

**FILED**  
April 19, 2017  
**INDIANA UTILITY  
REGULATORY COMMISSION**

**STATE OF INDIANA**

**INDIANA UTILITY REGULATORY COMMISSION**


PETITION OF COMMUNITY UTILITIES OF )  
INDIANA, INC. FOR (1) AUTHORITY TO INCREASE )  
ITS RATES AND CHARGES FOR WATER AND )  
WASTEWATER UTILITY SERVICE; (2) APPROVAL )  
OF NEW SCHEDULES OF RATES AND CHARGES )  
APPLICABLE THERETO; AND (3) APPROVAL OF )  
NEW DEPRECIATION RATES )

**CAUSE NO. 44724**

**INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR'S**  
**PROPOSED ORDER**

The Indiana Office of Utility Consumer Counselor ("OUCC") submits the attached proposed order and related schedules.

Respectfully submitted,

  
Daniel M. Le Vay, Atty. No. 22184-49  
Deputy Consumer Counselor

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**ORDER OF THE COMMISSION**

**Presiding Officers:**

**Angela Rapp Weber, Commissioner Chair**

**Aaron A. Schmoll, Senior Administrative Law Judge**

On December 15, 2015, Community Utilities of Indiana, Inc. (“CUII”) filed its Verified Petition. On December 15, 2015, Petitioner also filed its case-in-chief, workpapers, and information required by the minimum standard filing requirements (“MSFRs”) set forth at 170 IAC 1-5-1 and a request for administrative notice.

On December 22, 2015, a petition to intervene was filed by Lakes of the Four Seasons Property Owners’ Association (“LOFS”), which was subsequently granted by the Presiding Officers.

On February 15, 2016, the Presiding Officers established a procedural schedule for the Cause. On April 22, 2016 the Indiana Office of Utility Consumer Counselor (“OUCC”) and LOFS filed their respective cases-in-chief.

On May 13, 2016, CUII filed a Motion to Vacate Hearing Date and for Modification of Procedural Schedule. On May 31, 2016, CUII filed an Unopposed Motion to Suspend Procedural Schedule. Both motions were granted without objection.

On June 27, 2016, CUII filed the supplemental direct testimony of Witnesses Steven M. Lubertozzi and Justin P. Kersey. The OUCC and LOFS filed their supplemental testimony on October 24, 2016. CUII filed its Rebuttal Testimony on December 30, 2016.

Pursuant to notice of hearing given and published as required by law, proof of which was incorporated into the Commission’s official file, a public evidentiary hearing in this Cause was convened on February 7, 2017 and continued to February 8, 2017, at which time the parties presented their respective evidence and offered witnesses for cross-examination. Following the hearing, post-hearing proposed orders and briefs were filed in accordance with the established schedule for such filings.

The Commission, based upon the applicable law, the evidence herein, and being duly advised, now finds as follows:

**1. Notice and Jurisdiction.** Due, legal, and timely notice of the filing of the Petition in Cause No. 44724 was given and published by Petitioner as required by law. Proper and timely notice was given by CUII to its customers summarizing the nature and extent of the proposed changes in its rates and charges for water and wastewater service. Due, legal, and timely notice of all public hearings in this Cause was given and published as required by law. CUII is a public utility as defined in Ind. Code § 8-1-2-1(a). Pursuant to Ind. Code §§ 8-1-2-42 and 42.7, the Commission has jurisdiction over CUII's rates and charges for utility service.

**2. Petitioner's Organization and Business.** CUII is a public utility incorporated under the laws of Indiana with its principal office address located at 2335 Sanders Road, Northbrook, IL 60062. Petitioner is a "public utility" as defined in Ind. Code § 8-1-2-1 and is subject to the jurisdiction of the Commission in the manner and to the extent provided by the laws of the state of Indiana.

CUII was incorporated in 2015 for implementation of the merger into a single entity of the three separate wholly owned Indiana subsidiaries of Utilities, Inc. ("UI") that provide water and sewer services in Indiana. Those subsidiaries are Twin Lakes Utilities, Inc. ("TLUI" or "Twin Lakes"), Water Service Company of Indiana, Inc. ("WSCCI"), and Indiana Water Service, Inc. ("IWSI"). The merger was approved by the Commission's July 8, 2015 Order in Cause No. 44587.

CUII provides water service to approximately 5,000 customers and wastewater service to approximately 3,300 customers. Petitioner renders such water and wastewater utility service by means of utility plant, property, equipment and related facilities owned, operated, managed and controlled by it that are used and useful for the convenience of the public in the provision of water and wastewater service. Petitioner's service area includes portions of Jasper, Lake, Newton and Porter counties.

**3. Existing Rates.** The base rates and charges for CUII's operating divisions were previously approved in separate rate proceedings for each division. TLUI's basic rates and charges were most recently approved in the Commission's April 23, 2014 Order in Cause No. 44388. WSCCI's basic rates and charges were last approved in Cause No. 44104 on March 27, 2013. IWSI's basic rates and charges were last modified by the Commission's November 7, 2012 Order in Cause No. 44097. In addition to the above approved rates, CUII's IWSI subsidiary currently has an approved water tracker of \$0.35 per thousand gallons as well as a distribution system improvement charges of \$0.27 per thousand gallons. CUII's TLUI subsidiary currently has an approved sewer infrastructure improvement charge of \$2.36 per thousand gallons.

**4. Relief Requested.** CUII requests authority to increase its rates and charges for water and wastewater utility service and approval of (1) new schedules of rates and charges applicable to Petitioner's water and wastewater utility service, (2) revised depreciation rates, and (3) any other such relief as may be appropriate and proper. Petitioner requested an increase in water rates and charges so as to produce additional revenues of \$928,932 per year and an increase in wastewater rates and charges so as to produce additional revenues of \$666,033 per year. As discussed in greater detail below, CUII proposed to implement its rates in two phases, with Phase I to be effective on or about October 9, 2016 and Phase II to be made effective on or about October 9, 2017.

**5. Test Year and Rate Base Cut-off.** CUII proposed a forward-looking test year for the twelve month period ended September 30, 2017 using projected data as authorized by Ind. Code § 8-1-2-42.7(d). We find the test year to be used for determining CUII's projected operating

revenues, expenses and operating income shall be the 12-month period ending September 30, 2017, subject to the update process we discuss below regarding the implementation of Phase II rates.

Petitioner initially proposed “Phase I” rates be based on rate base as of September 30, 2016 and “Phase II” rates be based on rater base as of September 30, 2017. Subsequent to Petitioner’s case-in-chief filing, the parties agreed that “Phase I” rates will be based on actual rate base, as adjusted, at February 29, 2016 (Stipulation and Agreement in Lieu of Prehearing Conference filed with this Commission on January 28, 2016). We find that CUII’s Phase I rates shall be based on rate base as of February 29, 2016 as adjusted. We find CUII’s Phase II rates shall be based on rate base as of September 30, 2017 as adjusted. We establish the rate base certification process below.

**6. Rate Base.**

**A. Ground Storage Tanks.**

Petitioner’s Evidence. Mr. Steve M. Lubertozi, President of CUII, testified regarding the decision to construct a new 500,000 ground storage tank (the “North GST”) to replace the 1992 Peabody Tank. Mr. Lubertozi testified that the original “Peabody Tank” was installed in 1993 and had reached the end of its designed life. Pet. Ex. 3 at 8. He stated that the Peabody Tank had experienced numerous leaks around the bottom ring of the tank and needed replacement. *Id.* He testified that the Peabody Tank was removed from service and disassembled in order to install the new North GST, which provided the necessary storage to meet the needs of the community. *Id.* He further testified that this tank was completed and placed into service in the fourth quarter of 2015. *Id.*

Mr. Lubertozi also testified regarding the need for the 500,000 gallon South GST. He explained that CUII installed the new South GST in 2014 to provide additional storage capacity to meet the needs of the community and ensure water supply during peak periods of the year. Pet. Ex. 3 at 8. He further testified that construction of the South GST provided redundancy should either of the existing water storage tanks need to be taken off-line. *Id.*

OUC’s Evidence. Mr. James Parks, OUC Utility Analyst II, testified that Petitioner overpaid Central Sewer & Water (“CS&W”) for the two new ground storage tanks it installed for \$1,287,635. He stated that Petitioner changed its \$650,000 plan, approved the prior year, to build one new South GST and then rehabilitate the existing Peabody GST. Instead Petitioner chose to construct an unnecessary second new GST, paid CS&W for work never performed on the North GST, and also paid CS&W for inflated costs and work not shown on the design drawings. He testified that Petitioner should have reduced costs and shortened the construction time for the South GST by accepting the tank supplier Cady Aquastore’s \$367,292 turnkey construction proposal, which would have left nearly \$300,000 available for rehabilitating the existing Peabody GST. Pub. Ex. 3 at 2, 33, and 58 and Tr. at C-24 and C-27.

Mr. Parks testified that CS&W billed Petitioner \$106,938 in excessive South GST project charges for site clearing, excavation, and concrete. He testified Petitioner also paid CS&W nearly \$110,000 in inflated charges for the South GST for site restoration, a water line, storm sewer, and other items. He stated Petitioner charged \$35,763 capitalizing 756 hours of staff time for the South GST project, but since Petitioner did not describe the work performed or why the capitalized time was necessary, it was not possible to verify that such capitalized time charges were prudently

incurred or whether the charges should be recoverable. Pub. Ex. 3 at 36. Mr. Parks recommended limiting the South GST project cost to \$650,000, which amount was included in rate base under Cause No. 44388.

Mr. Parks testified that in Cause No. 44388, the OUCC accepted Petitioner's proposed Project No. 3 to build one new South GST and then rehabilitate the Peabody GST ensuring that Petitioner could meet the *Ten States Standards'* one-day water storage requirement. Pub. Ex. 3 at 11. Mr. Parks testified that in Cause No. 44388, other than listing the project's \$650,000 total cost, Petitioner provided no cost details for the new South GST or Peabody GST rehabilitation. Tr. at C-24, C-25, and C-27. Mr. Parks testified that the plan the OUCC agreed to was not that Petitioner would build two new GSTs instead for \$1,238,000. Tr. at C-24.

Mr. Parks recommended allowing the \$18,800 Peabody GST demolition cost, but disallowing the remaining \$543,997 of North GST project costs, since the second new GST was unneeded for satisfying *Ten States Standards'* storage volume. Pub. Ex. 3 at 2, 40, and 58. Pub. Ex. 7 at 18. He also testified that Petitioner paid CS&W for North GST work that was never actually performed, not part of the design, or that was inflated. He presented data showing water production dropped to an average of 591,000 gallons per day (gpd) and a peak day demand of 1,116,703 gpd. Pub. Ex. 3, Attachment JTP-2. He testified that historically CUII has met peak demand even during droughts without having a third storage tank by using its two existing storage tanks and other water system components including the wells, two treatment plants, and high service pumps with a combined 1,685,000 gpd capacity. Pub. Ex. 3 at 15 and 39.

Mr. Parks testified it is good practice to have the water storage volume recommended by the *Ten States Standard* but that he was aware many utilities don't even meet the minimum including Indianapolis, Shelbyville, and CUII's own WSCI division. He stated that Petitioner met water demand with its three high service pumps, one elevated water tower, and one water treatment plant before the Peabody tank was constructed. Tr. at 10 and 11. Mr. Parks testified that CUII has not provided studies or analyses of water consumption, well production, water treatment plant production, high service pumping, or storage to demonstrate constructing the second new GST was prudent. Pub. Ex. 3 at 13.

Mr. Parks discussed upcoming maintenance for Petitioner's elevated water tower and testified that CUII had time to evaluate its water storage needs to develop, analyze, and plan for water storage. Pub. Ex. 3 at 12. He stated if CUII's studies showed additional water storage was needed, alternatives could have included a new tank of a different capacity, type (such as elevated, welded, pre-stressed concrete, glass fused bolted steel, composite, etc.), and location. Mr. Parks testified that even though life-cycle analysis is a long-established engineering practice used by well-managed utilities and is beneficial for planning major capital improvement projects such as water tanks, Petitioner has not provided such analyses for its capital projects. Mr. Parks testified that Petitioner missed an opportunity to do asset planning for finished water storage. *Id.* He testified that CUII should have evaluated alternatives and analyzed life-cycle costs to show why storage capacity at WTP #1 needed to be 1,000,000 gallons, why a second new 500,000 gallon capacity bolted steel ground storage tank was the proper tank size and tank type needed, and why WTP #1 was the best location for additional storage. Pub. Ex. 3 at 38. He stated CUII could have discussed with the OUCC why it needed the second new GST and why it was needed immediately. Pub. Ex. 3 at 40. Mr. Parks testified that Petitioner could have simply removed the Peabody GST rather than replace it. Pub. Ex. 3 at 39.

Mr. Parks summarized his findings regarding the South and North GSTs by testifying that CUII did not follow its plan presented in Cause No. 44388 for Project No. 3, estimated at \$650,000, which consisted of constructing one new South GST (2014) and rehabilitating the Peabody GST, but instead CUII demolished the Peabody tank and constructed another new North GST (2015), nearly doubling costs to \$1,287,635 for both new GSTs. He questioned CUII's new claim labeling the Peabody GST as a "Twenty Year Temporary Tank", stating that CUII had no documentation supporting such a designation and that representatives from the tank manufacturer, CST Industries, were unfamiliar with their company marketing "temporary" tanks. Pub. Ex. 3 at 36. Mr. Parks testified that water storage tanks should be designed for service lives exceeding 50 years and stated it is not good utility practice to install "temporary" tanks. *Id.* Mr. Parks also discussed that CUII chose to install epoxy coated tanks, which must be routinely painted, versus the longer-lasting glass fused coated tank with lower maintenance costs. Pub. Ex. 3 at 32. Mr. Parks testified that CUII did not provide evaluations, inspection reports, or alternative analyses it relied on to determine the Peabody GST, deemed serviceable in May 2014, was unserviceable by early 2015 and had to be replaced instead. Mr. Parks stated CUII's justification for replacing the Peabody GST was limited to a two hour desktop review summarized in a one page letter by RHMG Engineers, Inc. The RHMG letter was submitted only after the OUCC filed its Direct Testimony recommending disallowance of the North GST. Pub. Ex. 7 at 7. The February 26, 2015 email from CUII asking RHMG for an opinion on the feasibility of replacement also requested a project quote (presumed to be the new GST design), indicating that CUII had previously decided to replace the Peabody GST and the engineer's opinion was requested only to support CUII's decision to replace the Peabody tank. Mr. Parks testified that CUII gave conflicting dates for when it decided to replace rather than rehabilitate the Peabody GST and it appeared CUII did not conduct a Peabody tank inspection as recommended by Tank Industry Consultants.

Mr. Parks also provided extensive testimony regarding overpayments to CS&W on the South GST and North GST projects. He testified that work invoiced by CS&W which CUII alleged was done at the direction of the Lake County Building Inspector, Mr. Bob Bakalar, was neither required by the Inspector nor actually done. The work not done totaled \$80,200 and included \$8,500 CS&W billed on Invoice No. 4093 and 80% of the \$89,500 CS&W billed on Invoice No. 4102. Pub. Ex. 7 at 11 and 12. Mr. Parks testified that he spoke directly to Mr. Bakalar who confirmed he made only one footing pre-pour inspection of the North GST, that he recommended approval, and that the alleged orders for additional excavations and more stone "did not happen." Pub. Ex. 7 at 11 and Appendix A.

Mr. Parks testified that ratepayers should not be expected to pay for tanks if they are unnecessary, poorly selected, and inadequately maintained so that they must be replaced prematurely and that ratepayers should also not be expected to pay inflated prices or for contractor work not performed. Pub. Ex. 7 at 17 and 18. Based on his review, Mr. Parks recommended that \$543,997 in North GST costs be disallowed from rate base and that the South GST costs be capped at no more than \$650,000. *Id.* at 17.

Petitioner's Rebuttal Evidence. Marcia McCutchan, P.E., Executive Vice President of RHMG Engineers, Inc. ("RHMG"), provided rebuttal testimony with regard to the replacement of the North GST. Ms. McCutchan stated that RHMG's involvement with CUII's GST's dates back to 1990, and, therefore, RHMG has extensive knowledge of, and experience with, the Peabody Tank and the decision for its replacement. Pet. Ex. 6R at 3-5. Ms. McCutchan testified that the decision to replace the 1992 Peabody Tank with the North GST was based on a review of records



and information regarding the tank, as well as an analysis of viable alternatives; the decision was not based on a “two hour desktop review” as Mr. Parks suggested. *Id.* at 4. She stated that based on this review, her personal observations of the condition and continuing corrosion of the Peabody Tank and discussions regarding the cost of various tank rehabilitation options, RHMG recommended full tank replacement. *Id.* at 5. Ms. McCutchan also responded to Mr. Parks’ claim that it is poor practice to install “temporary” water storage tanks, stating that at the time of construction, use of bolted steel tanks like the Peabody Tank, was industry standard and not considered “temporary.” *Id.* at 5. Ms. McCutchan further stated that design service lives of 20-30 plus years is typical for bolted steel storage tanks, and the observed service life of CUII’s Peabody tank was consistent with that of other tanks constructed at the time of similar construction. *Id.* at 5-6.

