recycling Corp., Case No. 98-1339-SWF-CN (Reopened), May 11, 2000, Order. See also, Central W Va. Refuse v. Public Sew. Comm'n, 190 W. Va. 416, 438 S.E.2d 596 (1993); Chesapeake and Potomac Tel. Co. v. Public Serv. Comm'n, 171 W. Va. 494, 300 S.E.2d 607 (1982). In regulatory duties, the Commission examines each case based on the particular facts and evidence of that particular case. Second, regardless of *stare decisis*, the Commission's Order distinguished the precedent cited by Valley.

The Public Service Commission of West Virginia has not only been granted the statutory authority to make rates for public utilities, it has been statutorily mandated to fix reasonable rates for a public utility whenever, after hearing, its finds the rates of any public utility to be unreasonable. West Virginia Code §24-2-3, states in part:

The commission shall have power to enforce, originate, establish, change and promulgate tariffs, rates, joint rates, tolls and schedules for all public utilities: . . . . And whenever the commission shall, after hearing, find any existing rates, tolls,

tariffs, joint rates or schedules unjust, unreasonable, insufficient or unjustly discriminatory or otherwise in violation of any of the provision of this chapter, the commission shall by an order fix reasonable rates, joint rates, tariffs, tolls or schedules to be followed in the future in lieu of those found to be unjust, unreasonable, insufficient or unjustly discriminatory or otherwise in violation of any provision of law . . . .

It has long been established that rate making is a unique process. Rate making is the exercise of legislative power, and where there are disputed facts and the Commission (the legislative authority) acts upon disputed facts, its actions will not ordinarily be reversed by the courts, unless its conclusions are reached by applying wrong legal principles to facts clearly disclosed. Pittsburgh & West Virginia Gas Company v. The Public Service Commission of West Virginia, 101 W. Va. 63, 132 S.E. 497 (1926). “. . . [T]he rate-making power necessarily implies a range of legislative discretion; and, so long as the legislative action is within its proper sphere, the courts are not entitled to interpose . . . their own judgment with respect to the reasonableness of rates for that of the legislature . . . .” United Fuel Gas Company v. Public Service Commission, 73 W. Va. 571, 80 S.E. 931 (1914). The Supreme Court of Appeals of West Virginia “. . . has persistently held that because the commission is (experienced) in rates and familiar with the intricacies of rate making [the Court] . . . will ordinarily not substitute [its] . . . judgment for that of the commission on controverted evidence.” City of Charleston, et al. v. Public Service Commission, 110 W. Va. 245, 159 S.E. 38 (1931). “When the Public Service Commission (PSC) is exercising its rate-making authority under W. Va. Code § 24-2-3, its decisions are not subject to the doctrines on *stare decisis* or *res judicata* simply because rate making is a legislative function.” State of West

Virginia ex rel. The Public Service Commission of West Virginia, v. Town of Fayetteville, Municipal Water Works, 212 W. Va. 427, 573 S.E.2d 338 (2002). It is essential to keep in mind that the Public Service Commission is not an executive administrative agency, but an agency created by the Legislature to perform the Legislature's rate making function. Numerous citations regarding administrative law as it applies to executive administrative agencies cannot alter the nature of the Public Service Commission. It is an extension of the Legislature and as such, is not and cannot be restricted by the application of the doctrine of *stare decisis*.

A close reading of the authority cited by the Appellant in support of its argument that the doctrine of *stare decisis* applies to the Public Service Commission will reveal that this Honorable Court reiterated its historic position that the Commission's actions were legislative in character. "The exercise by the Public Service Commission of its rate making authority is primarily a legislative function, and by its nature legislative action operates prospectively and not retroactively." C & P Telephone Company v. Public Service Commission, 171 W. Va. 494, 300 S.E.2d 607 (1982). The doctrine of *stare decisis* does not normally apply to administrative decisions. Id.

As a matter of fact this C & P case clearly establishes why the Appellant's case must fail. The Court found error in the Commission's actions, but not because the Commission failed to follow the doctrine of *stare decisis*, but because the Commission did the very thing that the Appellant seeks in this case - to engage in retroactive rate making.

On August 1, 2007, Valley identified several options for recognizing the old debt. One of those options, a surcharge to recover the amount, was proposed in the Recommended Decision. Valley cited several Commission cases in support of this position. The Commission notes that all cases cited by Valley are cases involving publicly-owned utilities (non-profit) rather than privately-owned utilities (for-profit).

Valley cited five (5) cases that involved five publicly-owned utilities, where the Commission approved a surcharge. Valley argues that these five (5) public-owned utilities were granted a surcharge to recover prior debt. These public-owned utilities cited by Valley were granted a surcharge due to violations of bond covenants, including bond deficiencies or excessive accounts payable, or falling behind on another type of loan. In Putnam Public Service District, Case No. 03-0303-PWD-42T the utility requested surcharge for bond deficiencies, but Staff concluded the utility's money problems were related to a recent change in operations. The Commission granted the surcharge. In South Putnam Public Service District, Case No. 05-0660-PWD-CN and Putnam Public Service District, Case No. 06-1291-PWD-T, the above referenced surcharge was already in place and not at issue. In West Virginia Water Development Authority v. City of Huntington, Case No. 03-1678-S-C, and City of Huntington, Case No. 04-0949-S-MA, the Commission granted a surcharge due to violations of bond covenants including unpaid bond payments and past due accounts payable. In Huntington Sanitary Board, Case No. 05-0624-S-CN, the surcharge was already in place and not at issue in that case. Boone-Raleigh Public Service District, Case No. 06-1472-PSWD-PC, Arbuckle Public Service District, Case No. 03-0388-PSD-19A, Lubeck