On cross-examination, Ms. McCutchan stated that she did not keep records of all of her recommendations to CUII, and that she kept “a lot of knowledge in my head.” Tr. at C-61-62. There were, however, additional documents regarding the GSTs in her files, not all of which she had provided to CUII. Tr. at C-59. She stated that she had done an “informal engineering analysis” of CUII’s water requirements under the Ten States Standard, but did not create a written copy. *Id.* at C-81-C-82.

Mr. Kersey responded to Mr. Parks’ contention that construction of the North GST was not needed to meet CUII’s finished water storage requirements. He testified that in Cause No. 44388, the OUCC agreed to and supported the addition of a new 500,000 gallon GST (the 2014 South GST), which brought Twin Lakes Utilities, Inc.’s total water storage to 1,200,000 gallons. Pet. Ex. R2 at 43. Mr. Kersey stated that the current storage capacity at the Twin Lakes facility of 1,200,000 gallons is no different than the storage capacity supported by the OUCC in Cause No. 44388. *Id.*

Mr. Lubertozi also responded to the OUCC’s contention that the North GST was not needed to meet finished water storage requirements. He testified that after construction of both the North GST and South GST, Twin Lakes’ service territory still only has 1,200,000 gallons of total finished water storage capacity. *Id.* at 14. He reiterated that the OUCC supported this level of water capacity in Cause No. 44388, and stated that it is unreasonable for the OUCC to accept a given capacity level in one case, only to reject that capacity level in the next case. Mr. Lubertozi further responded to Mr. Parks’ contention that CUII did not conduct a proper review prior to its decision to replace the 1992 Peabody Tank. Mr. Lubertozi stated that CUII relied upon the independent assessment of RHMG, and provided the e-mail from a former CUII Area Manager to Ms. Marcia McCutchan seeking RHMG’s opinion regarding the feasibility of replacement versus rebuilding of the Peabody Tank. *Id.* at 15. He said this e-mail shows that there was no doubt that on February 26, 2015, CUII’s local management was contemplating rehabilitating the 1992 Peabody Tank. *Id.* at 16. Mr. Lubertozi testified that, in his opinion, replacement of the Peabody Tank was reasonable and prudent. He noted that RHMG’s estimated cost to construct the North GST was \$550,000, compared to CUII’s actual costs of \$562,797. *Id.* at 20-21.

Finally, Mr. Lubertozi responded to Mr. Parks’ recommendation that the North GST be disallowed from rate base. He stated that the capital markets would have a negative reaction to this disallowance, and, if the Commission were to disallow the North GST from rate base, the Company would be forced to record a net loss of \$562,797 in the year the Commission’s order is finalized. *Id.* at 19-20. He said this loss would require CUII to sell or transfer the tank, and the tank would not be available to be used by CUII’s customers as discussed by Mr. Parks in his testimony. *Id.* That said, Mr. Lubertozi did discuss Invoice 4102 addressed by Mr. Parks and stated that because

of the nature of the excavation work contained in that invoice CUII could not physically confirm the work was performed. In order to minimize controversy, Mr. Lubertozi said that CUII would accept Mr. Parks' recommended disallowance of \$71,700 related to that work. Pet. Ex. R1 at 6.

Dr. John Norton, PhD, P.E., a project manager for UI, also responded to the OUCC's contention that construction of the North GST created excessive excess capacity. Dr. Norton argued that Mr. Parks is incorrect that the combined storage of 1,200,000 gallons is excessive, and based on his own citation, Mr. Parks' recommendation is too small and does not even meet the minimum requirements for system storage. *Id.* Dr. Norton further explained that Mr. Parks failed to understand the difference between the definition of "excessive" system storage and "minimum recommended" system storage. *Id.* Dr. Norton described TLUI's water system flow and treated water storage requirements, and explained that the implication of the flow data he provided, sourced from monthly reports of operations submitted to IDEM, shows that system demand is highly variable. *Id.* at 6. He explained that even during months of least demand there are still sporadic days of very high demand within those "low flow" months. *Id.*

Dr. Norton also discussed his other concerns about the OUCC's calculation of "minimum recommended storage volume" using the "average daily demand" calculated from a multi-year period. He testified that "average daily demand" calculated from a multi-year period does not have any value to account for seasonal variations, regional weather occurrences, operational upsets, power outages, firefighting demand, or other real factors which affect and impact water plant operations. *Id.* at 8. Instead, Dr. Norton testified that "minimum recommended storage volume" should have been calculated based on the peak daily flow determined from daily flow values measured over a representative period of time, preferably over a multi-year period. *Id.* at 8-9. He agreed with Mr. Parks' contention that excessive water age could lead to deterioration of water quality, but testified that it is not a concern for CUII's system because one day's worth of storage is not excessive. He stated that a review of state, federal, and international standards show concern for water degradation at seven days' worth of storage. *Id.* at 10-11.

Mr. Kersey responded to the OUCC's position regarding the removal of the 2014 South GST from water rate base. Mr. Kersey testified that the OUCC had proposed a reduction to rate base of \$63,141 for costs associated with the South GST. Pet. Ex. R2 at 41. He testified that CUII does not agree with this proposed reduction because, while the Company's forecast in Cause No. 44388 consisted of \$650,000 in capital costs, this forecast did not include an estimate for capitalized time and AFUDC. *Id.* at 42. He further testified that total costs booked for the South GST were \$715,318, but consisted of \$638,775 in capital spending, \$41,770 in AFUDC and \$34,773 in capitalized time. *Id.* He testified that total costs are in-line with the cost of \$650,000 approved in Cause No. 44388. *Id.* He also stated that CUII has already agreed to remove \$8,061 in AFUDC from its Water rate base, with approximately \$3,684 of these costs related to the 2014 GST project. Therefore, if an adjustment is necessary, then an adjustment of \$59,457 (\$63,141-\$3,685) would be necessary to limit gross recovery of the project to \$650,000. Ultimately, Mr. Kersey testified that if the Commission were to limit CUII's recovery of the South GST project, CUII suggests isolating AFUDC and capitalized time, as these components were not included in the Company's Cause No. 44388 forecast of \$650,000. *Id.*

Mr. Lubertozi further testified that CUII was not accepting the OUCC's adjustments on the South GST because CUII isolated similar CS&W costs and compared those to the North GST costs, and determined that the costs for the South GST and North GST were similar. *Id.* at 7. He

stated that based on the similarity of these projects and the similar nature of the work performed CUII does not believe any other adjustment is warranted.

Mr. Kersey also responded to the OUCC's position that CUII did not follow its plan presented in Cause No. 44388 to construct one new GST (2014 South GST) and rehabilitate the Peabody tank for \$650,000. Mr. Kersey disputed Mr. Parks' statements because they suggest the cost of rehabbing the Peabody tank were included within CUII's construction plan to build the 2014 South GST. *Id.* at 43. Mr. Kersey stated that the OUCC failed to produce a single document in discovery to support their position that rehabbing the Peabody tank was included within its "\$650,000 plan," and explained that Mr. Parks misinterpreted CUII's position in Cause No. 44388. *Id.* at 44.

Ms. McCutchan testified that she was not surprised that CUII did not perform a life-cycle cost analysis because, based on CUII's and RHMG's experience with alternative water storage structure types for tanks in this volume range, a life cycle cost analysis is not necessary to determine that a ground storage tank of steel construction is the recommended alternative. Pet. Ex. R6 at 7. She stated that despite Mr. Parks' contention that the South GST took almost two years to complete, it was her understanding that substantial completion of the tank and placement of the tank online was achieved well before the end date referenced in Mr. Parks' testimony of November 30, 2014. *Id.* at 7-8. However, she did state that it is not uncommon, as a result of contractor scheduling and mobilization issues, for a considerable lag to occur between the substantial and final completion dates. *Id.* at 8

Ms. McCutchan also testified regarding Mr. Parks' testimony that CUII has excess finished water storage. She testified that, on a number of occasions prior to the construction of the South GST, CUII's then existing storage volume of 700,000 gallons was inadequate to meet system demands during peak demand season. *Id.* at 9. She further testified regarding the variability in peak water demand and stated that as evidenced in Mr. Parks' testimony, the peak demand over the past four years has consistently ranged from 950,000 gallons per day to over 1,100,000 gallons per day. *Id.* She noted that this is not uncommon, as summer demand levels are generally consistently higher in communities like LOFS with golf and lake amenities; she also pointed out that LOFS Fire Department relies on CUII as a key source of water for its firefighting needs. *Id.* Thus, in order to meet these demands and maintain reliable operations, she testified that RHMG continues to recommend total finished water storage volume in excess of 1.0 million gallons for the CUII system. *Id.* Ms. McCutchan reiterated that the OUCC supported installation of the new South GST in 2014, and, even after the originally unplanned construction of the North GST, the resulting total storage volume is the same now as was contemplated by TLUI and supported by the OUCC in 2013. *Id.* at 9-10.

Commission Discussion and Findings. The OUCC recommended disallowing \$543,997 in North GST costs because the tank was unneeded to meet storage requirements and CUII altered its major Project No. 3, approved the previous year in Cause No. 44388, to construct one new South GST and rehabilitate the Peabody GST. The OUCC testified that CUII overpaid for the GSTs in several ways: by not accepting the tank supplier's lower cost turnkey construction proposal and by paying improper invoices from CUII's former main contractor, CS&W. The invoices were inflated and included charges for work either not done or called for in the design. We concur with the OUCC. We find these overpayments, combined with CUII's apparent lack of planning, fiscal oversight, or construction management of its capital projects to be unacceptable.

CUII's rebuttal focuses on an implied storage volume from Cause No. 44388, but does not address the near doubling of the rate base addition from the approved \$650,000 estimate to \$1,287,635. The OUCC accepted CUII's proposal in Cause No. 44388 to build one new GST matching the Peabody tank's volume so that the Peabody GST could then be taken off-line for servicing, while retaining 500,000 gallons of storage capability at WTP #1. OUCC Cross Ex. 3, p. 8 of 51. We agree with the OUCC's conclusion that after completing the South GST, CUII could have simply demolished the Peabody tank when CUII decided it was beyond rehabilitation. This would have still met the Ten States Standards' recommended one-day storage, and more importantly would have stayed within the \$650,000 approved cost.

To support CUII's argument that 1.0 million gallons of storage is needed at Water Treatment Plant #1, Ms. McCutchan disputed the OUCC's contention that CUII's two water plants have the capacity to fulfill the maximum day demand. Tr. at C-77-80. However, her testimony is contradicted by the rebuttal testimony of CUII's witness Dr. Norton, who shows Petitioner's total treatment capacity is 1.38 MGD. Pet. Ex. R7 at 5. McDonough Associates independently corroborated that CUII's total rated capacity is 1.388 MGD as listed in the Twin Lakes Water Supply Plan. See, CUII Resp. to IURC Docket Entry 4-27, p. 8 of 93. McDonough stated that the existing treatment plants could meet the 1.36 MGD maximum day demand in 2007 and that storage was sufficiently sized at 700,000 gallons to meet peak hour flows on the maximum day. *Id.* There is no dispute that CUII's average day demand has decreased and that maximum day demand over the last five years now ranges between 950,000 gallons a day and 1.1 MGD. Pub. Ex. 3 at 14 and Attachment JTP-2, and Tr. at C-80.

It is unclear why the Peabody tank rehabilitation choice was even presented by CUII in Cause No. 44388, based on the advanced state of corrosion testified to by Ms. McCutchan. Dr. Norton testified that CUII was *unable* to perform any substantial tank maintenance on the Peabody tank because CUII *did not* perform it, equating a failure to perform maintenance with an inability. Tr. D-12. This is more evidence of CUII's failure to maintain its system properly, as we discuss further below. The OUCC's concern that CUII proceeded with the replacement option based on a "two hour desktop review" was criticized but not much ameliorated by Ms. McCutchan, who testified to a near absence of records regarding the decision. Instead, she performed an "informal review", without a hydraulic analysis, to determine that replacement was the more prudent course of action. As noted in CUII's response to the Commission's fourth docket entry, CUII already had a system analysis from 2008. By the time CUII discussed various tank rehabilitation options with RHMG, Pet. Ex. 6R at 5, the tank had already degraded to the point that rehabilitation was deemed to be impractical. CUII therefore let the Peabody tank degrade, while simultaneously telling the Commission and parties that it planned to rehabilitate it.

As noted by Mr. Parks, CUII received quotes that would have allowed both installation of the new South GST as well as rehab of the Peabody GST, all within the \$650,000 budget that was approved in Cause No. 44388. Mr. Lubertozzi rebutted Mr. Parks' reliance on the Cady Aquastore "turnkey" proposal, saying that Cady Aquastore did not recommend CUII rely on Cady Aquastore to install the complete tank, because Cady Aquastore was not in the business of installing tanks and the Company was "probably going to get a better product and better service by using a vendor" such as CS&W. Tr. at B-121. We find this testimony to be self-serving, as CS&W was the vendor that CUII relied on to do – or not – most of its projects, and was the vendor involved in the fraudulent invoices. Cady Aquastore provided a "turnkey" proposal, and even if it was limited to providing the tank foundation, shell and appurtenances design, without site clearing, surveying,

pipng, site restoration or additional excavating, Mr. Parks' point is well taken. See Attachment JTP-11. CUII chose not to proceed with the turnkey proposal, and instead proceeded with a more expensive route. While the \$650,000 cost estimate in Cause No. 44388 did not indicate whether it included capitalized time or AFUDC, the evidence of budget manipulation through acceptance of higher bids for the same project leads us to conclude that CUII will not be harmed by sticking to this amount. We accept the OUCC's proposal to cap the cost of the South GST at \$650,000 and limit recovery to one GST, excluding the North GST. This has the effect of ameliorating several concerns at once, as it resolves the issues of inflated costs attendant to both GSTs and CS&W charges for work on the North GST that was not actually performed or not shown on the design drawings. We therefore agree with the OUCC that \$543,997 of the North GST costs be disallowed from rate base and that the South GST costs be capped at no more than \$650,000.

## **B. CS&W Invoices.**

OUCC's Evidence. Mr. Parks testified regarding CS&W invoices for manhole work performed. Mr. Parks testified that the 2016 manhole re-inspection and interior lining work occurred after CUII initiated its Confidential Investigation into CS&W prepaid invoices. *Id.* at 22. He further testified that three to five weeks after such re-inspections, all 21 re-inspected manholes and newly located manholes had their interiors lined or repaired by Spectra-Tech at a total cost of \$52,448. *Id.* Mr. Parks discussed his review of manhole sealing and lining work invoiced by CS&W and Spectra-Tech, LLC, and testified that his review indicates that \$149,001 of the \$160,627 paid to CS&W for manhole work was not performed. *Id.* at 22-23. He further discussed CS&W Invoice Nos. 3114 and 3115, and stated that six or seven of the 10 manholes shown as being "excavated from the outside" on such invoices also showed evidence of interior lining performed by Spectra-Tech. *Id.* at 25-26. He stated that in his experience it does not make financial sense for CUII to pay one contractor to excavate and seal the manhole exteriors, and pay a second contractor to also line the interiors of the same manholes. *Id.* at 28. He further stated that he identified 17 manholes that were both repaired by CS&W and lined by Spectra-Tech, and stated that his review of these invoices gave him a negative view of CUII's management. *Id.* at 28. Mr. Parks further discussed the costs associated with rehabilitating manholes shown on Invoice Nos. 3111, 3112, 3114 and 3115, and stated that constructing a new manhole would have cost less than the \$13,000+ rehabilitation costs paid by CUII to seal and line certain manholes. *Id.* at 29. Mr. Parks said that Invoices 3111, 3112, 3114 and 3115 were clustered at the end of the year and, based on the clustering and invoicing for sealant work in the winter, it appears the work invoiced on these invoices of \$60,490 was not completed. *Id.* at 36-37. Mr. Parks testified that based on his review, a total of \$149,001 of claimed manhole work was not performed.

Petitioner's Rebuttal Evidence. Mr. Lubertozi responded to the OUCC's criticisms related to CS&W invoices. Despite Mr. Parks' contention that no work invoiced on 3111, 3112, 3114 and 3115 had been performed, Mr. Lubertozi testified that CUII's internal investigation flagged these invoices and CUII was able to confirm that work listed on 3114 and 3115 was in fact complete. Pet. Ex. R1 at 4-5. He further testified that, in order to minimize the contested issues in this Cause, CUII agreed to remove \$41,750 (gross) of manhole work from its rebuttal and accepted the OUCC's adjustments to certain other CS&W invoices. *Id.* at 6.

Commission Discussion and Findings. The record shows the extensive review of the CS&W invoices. Based on its review, the OUCC recommended disallowance of \$149,001 in manhole work performed by CS&W. In CUII's rebuttal, Mr. Lubertozi stated that the Company's physical audit reviewed the invoices challenged by the OUCC and determined, in some instances, that the work had actually been performed. CUII relied on three audit techniques to confirm work had been completed: (1) a physical inspection; (2) verification that a third party performed restoration work in and around the manhole; and (3) verification from onsite local operating personnel. Pet. Ex. R1 at 5-6. However, CUII was unable in all instances to physically verify that work was performed as shown on the original invoice. Mr. Parks' supplemental testimony noted that during his second on-site inspection, CUII personnel confirmed that certain projects that were invoiced were not, in fact, done.

What is disturbing about the revelation of "pre-billed" - and sometimes non-existent - work is that this Commission ordered CUII to remedy the issue of I&I by sealing and repairing manholes. Further, we ordered CUII to file periodic reports with the Commission documenting progress on these goals. As shown by Mr. Parks' extensive exhibits, some of those reports contained inaccurate or false information. We are not persuaded by CUII's self-congratulatory testimony that it reduced its rate request once the fraud was revealed, and as we note further below, this fraud is an indication of the managerial malaise that persists in CUII. We accept the OUCC's recommendation that \$149,001 invoiced by CS&W for manhole work should be disallowed.

### **C. Capital Projects.**

Petitioner's Evidence. Mr. Lubertozi provided a summary of the major capital projects forecasted to be completed before the end of the test period. Pet. Ex. 3 at 9. He described each of the capital projects, its estimated cost, and identified its estimated completion date. *Id.* at 9-13. Mr. Lubertozi described CUII's proposed SCADA Water Treatment Plant Project, which aims to install SCADA controls which will create communication between both Water Treatment Plants #1 and #2 and the Elevated Storage Tank in the water distribution system within the TLUI system. Pet. Ex. 3 at 7. He explained that installing the SCADA controls will provide continuous monitoring and automated operations of the water treatment facilities and will allow automatic operations to maintain levels within the distribution system along with the existing GSTs. *Id.* The estimated cost of the project is \$87,170. *Id.*

He further testified regarding CUII's decision to replace its WCSI Hydro-Tank. He testified that CUII inspected the existing hydro-tank in 2014 and determined that the tank had reached the end of its useful life and posed a safety risk to nearby residents and operations staff. *Id.* at 9. He testified that a new tank was installed and placed in service in October, 2015, at an estimated project cost of \$161,211. *Id.* at 10.

Mr. Lubertozi testified regarding CUII's proposed construction of a Second Sludge Storage Tank. Mr. Lubertozi explained that CUII currently operates with one 400,000 gallon sludge storage tank but, with increasingly more stringent phosphorous limits, a second tank is needed. *Id.* at 7. He further testified that a second tank will also provide needed additional storage as well as redundancy so that one tank can be taken out of service for inspection or maintenance. *Id.* at 8. He said the estimated project cost for the tank is \$539,159. *Id.* at 7.

Mr. Lubertozi also testified regarding CUII's proposed Headworks upgrades. He explained that the sewage grinder originally in operation at the WWTP headworks structure failed and a manual bar screen is being temporarily used. *Id.* at 8. He further explained that a new structure will be added to the head of the plant which will employ the use of a mechanical step screen to remove the non-biodegradable solids from wastewater; the new structure will also have a grit removal system to remove sand-like debris from the wastewater before it enters the plant. *Id.* at 9. Mr. Lubertozi explained that the removal of these two types of solids will allow for more efficient solids removal and reduce future maintenance requirements within the WWTP, as well as aid in the reduction of potential blockages and backups within the plant. *Id.* He said estimated project costs for the Headworks project is \$1,072,503. *Id.* at 7.

OUCC's Evidence. Mr. Parks testified regarding CUII's plans to install a SCADA communication system at the TLUI water division to link both water treatment plants and the elevated water tower. He testified that he was not able to review project specifics, reasonableness of the project, etc. because CUII's case-in-chief did not provide this information. Pub. Ex. 3 at 41. He said that he requested this information via OUCC DR 11-25 but did not receive it. *Id.* at 42. He recommended that the Commission disallow the project in its entirety due to lack of information provided by CUII "that is needed to review whether the project is prudent and reasonable". *Id.*

Mr. Parks further testified regarding CUII's WSCI Hydro-tank project. Mr. Parks explained generally what a Hydro-tank is and explained why CUII needed to replace its original hydro-tank. *Id.* at 43-44. Mr. Parks testified that CUII estimated total capital investment of \$110,000, but that, based on his review, actual total project costs associated with the WSCI Hydro-tank project were \$183,239. *Id.* Mr. Parks further testified that, while he agreed with CUII that the WSCI Hydro-tank project was needed, he was unable to verify that the higher project cost was reasonable. *Id.* at 44.

Mr. Parks also testified regarding CUII's proposal to install a second digested sludge storage tank at the TLUI wastewater treatment plant in order to meet more stringent phosphorus limits, provide additional needed storage and for tank redundancy during maintenance. He testified that the estimated cost of such project is \$539,150. *Id.* at 45. He further testified that CUII has completed minimal planning regarding the tank's construction, and that he requested additional information regarding project specifics, but did not receive it. *Id.* at 46. He stated that he did not believe CUII needed to construct a second sludge storage tank in 2017, because the phosphorus limits CUII is using to justify the project will not take place until 2021. *Id.* Mr. Parks recommended that the Commission disallow CUII's Second Sludge Storage Tank project in its entirety. *Id.* at 48.

Mr. Parks also testified regarding CUII's proposed Headworks Upgrades. He testified that CUII proposed to construct new grit removal, mechanical step screening, and raw sewage odor control in a new Headworks Building; total project costs are estimated at \$1,072,503. *Id.* at 49. He further discussed the need for the Headworks project and stated that, while he requested additional information from CUII regarding project specifics, he did not receive such information. *Id.* at 50-51. He testified that despite CUII's contention that the Headworks project will benefit ratepayers, the cost savings are not quantified. *Id.* at 51. He recommended that the Commission disallow the project in its entirety. *Id.*

Petitioner's Rebuttal Evidence. Mr. Kersey provided an update on the capital projects and responded to the OUCC's proposed adjustments. As shown in his Table 7, CUII removed the SCADA Water Treatment Plant, Second Sludge Storage Tank and WWTP Headworks Upgrades projects from rate base. Mr. Kersey also revised the cost estimates for the remaining capital projects, resulting in an adjustment to CUII's rate base of \$(2,036,796). Pet. Ex. R2 at 31.

Mr. Kersey testified that CUII does not agree with the OUCC's position regarding the removal of hydro-pneumatic tank costs from CUII's water rate base. Pet. Ex. R2 at 33. He testified that despite OUCC witness Parks agreeing that the WSCI Hydro-Tank project was needed to replace the original hydro-tank, the OUCC proposed to limit project costs to \$110,000. *Id.* He further testified that the OUCC arrived at the \$110,000 threshold based on a figure that was communicated to Mr. Parks by Mr. Lubertoizzi, and that OUCC witness Parks admitted that he is not aware of the cost detail used to arrive at the \$110,000. *Id.* at 33. Mr. Kersey testified that CUII does not agree that any of these costs should be removed from rate base, because the OUCC fails to provide which of the "higher costs" are unreasonable and fails to base its recommendation on costs which are on record in this Cause. *Id.*

Mr. Lubertoizzi also responded to the OUCC's proposed adjustments. Mr. Lubertoizzi stated that capitalized time and interest during construction were not included in the original \$110,000 estimate communicated to Mr. Parks. Pet. Ex. R1 at 22. Mr. Lubertoizzi further stated that despite Mr. Parks' contention that he was "unable to verify that the higher project costs were reasonable," he admitted that he was able to review "project specifics, the reasonableness of the project and project costs." *Id.* at 23. Mr. Lubertoizzi stated that he is unsure what additional information the OUCC would need to review project reasonableness and, in his opinion, it is not appropriate, proper or consistent with regulatory practice to exclude costs based on a phone call that provided a preliminary cost estimate. *Id.* at 24. Mr. Lubertoizzi further stated that the OUCC was aware that CUII's original tank had failed inspection and a significant investment would need to be made in order to replace it. *Id.* at 25. He testified that the OUCC agreed that the project was necessary and has not identified any costs associated with the WSCI Hydro-Pneumatic Tank that it believes are imprudent or unreasonable. *Id.* at 25. For these reasons, Mr. Lubertoizzi recommended that the Commission reject the OUCC's proposed cap on CUII's Hydro-Pneumatic Tank project costs.

Commission Discussion and Findings. The OUCC identified concerns with several of the forecasted capital projects included in CUII's rate base. In rebuttal, CUII removed several of those projects because they will not be completed by the end of the forward-looking test period. Thus, the only remaining challenged project is the WSCI Hydro-tank replacement. The OUCC agrees that this project is necessary, but questions the increase in costs above the preliminary cost estimate provided to the OUCC.

We accept the OUCC's proposed adjustment to this project. CUII communicated informally with the OUCC to keep them advised of the status of upcoming capital projects and provided a preliminary cost estimate of \$110,000 for the WSCI Hydro-tank project. Mr. Lubertoizzi then testified that this cost estimate did not include capitalized time and interest during construction. While it is unclear whether that fact was communicated to the OUCC during the initial telephone discussion, the OUCC testified that it was unable to verify whether the final costs were reasonable. The OUCC acknowledged it was able to review project specifics, the reasonableness of the project and the project costs, but given that CUII did not provide a detailed



breakdown of the costs for the OUCC to review, we accept the OUCC's adjustments to its forecasted capital projects. Given the totality of this case and the paucity of information provided by CUII, we approve inclusion in CUII's rate base at an amount of \$468,558<sup>1</sup>, adjusted for the WSCI Hydro-tank disallowance.

#### **D. Working Capital**

Petitioner's Case-in-Chief Evidence. Mr. Kersey explained Petitioner's forecasted Working Capital is calculated based on forecasted O&M expense as well as forecasted Taxes Other Than Income expense. *Pet. Ex. 1 at 28-29.*

OUCC's Evidence. Ms. Margaret Stull, OUCC Senior Utility Analyst, explained Petitioner used the FERC-45 day method to estimate working capital and proposed to earn a return on working capital of \$194,043 for its consolidated water operations and \$136,167 for its consolidated wastewater operations. *Pub. Ex. 1 at 35 and 50.* Ms. Stull stated that for ratemaking purposes, working capital generally is defined as the average amount of capital provided by investors, over and above the investment in plant, to bridge the gap between the time expenditures are required to provide service and the time collections are received for that service. In other words, working capital is the money a utility needs to provide utility service before it receives payment for that service. She added that while some expenses are paid *after* the related service revenues have been collected (paid "in arrears"), some expenses are incurred and paid *before* the related revenues have been collected such as chemical expense, rent, and salaries. She testified that expenses paid in arrears include taxes, purchased water, and purchased power. She said working capital is the net amount of money needed on an ongoing basis to fund daily utility operations, and it is considered an investment necessary for providing utility service and is included in rate base for investor-owned utilities. *Id. at 34.*

Ms. Stull testified that the best method to determine a utility's working capital is to conduct a lead/lag study. She explained that a lead/lag study measures the differences between (1) the time a service is rendered until the revenues for that service are received, and (2) the time expenses are incurred until those expenses are paid. She noted that a lead/lag study requires an in-depth analysis of the timing of a specific utility's operating revenues and expenses, and the difference between these periods is expressed in terms of days. She explained the number of days determined through this process is multiplied by the average daily operating expenses to produce the cash working capital required for operations. She emphasized that a lead/lag study produces a reliable estimate of a utility's investment in working capital because it is based on *that* utility's actual operating conditions as well as *its* billing, collecting, and cash disbursement practices. *Id. at 35.*

Ms. Stull noted Petitioner did not perform a lead-lag study to determine its investment in working capital but used the FERC 45-day method to conclude its investment in working capital for inclusion in its proposed rate base. *Id. at 35.*

Ms. Stull explained the FERC 45 day formula method calculates a percentage of operating expenses as the estimate of the working capital requirements for a utility. Ms. Stull testified the formula method is quick and inexpensive, but it does not provide evidence that the resulting allowance represents actual investment of capital for a specific utility. *Id. at 35-36.*

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<sup>1</sup> This amount includes \$180,903 for the 2016 Sewer Capital Improvement Plant ("SCIP") and \$361,806 for the 2017 SCIP reduced by \$74,151 for the WSCI Hydro Tank disallowance.

Ms. Stull explained that the FERC 45-day method was developed over 75 years ago, before modern banking rules regarding money transfers were developed and implemented. Today, cash receipts and disbursements are cleared much more quickly than they were when this method was developed. She noted further that the ability for customers to pay their bills online further shrinks the lag between when expenditures are incurred and revenues are received. Finally, in Indiana, there is a two year lag between when property taxes are incurred and when these taxes are paid. *Id. at 36.*

Ms. Stull testified that it is not reasonable for Petitioner to use the FERC 45-day method to calculate its proposed working capital. She noted Petitioner requests a return on an investment in working capital but provides no evidence that any investment in working capital actually exists. She noted Petitioner has no cash accounts as all cash is managed at the corporate level by Water Service Company (“WSC”). She further noted that Petitioner was unable to provide a cash flow statement in this case because it had no cash accounts (Attachment MAS-13). Ms. Stull observed that, although each of Petitioner’s divisions may appear to be small and qualify for an exception to the Commission’s general preference for a lead-lag study, Petitioner is not financially unsophisticated. Since Petitioner’s cash is managed at the corporate level, she said it may be assumed that Petitioner’s parent company strives to minimize the amount of working capital necessary to operate its various businesses, including Petitioner. As such, she reasoned, the FERC 45-day method does not accurately reflect Petitioner’s working capital investment. However, because Petitioner has not conducted a lead-lag study in this case, she would accept the FERC 45-day method in this case after making certain adjustments to the amount of operating expenses included in the calculation. *Id. at 36-37.*

Ms. Stull noted that in its calculation of working capital, Petitioner included expenses that are known to be paid in arrears. She identified taxes as well as purchased power and purchased water as items paid at the time or after Petitioner has received revenues from its customers for the utility service provided, noting many taxes are paid on a quarterly basis (in arrears) and property taxes are paid up to two years in arrears. Therefore, she proposed the exclusion of all taxes as well as purchased power and purchased water expense from the calculation of operating expenses on which the FERC 45-day method is applied. Ms. Stull noted these types of downward operating expense adjustments have been approved by the Commission in previous rate cases involving TLUI, WSCI, and IWSI. Ms. Stull provided an example to show the lag in property tax expense. If plant is placed in service in 2020, this plant will be assessed as of January 1, 2021 (with the assessment form due in May 2021), and property tax bills for this plant will not be due until May and November of 2022. *Id. at 37-38.*

Ms. Stull proposed working capital of \$108,547 be included in consolidated water rate base. *Id. at 38.* Similarly, Ms. Stull proposed working capital of \$89,886 be included in consolidated wastewater rate base. *OUCS Supplemental Schedule 8S.* Finally, Ms. Stull recommended the Commission require Petitioner to perform a lead-lag study or otherwise support its proposed working capital in its next base rate case. *Id. at 38.*

Petitioner Rebuttal Evidence. Mr. Kersey accepted the adjustments proposed by the OUCS and said Petitioner will exclude the suggested expenses paid in arrears in order to calculate its working capital requirements. However, Mr. Kersey said the Company does not agree to perform a lead-lag study but proposes to continue to use the FERC-45 day method because it is a low cost calculation and is commonly accepted. He noted the IURC has accepted this method in each of the prior cases for CUII’s individual territories. However, he added the Company agrees

to perform and file a lead-lag study if it were to request a working capital allowance greater than 1/8<sup>th</sup> of its Operating Expenses. *Pet. Ex. 2R at 53.*

Commission Discussion and Findings: We agree and find that Petitioner’s forecasted working capital for purposes of establishing rate base is as follows:

Consolidated Water Working Capital

		Phase I	Phase II
Maintenance Expense		\$ 863,218	\$ 863,218
General Expense		448,680	450,384
Less:	Purchased Water	77,830	77,830
	Purchased Power	380,353	380,353
Adjusted Operation & Maintenance Expense		853,715	855,419
Times: 45 Day Factor		0.125	0.125
Working Capital Requirement		<u>\$ 106,714</u>	<u>\$ 106,927</u>

Consolidated Wastewater Working Capital

		Phase I	Phase II
Maintenance Expense		\$ 676,743	\$ 676,743
General Expense		295,338	296,453
Less:	Purchased Water	-	-
	Purchased Power	212,212	212,212
Adjusted Operation & Maintenance Expense		759,869	760,984
Times: 45 Day Factor		0.125	0.125
Working Capital Requirement		<u>\$ 94,984</u>	<u>\$ 95,123</u>

As to whether Petitioner should be required to perform a lead-ag study or otherwise support its proposed working capital in its next base rate case, we remind CUII that investor owned public utilities have the burden to establish their investment in working capital. In determining a utility’s investment in working capital, a lead-lag study provides greater transparency and precision, neither of which can be achieved by the FERC-45 day method. The FERC-45 day method was established more than 75 years ago and is considered appropriate for smaller investor-owned utilities, as well as municipal and not-for-profit utilities, to estimate their working capital without incurring the costs of a lead-lag study. The FERC-45 day method does not consider the latest in payment and billing methods, nor does it consider a specific utility’s actual operating conditions as well as *its* billing, collection, and cash disbursement practices.