Public Service District, Case No. 03-1473-PWD-CN, and City of Cameron, Case No. 03-0724-W-MA, involved, at least in part, surcharges granted due to bond deficiencies or repayment of other loans owed to lending institutions. These cases cannot be compared to the case of a private utility (for profit) that failed to pursue another rate case to recover operating costs to SES, its affiliate, at the time those costs were incurred. Valley's debt to SES accrued between 2000 and 2005 which is not extraordinary and is clearly outside the historical test year ended September 30, 2006. Therefore, the Commission prudently ruled in denying Valley's surcharge by following long-established and universally recognized principles of rate making with regard to: using a historic test year; refusing to engage in retroactive rate making; being unconstrained by the doctrine of *stare decisis*; and disallowing the accrued, out of period operation and maintenance expenses as extraordinary expenses. The Commission's decision regarding the unreasonableness of rate case and legal expenses, which would not have been incurred but for the inaction of Valley's management, was based on a similar established rate making principle and will be specifically addressed in the next section of this Brief.

**II. THE COMMISSION'S ORDER PROPERLY GRANTED VALLEY'S RATE CASE/ACCOUNTING AND LEGAL EXPENSES BECAUSE THE EVIDENCE SUPPORTED \$10,000 OVER A FIVE (5) YEAR PERIOD OR \$2,000 A YEAR.**

In Case No. 01-1343-W-C (a Final Order on September 26, 2002), Valley was ordered to file for a certificate to build a new tank prior to June 1, 2004, under the terms of the settlement agreement. Valley admitted that it did not comply with its own settlement

agreement to build a new tank prior to June 1, 2004, in this first complaint case. (Tr. 33).

Valley should not be rewarded for its management's neglect.

In Case No. 06-0508-W-C (a Final Order on March 6, 2007), the Association filed a second complaint. Valley was ordered again to file a certificate to replace its old water tank which led to the current general rate case and certificate case filed on March 21, 2007. (Tr. 10).

It has been a long-standing Commission policy to use a historic test year. Under Rule 42 of the Commission's Rules for the Construction of and Filing of Tariffs (Tariff Rules), a utility filing for a rate increase is required to provide financial information regarding what is known as the historical test-year.

On page 7 of the ALJ's Recommended Decision in this case, the ALJ stated that Valley was attempting to recover rate case/legal and accounting expenses of \$40,389 over three (3) years that were not incurred for the current filing and did not occur in the historical test year. Therefore, the ALJ rejected the amount of \$40,389 over three (3) years.

The second complaint-related (in Case No. 06-0508-W-C) legal and accounting expenses were not incurred in the test year. In fact, these expenses would not have been incurred at all, had Valley complied with the settlement agreement to construct a new tank prior to June 1, 2004, in the Association's first complaint case.

Valley should not be rewarded with higher rate case/legal and accounting expenses because of its neglect by not complying with the settlement agreement in Case No.

01-1343-W-C. Also, the ratepayers should not suffer higher rates because of Valley's inaction.

The Commission Orders upheld the ALJ's rationale that the rate case/legal and accounting expenses of \$10,000 over a five (5) period was reasonable and should be used to develop rates in this case. The Commission also affirmed the ALJ's five (5) year amortization as reasonable because Valley has only filed one previous rate case in 2003 in Case No. 03-1127-W-42T.

In its response to Staff's August 31, 2007, exceptions, Valley requested that the Commission allow it to recover accounting and legal expenses totaling \$40,389. These expenses were incurred by Valley in Case No. 06-0508-S-C and the current case. Valley requested that the rates be amortized over a period of three years at \$13,463 per year. The ALJ adopted Staff's rate case expense position which allowed \$10,000 to be amortized over 5 years or \$2,000 per year. In rendering its final decision the Commission found no evidence or sound principle of rate regulation to be applied to alter its decision on this rate case/accounting and legal expenses issue.

Based upon an adequately-supported record, the Commission's September 28 and October 30, 2007, Orders properly held that Valley's rate case/accounting and legal expenses should be recovered at \$10,000 over five years (5) or \$2,000 per year.

Therefore, the Commission's October 30, 2007, Order properly reaffirmed both its September 28, 2007, Order and the ALJ's August 16, 2007, Recommended Decision to grant Valley's \$10,000 rate case/legal and accounting expenses of \$10,000 over five (5) years or

\$2,000 per year; and the decision is supported by the evidence presented the hearing as well as sound rate making principles.

In summary, the Commission maintains that it considered the evidence properly, applied correctly the appropriate laws, applied correctly the Commission's Tariff Rules and justly denied the Appellant's exceptions to the ALJ's January 29, 2007, Recommended Decision.

### CONCLUSION


WHEREFORE, the Public Service Commission of West Virginia maintains that its Orders of September 28, 2007, and October 30, 2007, contain the proper ruling based upon evidence reviewed in this case. Therefore, the Commission made a proper and just decision in its Order and has committed no reversible error.

The Public Service Commission of West Virginia respectfully requests that this Honorable Court affirm the Commission Orders, entered on September 28, 2007, and October 30, 2007, and deny this Appeal.

Respectfully submitted this 2nd day of June, 2008.

THE PUBLIC SERVICE COMMISSION  
OF WEST VIRGINIA

By Counsel,

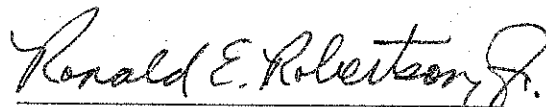
  
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**CERTIFICATE OF SERVICE**

I, RONALD E. ROBERTSON, JR., Staff Counsel for the Public Service Commission of West Virginia, do hereby certify that a copy of the foregoing "Initial Brief of the Appellee Public Service Commission of West Virginia" was served upon the following parties of record by First Class United States Mail, postage prepaid this 2nd day of June, 2008.

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