In the absence of a lead-lag study, it is appropriate for the Commission to approve the kind of refinements to the FERC-45 day method the OUCC proposed in this case. In the absence of a Utility performing a lead-lag study, we would continue to rely on the kind of refinements to the working capital calculation approved in this order. In determining whether to require a lead-lag

study or other evidence supporting its working capital proposal, we would do our own cost benefit analysis as to whether the FERC 45 day method should be considered good enough. Whether the FERC-45 day method should be considered good enough depends in part on the size of the utility. While CUII has a relatively small number of customers, it is part of a much larger group of utilities that are somewhat uniform in their operations. As such, we do not consider the FERC-45 day method to be adequate and, to the extent Petitioner desires to include working capital in rate base in its next rate case, it should perform or procure a lead-lag study or otherwise provide support in its next base rate case.

#### **E. Deferred Maintenance Expense**

OUCG's Evidence. OUCG witness Ms. Stull opposed Petitioner's proposal to include deferred maintenance expense in its rate base. Petitioner referred to these expenses as "deferred charges." Ms. Stull explained that these expenses represent maintenance costs and indicated such costs are sometimes amortized over the expected life of the deferred cost. She stated, however, these costs do not represent an investment in utility plant and should not be considered includable in rate base. *Pub. Ex. 1 at 33.*

Ms. Stull noted Petitioner forecasted \$41,318 of water deferred charges as of September 30, 2017, a decrease of \$331,393 from base year water deferred charges of \$372,711. *Pub. Ex. 1 at 32.* She noted that Petitioner also forecasted \$33,681 of wastewater deferred charges as of September 30, 2017, a decrease of \$229,504 from base year deferred charges of \$263,185. *Pub. Ex. 1 at 49.* Ms. Stull explained Petitioner's forecasted water deferred charges primarily consisted of deferred maintenance costs, including tank painting, VOC testing, tank maintenance and repair, and sludge hauling. She explained Petitioner proposed amortizing these costs over the expected life of each deferred expense. *Pub. Ex. 1 at 32.* Ms. Stull also explained Petitioner's wastewater deferred charges primarily consist of deferred maintenance costs, including sludge hauling, tank maintenance and repair, and sewer master planning. She explained Petitioner proposed amortizing these costs over the expected life of each deferred expense. *Pub. Ex. 1 at 49.*

Ms. Stull noted Petitioner proposed several adjustments to determine its forecasted water deferred charges as of September 30, 2017. First, Petitioner proposed a \$313,915 decrease to reflect the removal of a deferred loss recorded for retired meters. She said Petitioner referred to these retired meters as "prudently abandoned plant." Second, Petitioner projected additional deferred maintenance costs of \$5,710 for an elevated tank inspection to be conducted in 2016. Finally, Petitioner projected a decrease of \$23,189 to reflect the additional amortization expense on its projected deferred maintenance costs through September 30, 2017. *Pub. Ex. 1 at 33.*

Ms. Stull noted Petitioner also proposed several adjustments to determine its forecasted wastewater deferred charges as of September 30, 2017. First, Petitioner proposed a \$182,570 decrease to reflect the removal of a deferred loss recorded on retired meters, described by Petitioner as "prudently abandoned plant." Second, Petitioner projected a decrease of \$46,934 to reflect the additional amortization expense on its projected deferred maintenance costs through September 30, 2017. *Pub. Ex. 1 at 49.* Ms. Stull explained the OUCG does not accept Petitioner's inclusion in rate base of forecasted 2017 deferred charges, adding these costs have not previously been approved by the Commission for inclusion in Petitioner's rate base. Further, she noted Petitioner has not sought approval in this case to include these costs in its rate base. Finally, she noted

Petitioner did not provide any discussion or evidence to support its proposed inclusion of these costs in its rate base. *Pub. Ex. 1 at 33 and 49.*

Petitioner's Rebuttal Evidence. Mr. Kersey responded that the Company has requested recovery on certain maintenance costs, or projects, which he asserted should be deferred and amortized since the charges are incurred in frequencies greater than one year. He asserted the balance of these charges should be included in rate base due to the negative net present value associated with the necessary capital outlays and because these charges are incurred solely for the benefit of ratepayers. Mr. Kersey said his Attachment JPK-R7 shows the negative net present value nature of these projects. As an example, he noted that where a hydro tank is inspected every five years, the net present value of a deferred maintenance project is greater (less negative) when the project balances are included in rate base. He explained that the Company believes earning a return "on" and "of" these projects is necessary to help offset their negative net present value, which aids in attracting the capital necessary to continue providing a reasonable level of service.

Commission Discussion and Finding: Petitioner seeks to include in rate base and earn a return on the unamortized balance of maintenance expenses incurred in prior periods. The OUCC noted the Commission has not previously approved including such costs in Petitioner's rate base, and Petitioner provided no discussion or evidence in its case-in-chief to support such treatment. The OUCC opposed including these expense in rate base. In its rebuttal filing, Petitioner argued these charges should be included in rate base due to the negative net present value ("NPV") associated with these "projects."

As a general principle, prior period expenses should not be included in rate base, and a utility should not be allowed to earn a return on those expenses. Doing so would essentially guarantee a utility its proposed rate of return, which a utility is not guaranteed to earn.

We find Petitioner's evidence and argument for including these deferred charges in rates unpersuasive. While Petitioner provided an analysis (Attachment JPK-R7) purporting to show the negative NPV nature of these "projects" or deferred maintenance expenses, this analysis ignores the likelihood the cost of these maintenance expenses have already been recovered by being included in Petitioner's current revenue requirement. Petitioner provided no evidence showing that is not the case. To defer recovery of these costs and include them in rate base would allow CUII to recover these costs twice; once in current rates and again in rates being set in this case. As such, we need not address Petitioner's net present value argument or weigh the evidence presented as to net present value. Nor do we need to address the more basic issue as to whether the net present value even affects whether an expense should be included in rate base.

For the reasons discussed above, we agree with the OUCC and reject Petitioner's proposed inclusion of these deferred charges in rate base in this case. We find that Petitioner's rate base approved in this case should not include any amount for deferred maintenance expenses.

**F. Rate Base Determination.** Based on the foregoing, we find Petitioner’s forecasted rate base, subject to the update process discussed below, is as follows:

Consolidated Water Rate Base

	<b>Phase I</b>	<b>Phase II</b>
Plant in Service at 2/29/2016	\$ 13,445,342	\$ 13,445,342
North Ground Storage Tank	(543,997)	(543,997)
Vehicle Additions	-	5,611
General Plant Additions - Phase I	-	278,209
General Plant Additions - Phase II	-	476,929
Retirements	(370,211)	(412,927)
Disallowed Capital Costs	(374,998)	(374,998)
Utility Plant in Service	12,156,136	12,874,169
Accumulated Depreciation at 2/29/2016	2,684,682	2,684,682
Remaining Phase I Depreciation Expense	140,487	140,487
Phase II Depreciation Expense	-	255,195
A/D on Disallowed Capital Costs	(9,868)	(9,868)
Retirements	(370,211)	(412,927)
Accumulated Depreciation	2,445,090	2,657,569
Contributions in Aid of Construction, net at 2/29/2016	2,342,255	2,342,255
Amortization of CIAC Phase I	(8,426)	(8,426)
Amortization of CIAC Phase II	-	(14,445)
Contributions in Aid of Construction, net	2,333,829	2,319,384
Utility Plant in Service	7,377,217	7,897,216
Accumulated Deferred Income Taxes	(949,693)	(1,054,374)
Acquisition Adjustment, net	(339,291)	(330,754)
Customer Deposits	(37,650)	(37,650)
Net Deferred Charges	-	-
Working Capital (see below)	106,714	106,927
Original Cost Rate Base as of 9/30/17	<u>\$ 6,157,297</u>	<u>\$ 6,581,365</u>

Consolidated Wastewater Rate Base

	<b>Phase I</b>	<b>Phase II</b>
Utility Plant in Service at 2/29/2016	\$ 19,091,095	\$ 19,091,095
Less: 2016 Sewer Capital Improvement Plan	180,903	180,903
2017 Sewer Capital Improvement Plan	-	361,806
Vehicle Additions	-	3,682
General Plant Additions - Phase I	-	110,750
General Plant Additions - Phase II	-	189,857
Less: Retirements	(336,538)	(364,570)
Disallowed Capital Costs	(451,998)	(451,998)
Gross Utility Plant in Service	18,483,462	19,121,525
Accumulated Depreciation at 2/29/2016	6,256,180	6,256,180
Add: Remaining Phase I Depreciation Expense	267,882	267,882
Phase II Depreciation Expense	-	475,178
Less: A/D on Disallowed Capital Costs	(20,836)	(20,836)
Retirements	(336,538)	(364,570)
Accumulated Depreciation	6,166,688	6,613,834
Contributions in Aid of Construction, net at 2/29/2016	3,760,416	3,760,054
Less: Amortization of CIAC Phase I	(211)	(211)
Amortization of CIAC Phase II	-	(362)
Contributions in Aid of Construction, net	3,760,205	3,759,481
Net Utility Plant in Service	8,556,569	8,748,210
Less: Accumulated Deferred Income Taxes	(901,689)	(1,018,768)
Customer Deposits	(23,206)	(23,206)
Add: Working Capital (see below)	84,400	95,123
Total Original Cost Rate Base as of 9/30/17	<u>\$ 7,716,074</u>	<u>\$ 7,801,359</u>

**7. Capital Structure and Rate of Return.**

Mr. Lubertozi testified that rate case expense is normally included in the revenue requirement and that CUII has proactively taken steps to control such expense. He explained that in order to resolve this contentious issue and help reduce rate case expense, CUII and the OUCC entered into a settlement agreement that resolves all components to the Weighted Average Cost of Capital (“WACC”). Pet. Ex. 1 at 9-10. He explained that customer interests are best served when the authorized rate of return on rate base is neither higher nor lower than the overall cost of capital; thus, CUII and the OUCC reached a settlement on WACC that is equal to 8.18%. *Id.* at 10. He testified that the agreed-upon return on equity and capital structure is reasonable and was the result of an arms-length negotiation after considerable discussion between knowledgeable parties. *Id.* at 10-11. Mr. Lubertozi further testified that a 9.75% return on equity (“ROE”) is consistent with the Commission’s Order in Cause No. 44450.

At the hearing, the Presiding Officers asked Mr. Lubertozi and Mr. Kaufman about the stipulated cost of equity that the parties had recommended in this case. Tr. at B-131; E-17. Mr.

Lubertozzi testified that CUII looked at other approved ROEs in other states, and also looked at the cost of engaging a return on cost of capital expert, and determined it was beneficial to avoid bringing an ROE expert in to testify. Tr. at B-131-132. When asked to compare the relative cost of equities for a utility that has no service issues with one that does, Mr. Lubertozzi explained that most utilities are going to have some type of sanitary system overflow or manhole overflow or some surcharges. He did not think the return on equities that CUII was looking at were dependent upon the quality of service, but acknowledged that cost of equity could be used as a tool to send a message to the utility. Tr. at B-132-133. During questioning from the bench, Mr. Kaufman believed that in a prior order for Twin Lakes Utilities, the Commission reduced the agreed-upon cost of equity by 50 basis points to express their concern about customer service issues. Tr. at E-18. Mr. Kaufman also noted that Petitioner has gone through management changes in the past with the hope that change would improve service Tr. at E-19. That said, Mr. Kaufman declined to express an opinion as to whether a reduction would be warranted in this proceeding in light of the agreement between the parties. *Id.*

CUII experienced operational difficulties as a result of certain employees, but has indicated it has renewed its focus in conjunction with replacing those employees. The Commission continues to be concerned about the operational issues that seem to be persistent with this utility; it is our hope that along with its new personnel, CUII will improve its internal controls and significantly improve service quality.

With an expectation and goal of eliminating controversy and avoiding rate case expense, prior to the filing of its case Petitioner reached agreement with the OUCC on a cost of equity and capital structure thereby establishing its weighted cost of capital:

Class of Capital	% of Total	Cost (%)	Weighted Cost
Equity	50.00%	9.75%	4.88%
Debt	50.00%	6.60%	3.30%
	100.00%		8.18%

We find the agreement between the OUCC and CUII to be reasonable and so find the aforesaid cost of capital.

**8. Operating Revenues.**

**A. Declining Usage Adjustment.**

Petitioner’s Evidence. CUII proposes a decrease of \$133,301 to base year water revenues and a decrease of \$12,641 to base year sewer revenues. Mr. Kersey explained the forecasted revenues reflect the exclusion of surcharges related to Cause Nos. 44646, 42734 and 30-day filing #3304, test year-end customer counts and forecasted levels, which incorporate a usage normalization adjustment due to “the ongoing rate of consumption decline.” Pet. Ex. 2 at 8. Mr. Kersey stated that the usage normalization adjustment was calculated specifically for each territory and customer class and was developed by averaging the annual change in consumption



per customer from June 2009 through June 2015. *Id.* He further stated that the company analyzed consumption patterns during winter months (December through February) over the same period to determine whether the declining usage was weather neutral. *Id.* at 9. He testified that a similar level of decline in usage was seen during the winter months, suggesting that the decline is not a weather-related phenomenon. *Id.*

OUCC's Evidence. Mr. Kaufman testified that Petitioner's proposed declining usage adjustments would reduce anticipated revenues and consequently increase the proposed rate increase. Public's Exhibit No. 4. pp. 12-15. He explained Petitioner's declining consumption adjustment reduces total water revenues by \$34,008 for the forward looking forecasted year starting in 9/30/2016, and an additional \$32,571 (\$66,579 total) for the forecasted year starting 9/30/2017.<sup>2</sup> Petitioner's declining consumption adjustment reduces total wastewater revenues by \$8,894 for the forecasted year starting 9/30/2016, and an additional \$8,496 (\$17,390 total) for the forecasted year starting 9/30/2017 (Attachment ERK 9).

Mr. Kaufman testified that the passage of Indiana Senate Bill 383 diminishes the need to make a declining consumption adjustment to revenues in water/wastewater rate cases. He explained the new law allows a utility to collect (or "track") the difference between its authorized revenues and its collected revenues. Both the declining consumption adjustment and SB 383 protect a utility against potential declining revenues. He noted that, while a declining consumption adjustment protects the utility by assuming (or projecting) a lower base revenue forecast, SB 383 ensures a utility can collect its authorized revenues because it effectively tracks uncollected revenues. Both accomplish the same end.

However, he asserted, implementing a declining consumption adjustment after the passage of SB 383 can be harmful to ratepayers because an overstated declining consumption rate will reduce forecasted revenues and make the rate increase higher. He noted that when the actual rate of decline is overstated, a utility will have the opportunity to collect revenues greater than it is authorized to collect in rates. For example, if a hypothetical utility had base year revenues of \$10.0 million and assumed a 2.0% declining consumption adjustment, its projected revenues would be \$98.0 million in year 1 owing the base year and \$96.0 (rounded) in year 2 following the base year. However, he noted that if the actual decline in consumption is only 1.0%, the utility's actual revenues would be \$99.0 million and \$98.0 million (rounded) in years 1 and 2 following the base year. In this hypothetical scenario (holding other factors such as growth constant), the utility would over-collect approximately \$3.0 million in revenues.

Mr. Kaufman explained that to the extent a utility collects revenues greater than it is authorized to collect (unless the utility has previously initiated a filing under SB 383), SB 383 does not require a utility to initiate a filing to repay over-collected revenues to ratepayers. Yet SB 383 insulates a water/wastewater utility from under-collecting if its actual revenues are less than those authorized. SB 383 provides utilities the ability to recover revenues that could occur as a result of declining consumption. In light of SB 383, Petitioner, the Commission, and the OUCC do not need to speculate on future revenues and build that speculation into revenue requirements.

Mr. Kaufman also did not agree with Petitioner's calculation of declining consumption. Mr. Kaufman noted Petitioner adjusts base usage as of September 30, 2015. To the extent a utility

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<sup>2</sup> Petitioner's 9/30/2016 adjustment to water revenues also includes adjustments to remove the impact of water trackers and DSICs. OUCC witness Margaret Stull discusses these adjustments.

is proposing a declining consumption adjustment, Mr. Kaufman argued it should be made for as few months as possible. Estimated usage should not be used when actual usage figures exist, to the extent these figures can be reasonably reviewed by the OUCC and the Commission. He asserted any error in estimating declining usage will be magnified over longer periods of time. Thus, estimating usage for a shorter period of time will reduce the likelihood and scale of estimated errors.<sup>3</sup> If the Commission accepts Petitioner's proposal to make a declining usage adjustment, it should not be made for months where actual usage is available.

Mr. Kaufman proposed removal of the Company's usage adjustment in its entirety, because Indiana Senate Bill 383 diminishes the need to make a declining consumption adjustment to revenues. Pub. Ex. 4 at 13. He explained that Senate Bill 383 allows a utility to track the difference between its authorized revenues and collected revenues thereby insulating a utility from under-collecting its authorized revenues. *Id.* 13-14. He further testified that he did not agree with Petitioner's calculation of declining consumption, because estimated usage should not be used when actual usage figures exist. *Id.* at 15.

Petitioner's Rebuttal Evidence. Mr. Kersey testified with regard to the OUCC's proposed removal of the Company's usage adjustment. He asserted the OUCC did not dispute the Company's declining usage forecast or supporting data. Pet. Ex. R2 at 2-3. Mr. Kersey testified that the Company disagreed that it should update its billings for periods where actual usage data exists. *Id.* at 3. He explained that a significant amount of time went into reconciling the bill frequency distribution by the Company's cost of service consultants, and, because there was no significant change to the customer base or in weather patterns, an update would not materially change the proposed rates. *Id.* He testified that, as such, the Company does not believe an update is an efficient use of resources. *Id.* Mr. Kersey further testified that he did not agree with Mr. Kaufman's suggestion that any under collection should be recovered via Senate Bill 383. *Id.* He opined that relying on the mechanism provided via Senate Bill 383 would conflict with the purpose for utilizing a future test year and would not guarantee the Company full recovery of its revenue requirement. *Id.* at 3-4.

Commission Discussion and Findings. CUII seeks to incorporate Mr. Kersey's estimated declining usage in its forecasted revenues leading to a larger rate increase. The OUCC maintained that the passage of SB 383 diminishes the need to make an adjustment for estimated declining usage. The OUCC's witness Mr. Kaufman also argued if a declining usage adjustment is made, it should be made for as few months as necessary, and that where actual data exists, revenues need not and therefore should not be estimated. Mr. Kaufman explained that any error in estimating usage will get magnified over longer periods of time.

Predicting consumption in the short terms based on longer term trends is fraught with difficulty. Actual revenues can be measurably lower or higher than estimated. For instance, because of delays in this case we can now compare Petitioner's "Year 1 Forecasted Revenues" (twelve months ending 9/30/2016) to its actual revenues for the same time period. For its combined water operations Petitioner estimated \$1,887,200 (ERK 9, page 1 of 2) in annual revenues, yet recovered \$2,024,576 (OUCC CX 12), and for its combined wastewater operations,

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<sup>3</sup> In response to informal OUCC discovery during the OUCC's audit, Petitioner provided an Excel spreadsheet with its actual usage for the calendar year end 2015.

Petitioner estimated \$2,177,164 in annual revenues, yet recovered \$2,267,499. *Id.* It is clear that actual revenues can be measurably lower or higher than estimated revenues.

Before the passage of SB 383, this Commission addressed other requests by utilities to decrease revenues to a level lower than they otherwise would in response to forecasts of declining consumption. The issue and calculation of declining consumption was both complex and controversial in those cases. Many factors drive changes in water consumption, and not all of these changes point to a downward trend. Weather is one of the most important factors that will influence consumption and subsequent revenues.

But despite the complexity of these issues, CUII's case-in-chief testimony in support of its declining consumption adjustments was sparse, consisting of little more than three or four pages in Mr. Kersey's testimony, and the single page Schedule D of Attachment JPK-1. Thus, Petitioner's analysis is not sufficiently transparent to allow us to assess its reliability to predict consumption during the life of these rates. Moreover, Petitioner estimated declining consumption adjustments for each class of customer for each of three districts (According to Petitioner's wp-1 Usage Adjustment, it had 31 adjustments for estimated declining consumption). Thus, these types of adjustments are open to forecasting errors. The magnitude of these errors increases as the forecast goes further out in time.

Moreover, as demonstrated by Petitioner's responses to discovery (OUCC CX 12 and OUCC CX 19), Petitioner's revenues and consumption did not decrease, for example, during the forecast year for the 12 months ending 9/30/2016. Note we had a similar issue in Indiana American Water Company Cause No. 42520 (pg. 74-77), where revenues actually increased despite Petitioner's assertion revenues were decreasing. In that case we rejected Petitioner's proposed declining usage adjustment.

We also consider Mr. Kaufman's contention that under SB 383, a utility is permitted to seek recompense if it under collects its projected revenues, but it is not required to initiate a cause to compensate the ratepayer if it over collects its revenues. If so, it is all the more important that any adjustment to revenues based on declining consumption should be based on a competent and substantial evidence. The passage of SB 383 with its unilateral adjustment mechanism would suggest we err on the side of anticipating higher revenues because only under collection can be addressed. But if we underestimate revenues when setting rates, there is no corresponding mechanism for the ratepayer.

In Petitioner's rebuttal case, Mr. Kersey encouraged us not to consider the mechanism provided via Senate Bill 383, as doing so would conflict with the purpose for utilizing a future test year and would not guarantee the Company full recovery of its revenue requirement. *Id.* at 3-4. But a future test year does not absolve the utility of adequately supporting the forecast it asks us to adopt. We find that Petitioner has not adequately made its case for downward adjustment to its revenues based on estimated declining consumption. Therefore, we reject Petitioner's proposed declining consumption adjustments.

## **B. Surcharge Revenues.**

OUCC's Evidence. Ms. Stull included revenues for all of CUII's surcharges in determining her recommended level of revenues. She explained that there are currently three surcharges approved for CUII subsidiaries: (1) IWSI water tracker of \$0.35 per thousand gallons, (2) an IWSI distribution system improvement charges ("DSIC") of \$0.30 per thousand gallons,

and (3) a TLUI utility infrastructure improvement charge (“USIC”) of \$2.36 per thousand gallons. Ms. Stull explained that not including these revenues overstates the amount of revenue increase necessary for the utility to earn its allowed return and she asserted all surcharge revenues currently being collected by Petitioner should be included in operating revenues in order to determine the appropriateness of increases in this case. *Pub. Ex. 1 at 59-62 and 65-67.*

Ms. Stull explained IWSI is recovering increased purchased water costs through a water tracker and base year revenues were \$45,716. Ms. Stull explained it was necessary to reduce base year water tracker revenues by \$5,771 (OUCC Schedule 5W, Adjustment No. 3) to reflect the reduction in its water tracker rates from \$0.50 to \$0.35. This rate reduction reflects a decrease in purchased water expense due to the elimination of sales taxes paid on purchased water. *Id.*

Ms. Stull explained that IWSI is currently approved to recover \$33,064 of annual DSIC revenues plus an additional \$3,178 for under recovered DSIC revenues in its last reconciliation period (OUCC Schedule 7W, Adjustments No. 2). Ms. Stull stated TLUI is also currently authorized to recover \$87,608 of USIC revenues (OUCC schedule 5S, Adjustment No. 1). Ms. Stull stated DSIC and USIC surcharge revenues are “guaranteed” as these revenues are reconciled and adjusted on an annual basis to ensure Petitioner recovers the full amount of revenues approved. Therefore, it is appropriate to include the total amount of authorized revenues in Petitioner’s *pro forma* operating revenues with no normalization. *Id.*

Petitioner’s Rebuttal Evidence. Mr. Kersey explained that CUII did not consider it necessary to include surcharges in its forecasted revenues as the Company’s proposed tariff resets the surcharge rates to \$0 and are therefore a non-factor when determining rates to arrive at CUII’s total revenue requirement. Pet. Ex. R2 at 10. That said, he testified that CUII has agreed with Ms. Stull’s recommendation to include CUII’s surcharge revenues in its forecast. Pet. Ex. R2 at 9. He said the Company is annualizing surcharge revenues based on base year and forecasted usage and customer counts. Pet. Ex. R2 at 10.

Commission discussion and finding. As the parties have agreed to include all surcharge revenues as a component of operating revenue, we will confine our discussion to the appropriate level of surcharge revenue to be included. The OUCC proposes DSIC and USIC revenues should be included at their authorized levels as these revenues are “guaranteed” to be collected by Petitioner through the annual review and reconciliation process. Petitioner proposed to annualize surcharge revenues to reflect forecasted usage and customer counts. Based on the arguments and evidence presented, we agree with the OUCC and find it is reasonable to include these revenues at their authorized levels with no further adjustments. We find that DSIC surcharge revenues of \$36,242, an increase of \$4,683 over base year revenues, should be included in water operating revenues. Additionally, we find water tracker revenues of \$39,945, a decrease of \$5,771 from base year revenues, should be included in water operating revenues. We also find USIC revenues of \$87,668 should be included in wastewater operating revenues.

### **C. Authorized Operating Revenues.**

Based on the above, we find Petitioner’s *pro forma* water and wastewater revenues at present rates for the twelve months ended September 30, 2017 are \$2,062,297 and \$2,277,968, respectively.

## **9. Operating Expenses.**

The following operating expenses proposed by Petitioner, either in its case-in-chief, supplemental, or rebuttal testimony, were accepted by the OUCC: (1) salary and wage expense, (2) capitalized labor (Petitioner's rebuttal adjustments), (3) amortization of acquisition adjustment, and (4) payroll tax expense. Similarly, the following operating expenses proposed by the OUCC, either in its case-in-chief or supplemental testimony, were accepted by Petitioner: (1) pension and other benefits expense, (2) maintenance testing expense, (3) outside services expense, (4) transportation expense, (5) rent expense, (6) insurance expense, (7) rate case expense, (8) office supplies and other office expense, (9) office utilities expense, (10) miscellaneous expense, (11) capitalized labor (OUCC's case-in-chief adjustments), (12) amortization of loss on prudently abandoned plant, and (13) amortization of GIS mapping costs. We approve those levels of expense and discuss the remaining disputed operating expenses below.

### **A. Purchased Water Expense.**

Petitioner's Case-in-chief Evidence. Mr. Kersey testified regarding CUII's forecasted purchased water expense and explained that purchased water costs were forecasted, by month, based on respective levels of forecasted purchased water and forecasted purchased water rates. He stated that forecasted purchased water rates of \$2.90 per thousand gallons are based on current charges by CUII's supplier, Indiana American Water of \$2.83 and an anticipated increase of \$0.07. He further stated that forecasted purchased water volumes are calculated based on an average of the prior 9-10 years of purchased water volumes, discounted by 1% annually; the 1% discount assumes both consumer conservation and changes in water losses. Mr. Kersey stated Petitioner's proposed purchased water expense was \$381,398 compared to base year expense of \$341,794. Mr. Kersey explained this increase is due to both an increase in supplier rates and a one-time sales tax refund which was credited to the Company in the base period (\$24,155). *Pet. Ex. 2 at 15.*

OUCC's Evidence. The OUCC did not accept Petitioner's proposed purchased water expense. Ms. Stull explained that Petitioner's forecasted purchased water expense is based on forecasted volumes of 131,418 and a forecasted price per [thousand] gallons of \$2.9022. She further stated this forecasted price is a 2.55% increase over the \$2.63 price per [thousand] gallons charged by Indiana American Water during the base period. Ms. Stull disagreed with several aspects of Petitioner's proposal. First, she disagreed with the price used by Petitioner to forecast purchased water expense. She stated purchased water expense is comprised of a monthly meter charge as well as a volumetric charge and noted Petitioner's forecast does not appear to incorporate the monthly service charge. Second, she noted it is difficult to reconcile the fact that Petitioner has proposed a declining consumption adjustment for operating revenues, but here is proposing forecasted purchase water volumes greater than base year levels. Finally, she noted it is not necessary to forecast purchased water expense as long as Petitioner has the ability to file a water tracker for any purchased water cost increases. She said that according to workpaper JPK-10, Petitioner has included forecasted costs to file a water tracker in 2017. *Pub. Ex. 1 at 75.*

Ms. Stull proposed forecasted purchased water expense of \$377,365, an increase of \$35,571 over base year purchased water expense (OUCC Schedule 7W, Adjustment No. 1). She stated her forecasted expense was comprised of three parts: (1) meter charges (\$10,524), (2) volumetric charges (\$359,914), and (3) IA DSIC-9 rate increase (\$6,927). Ms. Stull explained the meter charge portion of her forecasted purchased water expense is based on the monthly rate for

two 6” meters (\$438.74 x 2 meters x 12 months). The volumetric portion of her forecasted expense is based on the current volumetric rate times base year volumes purchased (\$2.83 x 127,178). She explained base year volumes were used because the OUCC did not accept Petitioner’s forecasted chemical expense. The decrease Petitioner forecasted depends on the Commission accepting Petitioner’s proposed revenue reductions for declining consumption, which the OUCC opposed through the testimony of Edward Kaufman. Ms. Stull further explained that even though she applied current rates to base year volumes, her adjustment represents a 10% increase over base year purchased water expense due to a \$24,156 sales tax refund. She noted Petitioner recorded the refund as a reduction to purchased water expense. Finally, Ms. Stull included the Indiana American Water DSIC-9 rate increase in her projected purchased water expense under the condition that Petitioner will be precluded from filing a water tracker to respond to this increase. *Id.* at 76-77.

Petitioner’s Rebuttal Evidence. Mr. Kersey testified the Company does not accept the projected purchased power expense proposed by the OUCC, but it agrees the OUCC’s proposed forecasting method. Mr. Kersey stated the Company proposes an adjustment to the Indiana American Water rates used by the OUCC to calculate its proposed purchased power expense as these rates did not include a 0.79% increase effective January 29, 2016 as a result of a true-up provision from Indiana American’s most recent rate case. Mr. Kersey further stated that the Company accepts the forecasted volumes proposed by the OUCC and does not believe future volume reductions are warranted as the Company’s original forecasted volumes were greater than the volumes proposed by the OUCC. Mr. Kersey proposed an adjusted forecast for purchased water expense of \$380,353. Finally, Mr. Kersey testified that the Company agrees to avoid filing a water tracker to respond to increases associated with Indiana American’s DSIC-9 increase as well as the 0.79% increase which was the result of a true-up provision in Indiana American’s most recent rate case. *Pet. Ex. R2 at 12-13.*

Commission Discussion and Findings. As Petitioner has agreed to accept the base year purchased water volumes (127,178,000) proposed by the OUCC, we will confine our discussion to the rates charged by Indiana American Water. We agree with Petitioner that it is appropriate to include all rate increases approved for Indiana American<sup>4</sup> in the determination of forecasted purchased water expense. We find Petitioner’s forecasted purchased water expense is \$380,353.

## **B. Purchased Power Expense.**

Petitioner’s Case-in-chief Evidence. Mr. Kersey explained that electric power costs are forecasted, by month, based on the historical levels of electric power costs, and that FY 2016 and FY 2017 forecasts are based on the latest four years of vendor invoicing for the service periods June 1, 2011 through May 30, 2015. *Pet. Ex. 2 at 14.* He added that the latest twelve months (June 1, 2014 through May 30, 2015) of service costs were used as a base and an average annual growth rate from the historical periods was applied to all forecast periods. He assumed any seasonality from the four years analyzed will continue. *Id.* Based on the calculations, Mr. Kersey testified that purchased power costs are forecasted to increase by approximately 1% from \$290,042 in the base period to \$292,381 in the test year, which includes the forecasted reduction in usage. *Id.*

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<sup>4</sup> Note the DSIC-10 rate increase approved by this Commission on March 22 2017 is not included in the determination of projected purchased water expense in this case. Therefore, Petitioner may file a water tracker to recover this increase.

OUCC's Evidence. The OUCC did not accept Petitioner's proposed purchased power expense. Ms. Stull disagreed with Petitioner's use of a year-over-year growth rate to forecast purchased power expense. *Pub. Ex. 1 at 73-74.* She explained that the calculated year-over-year growth rates show unusual fluctuations that appear to skew the results. She also noted that calculated growth rates for the same electric provider are inconsistent within the same year. For instance, she noted that in YOY1, Kankakee Valley shows a growth rate of +2.42% for water but -6.81% for wastewater. She added that the average growth rate calculated for Jasper County REMC is 4.90% for water and 6.68% for wastewater. Ms. Stull stated that if this methodology is a valid and reasonable method for forecasting purchased power expense, it does not make sense that the growth rates would be so different for the same provider. Finally, Ms. Stull noted that Petitioner proposed a reduction to operating revenues to project declining consumption, and this assumption does not appear to be a factor in Petitioner's determination of forecasted purchase power expense. Ms. Stull proposed there be no change to base year purchased power expense of \$290,042 (\$77,830 for consolidated water and \$212,122 for consolidated wastewater). Ms. Stull explained this is consistent with the OUCC's rejection of Petitioner's proposed revenue reduction for declining consumption. Ms. Stull added that any forecast of purchased power expense should be based on the same assumptions used to forecast sales volumes and operating revenues.

Petitioner's Rebuttal Evidence. Mr. Kersey testified the Company does not agree to the OUCC's proposal to make no purchased power expense adjustment and use base year purchased power expense as being representative of projected purchased power expense. *Pet. Ex. R2 at 11.* Mr. Kersey stated that the Company has considered all aspects of electric cost trends and its proposed declining usage when forecasting for purchased power expense. *Id.* at 11. He further stated that historical cost trends take all components into consideration, including, weather impacts, cost changes by electric providers and consumption changes by the Company and its customer base. *Id.* at 12.

Commission Discussion and Findings. Given our finding above rejecting CUII's proposed declining consumption adjustment, we also reject Petitioner's projected purchased power expense, which is at least partly based on the same declining consumption hypothesis. We find projected purchased power expense for water and wastewater operations of \$77,380 and \$212,212, respectively.

### **C. Salaries and Wages Expense.**

OUCC's Evidence. Mr. Richard Corey, Utility Analyst with the OUCC, proposed removal of \$7,976 of salaries and wages due to an incorrect expense recognition in the Company's FYE September 30, 2015 Trial Balance. *Pub. Ex. No. 2, at 14.*

Petitioner's Rebuttal Evidence. Mr. Kersey testified that CUII does not agree to the negative adjustment of \$7,976 to salary and wage expense. *Pet. Ex. R2 at 11.* He explained that, while that one employee's costs were incorrectly booked to CUII's general ledger in its base year, the Company's forecast should not be adjusted by this amount because this employee was not included within the Company's salary and wage forecast. *Id.* at 11. He further explained that all salary expense forecasts are built up from the individual employee level and are not dependent on base year salary expense. *Id.*

Commission Discussion and Findings. In its proposed order, the OUCC accepted the explanation Mr. Kersey included in his rebuttal testimony. The record shows the salaries and wages expenses were calculated by employee and are based upon current and anticipated levels of

staffing. *Pet. Ex. 2 at 13-14*. Accordingly, the employee's costs at issue were not included within CUII's forecast. We approve CUII's proposed *pro forma* salaries and wages expense for water and wastewater operations of \$339,574 and \$229,384, respectively.

#### **D. Chemical Expense.**

Petitioner's Case-in-chief Evidence. Mr. Kersey explained that forecasted chemical costs were forecasted by month, based on historical levels of chemical costs. The forecast is based on analysis completed by Operations, including estimated chemical costs per unit by chemical type. *Pet. Ex. 2 at 18*. Mr. Kersey further testified no cost increases are currently anticipated and chemical expense was forecasted to decrease from \$84,799 in the base period to \$80,790 in the test year. *Id.*

OUCC's Evidence. Ms. Stull proposed the Commission reject the Company's forecasted \$4,009 [\$80,790 - \$84,799] decrease to chemical expense. *Pub. Ex. 1 at 78*. Although she agreed with the methodology Petitioner used to forecast chemical expense, Ms. Stull did not accept Petitioner's forecasted chemical expense because the decrease forecasted by Petitioner depends on the Commission accepting Petitioner's proposed revenue reductions for declining consumption, which the OUCC rejected through the testimony of Edward Kaufman. Ms. Stull proposed the 2015 base year chemical expense be used to represent 2017 projected chemical expense. She explained that the 2015 base year operating revenues are the basis for 2017 projected operating revenues for the same reason – rejection of declining consumption. Because base year chemical purchases reflect the amount of chemicals needed to treat base year water and wastewater revenues, she added this proposal is consistent with her proposed operating revenue adjustments. Base year chemical expense is \$42,003 for water operations and \$42,796 for wastewater operations.

Petitioner's Rebuttal Evidence. Mr. Kersey explained that the Company does not accept the OUCC's projected chemical expense because the Company does not accept the OUCC's removal of its declining usage adjustment. *Pet. Ex. R2 at 16*. He further explained that, while the Company was still proposing projected total chemical expense of \$80,790, the Company was proposing an adjustment to reflect the proper distribution of chemical expense between water and wastewater operations. He testified the Company originally allocated total chemical expense but, because the Company forecasted these costs by its water and sewer division, it was unnecessary to allocate these costs. Mr. Kersey testified the Company projected chemical expense of \$17,556 for its water operations, a decrease of \$31,224. He further testified the Company projected chemical expense of \$63,235 for its wastewater operations, an increase of \$31,224 (*Pet. Ex. R2 at 16, Table 1*). *Id.*

Commission Discussion and Findings. Given our finding above rejecting CUII's proposed declining consumption adjustment, we reject Petitioner's proposed decrease to base year chemical expense. This finding makes Petitioner's proposed redistribution of chemical expense between water and wastewater operations unnecessary as actual base year water and wastewater chemical expense should be used.



### **E. Maintenance and Repair Expense.**

Petitioner's Case-in-chief Evidence. Mr. Kersey stated maintenance and repair expenses are forecasted based on an analysis of historical data and estimated need of operations. Mr. Kersey stated Petitioner forecasted an increase from base year maintenance and repair expense of \$129,797 to test year expense of \$189,009. Mr. Kersey explained maintenance and repair expenses consist of (1) deferred maintenance, (2) sewer rodding, (3) sludge hauling, (4) permits, (5) uniforms, and (6) other.

OUCC's Evidence. Ms. Stull accepted Petitioner's projected maintenance and repair expense as presented in its case-in-chief testimony. However, in Ms. Stull's case-in-chief testimony, she proposed the removal from rate base of costs that were capitalized in error and stated that, to the extent the costs removed should be considered a recurring operating expense and were not already included in test year operating expense, she would propose an adjustment to maintenance and repair expense as appropriate. *Pub. Ex. 1 at 22.* The \$171,845 of water rate base costs eliminated by Ms. Stull consisted of well cleaning and rehab costs as well as filter media maintenance. The costs eliminated were incurred during the period 2011 through 2015. (Attachment MAS-4) *Id.* The \$4,222 of wastewater rate base costs eliminated by Ms. Stull consisted of repair costs, tree removal and renewal of an NPDES land application permit. The costs eliminated were incurred during the period 2013 through 2015. (Attachment MAS-15)

Petitioner's Rebuttal Evidence. Mr. Kersey noted that no maintenance and repair expense adjustments were proposed by the OUCC. Mr. Kersey asserted that Ms. Stull goes so far as to clarify that the OUCC is proposing an adjustment for operating expense based on the transactions it proposes to exclude in Attachment MAS-4; however, no adjustment to operating expenses was actually made by the OUCC. *Pet. Ex. R2 at 14.* Mr. Kersey explained the Company believes the various non-capital costs Ms. Stull removed from rate base should be amortized over three years, which would result in additional forecasted maintenance amortization expense. Mr. Kersey stated Attachment JPK-R2 breaks down Ms. Stull's proposed rate base adjustment for non-allowed costs between those costs which Petitioner believes should remain capitalized and those that should be amortized. Mr. Kersey stated the total amount of incremental amortization per year proposed by Petitioner is \$42,567 ( $\$127,700 / 3$ ). Mr. Kersey explained the three year amortization period proposed by Petitioner was chosen to reflect the above-normal corrosiveness of the water, which requires well reconditioning at an above-normal frequency. *Id.*

Commission Discussion and Findings. Petitioner's proposed annual maintenance and repair expense of \$189,009 as of September 30, 2017 (JPK-23) includes \$34,710, which represents periodic maintenance costs which are not incurred on an annual basis (WP-JPK-05). This \$34,710 of periodic maintenance expense represents the amortization of deferred charges Petitioner proposed be included in rate base.

As the parties have agreed to the initial maintenance and repair expense adjustments proposed by Petitioner in its case-in-chief testimony, we will limit our discussion to the adjustments proposed by Petitioner in its rebuttal case and which represent the annual amortization of non-capital costs Ms. Stull removed from Petitioner's rate base. First, we note Mr. Kersey misstates Ms. Stull's case-in-chief testimony regarding the need for adjusting entries. Mr. Kersey states that Ms. Stull "went so far as to clarify that the OUCC is proposing an adjustment to operating expense based on the transactions [the OUCC proposes] to exclude in Attachment MAS-4." However, Ms. Stull's actual testimony was, "To the extent the costs I remove should be

considered a recurring operating expense, *and* that operating expense is not already included in test year operating expenses, I propose an upward adjustment to maintenance and repair expense *as appropriate.*” Ms. Stull did not make any additional adjustments to maintenance and repair expense, and therefore must have determined that no further adjustments were appropriate. Having reviewed the evidence before us, we agree with Ms. Stull and find that Petitioner’s forecasted maintenance and repair expense is \$189,008, of which \$48,864 represents water operations maintenance and repair expense and \$140,144 represents wastewater operations maintenance and repair expense.

**F. Taxes Other Than Income Tax Expense.**

Petitioner’s Case-in-chief Evidence. Mr. Kersey explained how taxes other than income taxes were determined. He explained that these expenses were forecasted to increase from \$380,465 in the base period to \$420,929 in the test year, and that such adjustments were forecasted based on forecasted levels of salaries, revenues, and plant in service. *Pet. Ex. 2 at 25.* He testified that, specifically, Utility Commission Taxes were forecasted to increase from \$64,368 in the base period to \$73,589 in the test year, and such increase was calculated at 1.50% of revenue. *Id.*

OUCC’s Evidence. Mr. Corey proposed removal of the Company’s “Utility Commission Taxes” based on a rate of 1.5% and replaced with a 1.4% rate for Utility Receipts Tax. *Pub. Ex. 2 at 6.* He further proposed inclusion of 0.1077802% IURC fee expense. *Id.* Mr. Corey further proposed to reduce forecasted payroll taxes in the amount of \$903, which he specifically related to his proposed salary adjustment of \$7,976. *Id.* at 14, (*See also* Schedule 6-M at 1). Ms. Stull did not accept Petitioner’s projected property tax expense, but did accept Petitioner’s methodology for calculating property tax expense. She testified her forecasted net utility plant balance, upon which the average property tax rate is applied, is less than Petitioner’s and, therefore, her projected property tax expense is less. In her supplemental testimony, Ms. Stull proposed projected water property tax expense of \$116,593 (OUCC Supplemental Schedule 7w, Adjustment Nos 8 and 9) Ms. Stull also proposed a projected wastewater property tax expense of \$139,824 (OUCC Supplemental Schedule 7S, Adjustment Nos. 7 and 8). *Pub. Ex. 6 at 31 and 45.* She explained the OUCC’s projected property tax expense was solely related to the reductions proposed by the OUCC to the Company’s forecasted net utility plant balance. *Id.* at 22 and 34.

Petitioner’s Rebuttal Evidence. Mr. Kersey testified that, while the Company agrees to the adjustment methods used by the OUCC, it does not agree to the payroll tax reduction of \$903. *Pet. Ex. R2 at 22.* Mr. Kersey stated that the Company is contesting the accuracy of the \$7,976 salary adjustment and, as a result, is therefore contesting the accuracy of the \$903 payroll tax adjustment. *Id.* Mr. Kersey also stated the Company agrees to use a 1.4% utility receipts tax rate and a 0.1077802% IURC fee rate as proposed by the OUCC. *Id.* Finally, Mr. Kersey testified the Company also agrees to the OUCC’s property tax calculation method, but believes property taxes should be updated once utility plant in service is updated as of September 30, 2017. *Id.* at 22 and 23.

Commission Discussion and Findings. Given our determination regarding salaries and wage expense above, we find the OUCC’s proposed reduction in forecasted payroll taxes of \$903 should be rejected. Petitioner has agreed to the OUCC’s proposed utility receipts tax and IURC fee rates of 1.4% and 0.1077802%, respectively. We find the agreement to be reasonable. The OUCC and Petitioner have used the same forecast method for property tax expense. Given

our findings regarding rate base above, we find projected water property tax expense should be \$108,704 and projected wastewater property tax expense should be \$132,009. We also find property taxes should be updated as part of the implementation of Phase II rates once rate base is updated as of September 30, 2017.

**G. Depreciation Expense.**

Petitioner's Case-in-chief Evidence. John F. Guastella, President of Guastella Associates, LLC, performed a depreciation analysis of CUII's water and sewer utility systems and recommended appropriate depreciation rates. Mr. Guastella discussed the concept of depreciation, identified the components of the calculation of depreciation rates, and explained how the accounting for depreciation affects rates for service. Pet. Ex. 5 at 2-5. He stated the Company's water and sewer systems are comprised of relatively small utilities that do not have sufficient retirement data that are readily available to perform either an actuarial or simulated plant balance method for determining average service lives. He said, therefore, he undertook a comparative analysis in order to establish appropriate average service lives and depreciation rates. He noted he has prepared similar comparative analyses that have been accepted in other jurisdictions in recent years. Pet. Ex. 5 at 5.

Mr. Guastella described the comparative data he collected and identified the basis for the negative net salvage values used in his analysis. Pet. Ex. 5 at 6-7. He explained that to develop the relationship between original and current construction costs he used the ratio of the current year Handy-Whitman Construction cost Index to the vintage year index, with the vintage years determined by the number of years of the respective average service life. Pet. Ex. 5 at 7-8. He said the Handy-Whitman Construction cost Index is commonly used in construction cost comparisons like the one he prepared for CUII. Mr. Guastella testified that the average service lives he recommended are not only reasonable in general, but are reasonable for determining depreciation rates for the Company. Pet Ex. 5 at 9.

OUCC's Evidence. Mr. Edward Kaufman, Chief Technical Advisor with the OUCC's Water-Wastewater Division, testified in opposition to Petitioner's proposal to dispense with the Commission's composite depreciation rates to determine its depreciation expense. Mr. Kaufman explained that Petitioner's witness John Guastella proposes to apply depreciation rates not generated from a depreciation study that considers the condition of Petitioner's plant. Mr. Kaufman advised that absent such a study, Petitioner should rely on the Commission's previously established composite depreciation rates. Pub. Ex. 4 at 1-5. Mr. Kaufman also rejected Mr. Guastella's inclusion of negative net salvage value in its proposed depreciation rates, arguing that Petitioner provided no documentation that it actually incurs the removal or dismantling costs indicated by Mr. Guastella's depreciation analysis. Pub. Ex. 4 at 7-8. He also argued that Mr. Guastella's analysis of the relationship between original and current construction costs is not utility specific and does not provide an accurate approach to estimate or infer negative net salvage ratios. Pub. Ex. 4 at 8-9. He stated water/wastewater utilities do not typically remove old pipe when replacement pipe is being added, and thus the actual cost a utility would incur to remove or dismantle old assets is minimal. *Id.* at 10. Mr. Kaufman concluded that Petitioner's proposed depreciation expense is not based on a depreciation study specific to the actual condition of its plant and that depreciation expenses should therefore be based on the Commission's approved composite depreciation study. *Id.* at 12.

Mr. Kaufman noted that in past cases Petitioner's various divisions have used the Commission's composite depreciation rate for its water and wastewater utilities. But in this case Petitioner proposes to use depreciation rates on an account specific basis, based on the results of Mr. Guastella's depreciation "analysis." Mr. Kaufman explained Mr. Guastella's estimated depreciation rates range from 1.47% for "Lake, River and Other Intakes" to 14.29% for "Back Flow Prevention Devices." He added that a key element of Mr. Guastella's depreciation analysis is that he adjusts upward his proposed depreciation rates to recognize the effect of estimated "negative net salvage value." Including negative net salvage value attempts to recognize the current cost of dismantling and removing assets, such as structures, storage facilities, pumps, mains and service laterals. Mr. Kaufman explained he used the term "depreciation analysis" because Mr. Guastella's proposed depreciation rates are not based on the actual physical condition of Petitioner's plant. In fact, Mr. Kaufman noted, Mr. Guastella did not physically inspect the condition of Petitioner's plant.<sup>5</sup>

Mr. Kaufman stated Petitioner's alternative depreciation rate is not more reliable than the Commission's composite depreciation rate. Mr. Kaufman explained that a water or wastewater utility has the option of relying on the Commission's composite depreciation rate or conducting its own depreciation study. Mr. Kaufman explained that Mr. Guastella's analysis is not specific to the conditions in Indiana or Petitioner's plant. In the absence of a utility-specific depreciation study, Mr. Kaufman testified that the Commission's composite depreciation rates should be used to estimate depreciation expense. Mr. Kaufman explained Petitioner's proposed depreciation expense is 3.03% for its water operations and 2.79% for its wastewater operations (Attachment 4) compared to the Commission's composite depreciation rates of 2.0% for a complete water system, 1.7% for a water system that purchases its water, 2.5% for a sewer system with a treatment plant, and 2.2% for a sewer system without a treatment plant.

Mr. Kaufman discussed Petitioner's proposal to recognize negative net salvage value increase Petitioner's proposed depreciation rates. He stated that if the influence of proposed negative net salvage value is removed from Petitioner's effective depreciation rates, their depreciation rates would be reduced from 3.03% to 2.40% for Petitioner's water operations and from 2.79% to 2.12% for its wastewater operations.

He explained Petitioner's proposal to recognize negative net salvage value in its proposed depreciation rates increases depreciation rates. He noted Petitioner's proposed depreciation expenses for its water operations totals \$393,735. Mr. Kaufman said that the effect of negative net salvage value is factored out of Mr. Kersey's depreciation calculation, the annual depreciation expense for Petitioner's water operations would be reduced by \$82,443 to \$311,292. With respect to the wastewater operations, Petitioner's proposed depreciation expenses for its wastewater operations totals \$557,584. Mr. Kaufman explained that if the effect of negative net salvage value is removed from Mr. Kersey's calculation, the annual depreciation expense for Petitioner's wastewater operations would be reduced by \$136,459 to \$421,125. Mr. Kaufman noted Petitioner

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<sup>5</sup> Petitioner's response to OUCC data request 16.1 (Attachment ERK 8). On page 5 of his testimony, Mr. Guastella states "The Company's water and sewer systems are comprised of relatively small utilities that do not have sufficient retirement data that are readily available to perform either an actuarial or simulated plant balance method for determining average service lives. I have, therefore, undertaken a comparative analysis in order to establish appropriate average service lives and depreciation rates." (Emphasis added.)

has not provided any documentation that it actually incurs the removal or dismantling costs indicated by Mr. Guastella's depreciation analysis. Nor has Petitioner provided any documentation that it tracks the removal or dismantling costs indicated by Mr. Guastella's depreciation analysis. Mr. Kaufman added that Petitioner does not track the cost of removal or dismantling, but (to the extent they are incurred) these costs are typically included in the cost of a new project. Mr. Kaufman noted Mr. Guastella assumes a negative net salvage value ratio of 70% for Transmission and Distribution Mains (account 331) and a negative net salvage ratio value of 100% for Services (account 333). But Mr. Kaufman added that water/wastewater utilities typically do not incur significant expenses to remove or dismantle these categories of plant. He explained that when service lines are replaced, the retired plant is typically destroyed or left in the ground.

Mr. Kaufman indicated the net salvage ratios provided in Mr. Guastella's testimony and used by Mr. Kersey to determine Petitioner's proposed depreciation expense were not based on specific calculations. He explained that Petitioner responded to the OUCC's request to provide the calculations of all Negative Net Salvage Values by stating that "[b]ecause the average service lives and net salvage values are based on judgment from comparable data, there are no specific calculations to provide." (Emphases added). Because Mr. Guastella's negative net salvage ratios were derived from his judgment, Mr. Kaufman asserted there is nothing tangible to review and no data from which to analyze the legitimacy of his figures.

Mr. Kaufman disagreed with Mr. Guastella's assertion that his analysis confirms the reasonableness of the negative net salvage percentages he used in his study. Mr. Kaufman did not dispute that the cost to construct and install water utility plant has progressively gotten more expensive over the last 75-100 years, but he asserted Mr. Guastella's analysis does not provide a reasonable basis to estimate removal/dismantling costs. Mr. Kaufman noted Mr. Guastella's analysis not utility specific. Mr. Kaufman added it is an inaccurate approach to estimate or infer negative net salvage ratios.

Mr. Kaufman noted Mr. Guastella uses average service life to calculate a multiplier of original cost to current cost. For example, Mr. Guastella assumes transmission and distribution mains have an average service life of 70 years, a time span Mr. Kaufman did not dispute. Mr. Guastella then calculates a multiplier of current vs. original cost by comparing the cost to install transmission and distribution mains 70 years ago (1945) to the cost of installing transmission and distribution mains today (2015 Cost Index) resulting in a cost multiplier of 25.96. Mr. Kaufman asserted this approach is not reasonable. He said this relationship might make sense if the average age of Petitioner's transmission and distribution mains was 70 years. But (hypothetically) if the average age of Petitioner's transmission and distribution mains are only 30 years old, the relationship of the cost of mains today compared to 70 years ago (1945) is irrelevant. Mr. Kaufman asserted this age-price relationship does not provide a reasonable basis to determine a negative net salvage value ratio. Mr. Kaufman explained that using a vintage year (starting point) calculated by subtracting the estimated life of the asset from 2015, Mr. Guastella calculates negative net salvage value multipliers that assume all of Petitioner's plant has an age equal to its estimated life. This type of analysis is inaccurate and overstates negative net salvage value "multipliers" and Petitioner's estimated depreciation expense.

Mr. Kaufman asserted Mr. Guastella's estimate of the negative net salvage value ratios will be the same for all water and wastewater utilities regardless of their actual age. Mr. Kaufman explained this type of analysis distorts estimated depreciation expense and overstates the cost of negative net salvage value for newer plant. He explained newer plant will have a higher

construction cost than parts of a similar, older utility. Thus, using the same multiplier results in the newer utility having a higher estimated cost to remove the same plant. Mr. Kaufman stated there is no basis to estimate that it costs more to remove plant constructed in 2015 than plant constructed in 1990, which is the effect of Mr. Guastella's negative net salvage value analysis. He asserted the cost of removal, if there is any, should be the same for similar plant, regardless of the cost to install the plant that is being removed.

Mr. Kaufman noted Accounts 331.4 (T&D Mains) and 333.4 (Services) explain the largest portion of additional expense generated by Petitioner's proposal to recognize negative net salvage value for its water utility. Accounts 360.20 (Collection Sewers – Force) and 361.20 (Collection Sewer Gravity) explain the largest portion of additional expense generated by Petitioner's proposal to recognize negative net salvage value for its wastewater utility.

Mr. Kaufman acknowledged negative net salvage value is typically included to estimate depreciation rates for electric utilities. But unlike water and wastewater utilities, which do not typically remove old pipe when replacement pipe is being added. Mr. Kaufman explained Electric utilities (especially those with nuclear generation) will incur significant one-time dismantling costs when a generating plant reaches the end of its useful life. Mr. Kaufman stated the calculation of dismantling and decommissioning costs included in depreciation rates is very complex, needs to be well supported with detailed cost estimates, and is often controversial. Mr. Kaufman added Mr. Guastella did not provide the level of support that an electric utility would be required to provide to support its proposed removal/dismantling costs. Mr. Kaufman asserted that because Mr. Guastella's individual negative net salvage ratios are based on his judgment and not based on specific calculations, they are unsupported estimates, without foundation, that cannot be reviewed, evaluated or challenged. Mr. Kaufman noted that approximately \$218,900 of Petitioner's proposed depreciation expense relates to its estimated negative net salvage. To ensure that these funds are available for plant removal, funds collected for negative net salvage should be segregated in a separate account to pay for future removal costs. Petitioner should then be required to track its actual cost for removal/dismantling costs as they are incurred. Petitioner can use the funds in its separate account to pay for the actual cost of removal.

Mr. Kaufman pointed out that Petitioner's proposed depreciation expense is not based on a depreciation study considering the actual condition of its plant. Mr. Kaufman testified that absent an actual depreciation study based on the actual condition of Petitioner's plant, its depreciation expense should be based on the Commission's approved composite depreciation study.<sup>6</sup>

LOFS Evidence. Mr. Theodore Sommer testified on behalf of LOFS and disagreed with the depreciation analysis performed by CUII witness Guastella, which purports to take three smaller systems using different composite depreciation rates and create specific depreciation rates by utility asset account that will be applied across all three systems. Mr. Sommer agreed that there are cost savings associated with doing a "desk analysis" of the plant that CUII has on its books, but questioned the accuracy of Mr. Guastella's result and testified CUII's proposed adjustment should not be accepted. Mr. Sommer explained that CUII's data responses indicated that CUII has historically used a composite depreciation rate and when an asset is fully depreciated, CUII stopped recording additional depreciation. Mr. Sommer testified that when an asset is replaced, the Handy Whitman Index is used to calculate the amount of plant and Accumulated Depreciation

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<sup>6</sup> OUCU witness Margaret Stull provides the calculation of the OUCU's proposed depreciation expense.

booked to eliminate the impact of the asset on net plant. He stated that while that process allows for valuation of assets being removed and avoids over-depreciation, such a methodology implies that the Cost of Removal and Salvage were paid and expensed through operations. When expensed, Mr. Sommer stated that CUII or its predecessors would have recovered past Cost of Removal and Salvage amounts through base rates unless specifically accounted for and removed.

Mr. Sommer testified that there is no way to know what original Cost of Removal was embedded in a fully depreciated asset using CUII's composite depreciation rates, but it is assumed that there is an element of Cost of Removal as well as Salvage Value within the composite rate. However, Mr. Sommer observed that to simply increase the depreciation rate to recognize a calculated current period cost of removal without examination of the facts related to the history of the specific assets of CUII may increase the value of fully depreciated or substantially depreciated assets, in essence, creating plant in service to further depreciate.

Mr. Sommer explained that the Cost of Removal must represent an accurate estimate of what it actually costs to remove an asset. He stated that Mr. Guastella relies on the Net Salvage Value method to determine the Cost of Removal, but current technology includes the En Situ method, which is likely more appropriate given the character of CUII's system. Mr. Sommer testified that the En Situ method eliminates cost of removal for some collection and transmission lines, which in turn impacts the Cost of Removal. Mr. Sommer referenced the Direct Testimony of CUII Bruce Haas on pages 22 and 23 (which was later adopted by Mr. Lubertozzi), that discusses the "pipe-bursting" method of gravity sewer main remediation, and how it has been applied to 2,200 linear feet of main in the TLU system. Mr. Sommer testified that his understanding is that the pipe-bursting method involves inserting "slip-lining" into a main by inserting a composite material into a main, expanding the material through blowing air into the material, and then curing the pipe in place with hot water or steam. This allows for a replacement of existing pipe without removing any of the old pipe. Mr. Sommer stated that CUII's system contains a great deal of main that contains asbestos, which suggests that the En Situ method for replacement of mains in the CUII system is appropriate. Mr. Sommer testified that Mr. Guastella did not examine the plant, nor did his Data Requests to CUII inquire as to whether the topography of the system lent itself to the pipe bursting technique. Mr. Sommer concluded that Mr. Guastella's use of old net salvage rates that do not consider the impacts of new technology will in the current situation result in depreciation rates that are too high. As such, Mr. Sommer recommended that the Commission reject Mr. Guastella's depreciation analysis.

Petitioner's Rebuttal Evidence. Mr. Kersey testified that, while the Company agrees to recalculate depreciation expense based on plant in service as of February 29, 2016 and September 30, 2017, it does not agree to the continued used of the Commission's composite rates. Pet. Ex. R2 at 23. Mr. Kersey stated that not only are the Commission's composite rates outdated, they prevent the Company from earning its authorized return. *Id.* He testified that the composite rates are outdated because they were adopted approximately 30 years ago and do not accurately reflect the greatly changed industry landscape, e.g. current drinking water act and clean water regulations and identification of the concept of aging infrastructure. *Id.* at 23-24. He further testified that the Commission's composite rates do not allow the Company to earn its authorized return, because these rates do not allow the Company to adjust depreciation rates for assets which are not held on its books. *Id.* at 24. He stated that if the Commission is going to reject the depreciation rates used by CUII's service company, CUII must be allowed to reestablish plant

values for such short-lived assets; Mr. Kersey provided tables showing the impact of reestablishing these plant values for both water and sewer on pages 25 and 26 of his testimony. *Id.* at 25-26.

Mr. Guastella also responded to Mr. Kaufman and Mr. Sommer. He stated their criticisms do not reflect a reasonable assessment of his study or his comparative analysis, which uses a methodology that has been accepted by utility regulatory jurisdictions throughout the country for thousands of small water and wastewater utilities. Pet. Ex. 5R at 2. He said their criticisms also do nothing to support the continued use of the fixed composite depreciation rates.

Mr. Guastella testified that the application of a composite depreciation rate is the least preferred method of satisfying the purpose of depreciation – intergenerational equity. Pet. Ex. 5R at 3. Specifically, he said an arbitrary 2% composite depreciation rate for a water system is the least accurate way to determine depreciation expense as compared with any of the other methods used to estimate the most likely average service life of each type of asset. Pet. Ex. 5R at 3. Mr. Guastella responded to Mr. Kaufman’s testimony regarding net salvage and cost of removal and explained that the percentages net salvage that Mr. Guastella recommends reflect reasonable estimates that result in depreciation rates to achieve intergenerational equity. He said failure to include net salvage at all is not reasonable. Pet. Ex. 5R at 5-7. Mr. Guastella also explained why Mr. Kaufman’s recommendation that the funds collected for negative net salvage be segregated in a separate account was unnecessary and speculative. Pet. Ex. 5R at 7-9.

With respect to Mr. Sommer’s accounting issues, Mr. Guastella testified that several of Mr. Sommer’s statements are incorrect. He noted that neither Mr. Sommer nor Mr. Kaufman have presented any documentation or other support to identify the basis for their recommended composite rates, or whether they include anything for net salvage. On the contrary, he said the composite rates resulting from the typical average service lives for individual accounts in his analysis are higher than their recommended composite rates, before taking into consideration cost of removal, see Mr. Kaufman’s Schedule EFK 1, which is a strong indication that their recommended composite depreciation rates do not include any consideration of cost of removal. Pet. Ex. 5R at 9-10. He said that contrary to M. Sommer’s assertion, using depreciation rates that include consideration of cost of removal do not increase or decrease the full value of assets, the original cost of the assets remains unchanged; the cost of removal is charged to accumulated depreciation in accordance with the accounting treatment prescribed in the USoA.

Mr. Guastella concluded that both Mr. Kaufman and Mr. Sommer recommend the continued use of composite depreciation rates that were apparently established 28 years ago for water systems and 32 years ago for sewer systems. He said neither witness provides any support for those composite rates as to how they were calculated or the utilities under consideration and applicable individual plant data that was used, if any. He added that both witnesses focus on their assumptions of the physical condition of certain assets, apparently absent any recognition of such other causes of depreciation as obsolescence and changes in regulatory requirements. He said that on the basis of the magnitude of those composite rates, it is likely that they do not reflect any consideration of net salvage values. He said Mr. Kaufman and Mr. Sommer offer no opinion as to the reasonableness of the depreciation rates for individual accounts that he recommended. He added that they do not disagree that CUII does not have sufficient data to perform actuarial or simulated plant balance studies, or that the cost of such studies, even if they were feasible, would not be a worthwhile addition to rate case expenses. He said the criticisms they raise are not only inappropriate to his study but instead are more germane to the use of their unsupported composite depreciation rates. He concluded that the depreciation rates for individual accounts that he is



recommending have been generally accepted and considerably more accurate than their recommended composite depreciation rates – and most importantly best accomplish the goal of intergenerational equity. Pet. Ex. 5R at 11.

Commission Discussion and Findings. In Cause No. 43957, Twin Lakes used the Commission’s composite depreciation rates for all of its water and sewer plant except for computers and vehicles, to which it proposed to apply different depreciation rates. The Commission declined to approve Twin Lakes’ proposed depreciation rate for those assets and stated that “[i]f Petitioner believes that a composite rate provides inaccurate information, it should have conducted and submitted for Commission approval its own depreciation study to more accurately reflect the expense.” 43957 Order at 21. In this proceeding, CUII did not perform its own depreciation study examining the condition of Petitioner’s plant, but instead retained an outside consultant to prepare a “depreciation analysis.” Based on this analysis Petitioner proposed application of various depreciation rates. As explained above, Mr. Guastella did not complete a depreciation study, which would have considered the condition of Petitioner’s plant, but completed a “comparative analysis” [Guastella direct, page 5 line 20]. Mr. Guastella could apply his comparative depreciation analysis to any water or wastewater utility in Indiana (or outside Indiana) with equal validity. Thus, Mr. Guastella’s proposed depreciation rates is really an alternative to our composite depreciation rates. In any case, it is not a depreciation study. In response to the OUCC’s objection to the use of his analysis, Mr. Guastella asserted he has presented this type of study in multiple jurisdictions. However, that does not make the analysis sufficiently credible or appropriate for rate setting in Indiana.

We agree with Mr. Kaufman and Mr. Sommer. Mr. Guastella’s depreciation analysis is not specific to Petitioner and its conditions, or even to Indiana utilities in general. Thus, it does not rise to the level that we can rely on or use to set Petitioner’s rates. In past cases we have not accepted adjustments to our composite depreciation rates outside of a full depreciation study. As we stated in Chimneywood Sewer Works Inc. Cause No. 39015-u, p. 2, 1991 WL 11811755 (Ind. Util Regulatory Comm’n May 22, 1991, “[a]lthough this Commission recognizes there are many ways of calculating depreciation expense, we note utilizing a composite straight-line depreciation rate is the generally accepted method in ratemaking cases.” We did not accept an adjustment to our composite depreciation rates in Chimneywood and we do not do so here.

Mr. Guastella’s argument for providing a comparative depreciation analysis instead of a full depreciation study is based, in part, that he lacks sufficient data to complete a depreciation study or to provide actual costs incurred for retirements and removals. Mr. Guastella testified that “[t]he Company has not experienced sufficient retirements with which to perform either an actuarial or simulated plant balance method for determining average service lives.” (Guastella direct page 8 lines 19-21). Petitioner’s lack of data does not justify using an unsupported depreciation analysis over the Commission’s composite depreciation rate.

Moreover, one of the key drivers to Petitioner’s proposed increase to its depreciation rates is its proposal to recognize negative net salvage value through its proposed depreciation rates. By including negative net salvage value in the depreciation rates, Petitioner is attempting to recover “the current cost of dismantling and removing such assets as structures, storage facilities, pumps, etc.” But no costs have been established. When asked to provide the calculations for all “Negative Net Salvage Values,” Petitioner responded that “because the average service lives and net salvage values are based on judgment from comparable data, there are no specific calculations to provide.”

(Kaufman Direct page 8, lines 17-20). Further, because the negative net salvage values were based on “judgment” there was nothing tangible to review or data to support the legitimacy of Mr. Guastella’s figures. (ibid line 20-22)

Moreover, as Petitioner acknowledged in its response to discovery by the OUCC, Petitioner does not even incur costs to remove retired assets:

CUII does incur costs to remove retired assets. That said, generally the retirement of an asset is due to replacement or upgrade of such an asset and the costs for removal of the asset are included in the project or expense of the replacement. The cost for removal is included in the cost for the entire replacement job; CUII's contracts do not generally break out the cost for removal separate from the rest of the project.

(Petitioner’s response to OUCC DR 06-07 (OUCC CX 15))

Likewise, Petitioner acknowledged, “the Company does not separately recognize removal costs when retiring assets.” (Petitioner’s response to OUCC DR 06-08 (OUCC CX 16)). Finally, it acknowledged that “Removal and disposal of is determined on a case-by-case basis.” and “There is not a policy in place for removal and disposal of plant.” (Petitioner’s response to OUCC DR 32-04 (OUCC CX 13).)

Mr. Guastella’s asserted that his Attachments JFG-3 and JFG-4 demonstrates the relationship between original and current construction costs. While we may recognize that water utility plant has gotten more expensive, we disagree that Mr. Guastella’s analysis provides us a reasonable basis to estimate removal/dismantling costs. Mr. Guastella used average service life (not actual life) to estimate his multipliers of original cost. Mr. Guastella’s analysis can only make sense if the actual life of Petitioner’s plant equals the average expected life. We have no basis to embrace such an assumption. Mr. Guastella’s analysis overstates Mr. Guastella’s estimated negative net salvage value multipliers. We agree that Mr. Guastella’s analysis here does not support his negative net salvage value estimates.

The OUCC’s posited that if Petitioner is permitted to recover Negative Net Salvage Value in depreciation, it should be required to place the funds collected through depreciation for Negative Net Salvage Value in a segregated account to ensure they were available to meet their intended costs. For instance, in electric cases we require a detailed analysis that is heavily scrutinized before providing recovery of future dismantling costs in depreciation. Yet in this case Petitioner is seeking to increase the depreciation it recovers in rates by \$82,443 (water) and \$136,459 (wastewater), based solely on Mr. Guastella’s judgment. Having denied Petitioner’s request to include Negative Net Salvage Value in rates, we need not address this issue.

Petitioner does not separately recognize removal costs when retiring assets. Moreover, these costs will be recognized and the cost for removal is included in the cost for the entire replacement job. Thus Petitioner will collect the cost of retirement through depreciation on the new project. Petitioner has not demonstrated a need to include negative net salvage value by increasing its depreciation rates. Even if we were inclined to increase depreciation rates to recognize dismantling costs, the Commission would need evidence of costs incurred and something beyond simple judgment. Thus, we will not include negative net salvage value to determine Petitioner’s depreciation expense.

Many of these issues addressed in this section could have been avoided if Petitioner had performed a depreciation study or accepted the Commission's composite depreciation rates. As we have concluded in past cases, a utility has the choice of conducting a depreciation study or using our composite depreciation rates. Given the generic nature of Petitioner's proposed depreciation rates, it is effectively proposing an alternative composite depreciation rate. However, this alternative depreciation rate is not specific to conditions in Indiana and was not sufficiently developed to replace our composite depreciation rates. Therefore, we reject Petitioner's proposed depreciation expense and accept the OUCC's proposed depreciation expense.

#### **H. Amortization Expense - CIAC.**

Petitioner's Case-in-chief Evidence. Mr. Kersey testified Petitioner's forecast for amortization of CIAC reflects the removal of TLUI CIAC amortization expenses incorrectly recorded to Petitioner's general ledger during the base period. Mr. Kersey stated that because Petitioner does not amortize TLUI CIAC for ratemaking purposes, it was necessary to reverse these base year transactions. Mr. Kersey also testified that forecasted amortization of CIAC for IWSI and WSCI was annualized based on Mr. Guastella's recommended depreciation rates. *Pet. Ex. 2 at 27.*

OUCC Evidence. Ms. Stull testified that she did not accept CUII's changes to consolidated water net contributions in aid of construction ("CIAC") because there is no need to forecast additional adjustments to CIAC. *Pub. Ex. 1 at 32.* She noted that her proposed amortization was based on the Commission's composite rates and removed the impact of amortizing CIAC at the Company's proposed rates, which were derived from its proposed depreciation rates. *Id.*

Petitioner's Rebuttal Evidence. In his rebuttal testimony, Mr. Kersey testified the Company did not agree with the OUCC's removal of the impact of its proposed depreciation rates on CIAC amortization and, therefore, did not agree with the OUCC's proposed CIAC amortization based on the Commission's composite depreciation rates. *Pet. Ex. R2 at 27-28.*

Commission Discussion and Findings. In light of our finding above regarding CUII's lack of a depreciation study to support its proposed depreciation rates, we find the Commission's composite depreciation rates shall be used to establish CIAC amortization expense.

#### **I. Authorized Operating Expenses.**

Based on the above, we find Petitioner's *pro forma* water and wastewater operating expenses for the twelve months ended September 30, 2017 are \$1,940,851 and \$1,905,469, respectively.

**10. Net Operating Income at Present Rates.**

**A. Water Utility's NOI under Present Rates.** Based on the evidence and the determinations made above, we find Petitioner's water utility adjusted forecasted operating results under present rates<sup>7</sup> are as follows:

	<b>Phase I</b>	<b>Phase II</b>
<b>Operating Revenues</b>		
Water Revenues	\$ 1,999,237	\$ 1,999,237
Late Fee Revenues	28,885	28,885
Cell Tower Rental	21,780	21,780
Other Miscellaneous Revenues	12,395	12,395
	<u>2,062,297</u>	<u>2,062,297</u>
<b>Operating Expenses</b>		
O&M Expense	863,218	863,218
General Expense	448,680	448,680
Depreciation Expense	240,835	255,195
Amortization of Prudently Abandoned Plant	33,906	33,906
Amortization of CIAC	(14,445)	(14,445)
Amortization of Acquisition Adjustment	(8,537)	(8,537)
Taxes Other than Income	177,589	183,204
Income Taxes	45,440	32,516
Total Operating Expenses	<u>1,786,686</u>	<u>1,793,737</u>
Net Operating Income	<u>\$ 275,611</u>	<u>\$ 268,560</u>

We further find that the net operating income available to Petitioner for return under its present rates for water utility service of \$268,560 is insufficient to provide a fair return on the fair value of its properties used and useful in providing water service for the convenience of the public, and is therefore unjust and unreasonable and should be increased.

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<sup>7</sup> Note – Phase II results under present rates reflects the level of revenues approved in Phase I, as well as increased bad debt expense, utility receipts tax expense, IURC Fees, and income tax expense.

**B. Wastewater Utility’s NOI under Present Rates.** Based on the evidence and the determinations made above, we find Petitioner’s wastewater utility adjusted forecasted operating results under present rates<sup>1</sup> are as follows:

	<b>Phase I</b>	<b>Phase II</b>
<b>Operating Revenues</b>		
Wastewater Revenues	\$ 2,258,732	\$ 2,258,732
Late Fee Revenues	15,056	15,056
Other Miscellaneous Revenues	4,180	4,180
	<u>2,277,968</u>	<u>2,277,968</u>
<b>Operating Expenses</b>		
O&M Expense	676,743	676,743
General Expense	295,338	295,338
Depreciation Expense	459,226	475,178
Amortization of CIAC	(362)	(362)
Amortization of GIS Mapping	21,368	21,368
Taxes Other than Income	190,209	260,386
Income Taxes	153,685	143,975
Total Operating Expenses	<u>1,796,207</u>	<u>1,872,626</u>
Net Operating Income	<u>\$ 481,761</u>	<u>\$ 405,342</u>

We further find that the net operating income available to Petitioner for return under its present rates for wastewater utility service of \$403,342 is insufficient to provide a fair return on the fair value of its properties used and useful in providing water service for the convenience of the public, and is therefore unjust and unreasonable and should be increased.

**11. Authorized Rate Increase for Phase I.**

**A. Water Utility.** For Phase I, Petitioner should be permitted to increase its rates and charges to produce additional operating revenue of \$374,861, or 18.48%, to produce total annual operating revenues of \$2,368,759 and net operating income of \$503,359:

		<b>Phase I</b>
<b>Operating Revenues</b>		
	Water Revenues	\$ 2,368,759
	Late Fee Revenues	34,224
	Cell Tower Rental	21,780
	Other Miscellaneous Revenues	12,395
		<u>2,437,158</u>
<b>Operating Expenses</b>		
	O&M Expense	863,218
	General Expense	450,384
	Depreciation Expense	240,835
	Amortization of Prudently Abandoned Plant	33,906
	Amortization of CIAC	(14,445)
	Amortization of Acquisition Adjustment	(8,537)
	Taxes Other than Income	182,817
	Income Taxes	185,621
	Total Operating Expenses	<u>1,933,799</u>
	Net Operating Income	<u>\$ 503,359</u>

The determinations in the preceding table reflect the effect of additional revenue on federal and state income taxes, Utility Receipts Tax, Bad Debt Expense and the IURC Fee.

The calculation of CUII's water utility authorized percent increase for Phase I is depicted below:

Original Cost Rate Base	\$ 6,157,297
Times: Weighted Cost of Capital	8.175%
NOI Required for Return on Rate Base	503,359
Less: Adjusted NOI at Current Rates	275,611
Revenue Increase before Gross-up	227,748
Gross Revenue Conversion Factor	164.594544%
Revenue Increase Required	<u>\$ 374,861</u>
Revenue Percentage Increase	<u>18.48%</u>

**B. Wastewater Utility.** For Phase I, Petitioner should be permitted to increase its rates and charges to produce additional operating revenue of \$245,292, or 10.79%, to produce total annual operating revenues of \$2,523,260 and net operating income of \$630,789:

		<b>Phase I</b>
<b>Operating Revenues</b>		
	Wastewater Revenues	\$ 2,502,400
	Late Fee Revenues	16,680
	Other Miscellaneous Revenues	4,180
		<u>2,523,260</u>
<b>Operating Expenses</b>		
	O&M Expense	676,743
	General Expense	296,453
	Depreciation Expense	459,226
	Amortization of CIAC	(362)
	Amortization of GIS Mapping	21,368
	Taxes Other than Income	193,630
	Income Taxes	245,413
	Total Operating Expenses	<u>1,892,471</u>
	Net Operating Income	<u>\$ 630,789</u>

The determinations in the preceding table reflect the effect of additional revenue on federal and state income taxes, Utility Receipts Tax, Bad Debt Expense and the IURC Fee.

The calculation of CUII's wastewater utility authorized percent increase for Phase I is depicted below:

Original Cost Rate Base	\$ 7,716,074
Times: Weighted Cost of Capital	8.175%
NOI Required for Return on Rate Base	630,789
Less: Adjusted NOI at Current Rates	481,761
Revenue Increase before Gross-up	149,028
Gross Revenue Conversion Factor	164.594544%
Revenue Increase Required	<u>\$ 245,292</u>
Revenue Percentage Increase	<u>10.79%</u>

**C. Ultimate Finding.** Based on the evidence and giving appropriate weight to the need for Petitioner to discharge its public duties and to earn a return commensurate with that earned by enterprises of corresponding risk, the Commission finds that Phase I rates estimated to produce the results described in Finding No. 11(A) and 11(B) above are just and fair and should allow Petitioner the opportunity to earn a reasonable return on its property dedicated to providing

water and wastewater utility services to the public for the period the Phase I rates are estimated to be in effect. We discuss the implementation of Phase II rates below.

## 12. Rate Design.

Petitioner's Case-in-chief Evidence. Since the Commission's approval of the merger that resulted in the formation of CUII, CUII has maintained separate tariffs for each of its water and wastewater operating divisions. In this proceeding, CUII proposed to adopt single-tariff pricing for all of its water and wastewater operations. In support of its proposal, CUII presented the testimony of Scott A. Miller, partner in the firm of H.J. Umbaugh & Associates, LLP. Mr. Miller presented a cost of service study for each of the Company's individual water and sewer service territories within Indiana as well as state-wide consolidated water and sewer cost of service studies. He said these analyses were then used as a basis to make recommendations regarding changes in the Company's present schedules of rates and charges for water and sewer service. Pet. Ex. 4 at 4.

Based on his cost of service study, Mr. Miller concluded that consolidated rates appear reasonable for the individual service territories. Pet. Ex. 4 at 24. He said on their own, each service territory is relatively small and lacks the economies of scale that could ultimately result in savings to the customers. He said consolidating the rates mirrors the overall ownership and operation of the different units and more closely matches the allocation of costs to the service areas. He concluded that the consolidated water and sewer rates proposed in his accounting report are fair, just, non-discriminatory and reasonable and necessary to meet the projected revenue requirements of CUII. Pet. Ex. 4 at 26.

OUC's Evidence. Mr. Jerome Mierzwa, Exeter Associates, Inc., was retained by the OUC to review the class cost of service ("CCOS") studies and rate design proposals for CUII's water and wastewater utilities. Mr. Mierzwa's testimony addressed Petitioner's CCOS studies and proposals for its water and wastewater utilities.

With respect to CUII's water cost of service study, Mr. Mierzwa indicated that CUII has three subsidiaries (Twin Lakes Utilities, Inc. ("TLU"); Water Service Company of Indiana, Inc. ("WSC"); and Indiana Water Service, Inc. ("IWS")). He also explained that CUII had prepared separate CCOS studies for each individual service territory as well as a CCOS study that combines all three service studies. Mr. Mierzwa explained that Petitioner's CCOS studies were prepared in a manner consistent with the base-extra capacity method described in the AWWA M-1 Manual. He noted that in preparing its CCOS studies, CUII developed maximum day and maximum hour extra capacity factors for the residential and commercial classes using an approach described in Appendix A of the AWWA M-1 Manual. (Note: Petitioner has no industrial class customers) He explained this approach uses monthly billing data and several adjustment factors to develop extra capacity factors. One of these is a weekly adjustment factor. Mr. Mierzwa noted that in developing the maximum day extra capacity factor for residential customers, CUII used the weekly adjustment factor identified in the AWWA M-1 Manual for commercial customers rather than the weekly adjustment factor for residential customers. He indicated that applying the AWWA M-1 Manual weekly adjustment factor for residential customers to develop extra capacity factors would result in a small increase of \$16,000 in the indicated cost of service for residential customers and a corresponding decrease in the indicated cost of service for commercial customers. However, he explained that notwithstanding the results of the combined CCOS study, which showed a variance of \$47,683 to \$54,656 in indicated cost of service, CUII did not propose to



adopt separate rates for residential and commercial customers. Rather, he indicated that Petitioner used the results of its combined CCOS studies to design base and volumetric charges and is proposing to adopt tariffs that provide for uniform water rates (i.e., single-tariff pricing) to both residential and commercial customers across all three service territories. He indicated that under CUII's proposal in this proceeding, the same base (monthly service charge) and volumetric charges will be assessed to all customers (residential and commercial). Mr. Mierzwa stated that he generally found the Company's water and wastewater CCOS studies to be reasonable. He also found CUII's proposal to consolidate the rates of its individual water service territories to be reasonable. He also stated that he found CUII's proposed distribution of the revenue increase authorized in this proceeding and the proposed design of rates to be reasonable. Ultimately, Mr. Mierzwa recommended that Commission accept CUII's rate design proposal for its water utilities.

With respect to CUII's wastewater cost of service study, Mr. Mierzwa indicated that Petitioner utilized the User Charge System methodology developed by the U.S. Environmental Protection Agency to prepare its wastewater CCOS studies. He explained that CUII subsidiaries TLUI and WSCI provide wastewater service and that CUII has prepared separate CCOS studies for each of the individual service territories of these companies as well as a CCOS study that combines the two service territories. He also indicated that CUII's wastewater CCOS studies include the residential, commercial, and campground customer classes. As indicated previously, CUII is proposing to adopt tariffs that provide for uniform wastewater rates (i.e., single-tariff pricing) for its two service territories. Mr. Mierzwa indicated that, in this proceeding, CUII has used the results of its combined wastewater CCOS studies to design base and volumetric charges. He explained that CUII's combined wastewater CCOS studies do not separately distinguish the cost of service for each customer class. Mr. Mierzwa explained that for the campground class the current rate increase for this class was limited to 10 percent for the reasons set forth by CUII witness Scott A. Miller. Ultimately, Mr. Mierzwa indicated that the OUCC did not object to the proposed single tariff rate design. Mr. Mierzwa suggested the rates determined in CUII's CCOS studies should be proportionately scaled-back if the revenue increase authorized by the Commission is less than CUII's proposal.

In addition, OUCC witness Ms. Stull testified that single-tariff pricing in this case appears reasonable. Pub. Ex. 1 at 9. She described the review and analysis she performed to reach this conclusion. Pub. Ex. 1 at 9-15. She stated that in its next base rate case, CUII should be required to provide all [cost of service study] workpapers and schedules, both on a combined basis and an individual company basis. She said this will allow any party to that case to review and determine whether single-tariff pricing continues to be reasonable. Pub. Ex. 1 at 15.

Petitioner's Rebuttal Evidence. Petitioner's witness Mr. Kersey agreed with the OUCC's proposal to that rates should be proportionately scaled-back if the revenue increase authorized by the IURC is less than CUII's proposal. Mr. Kersey also noted the OUCC did not provide an updated rate design or proof of revenue.

Commission Discussion and Findings. Based on the evidence presented, we find CUII's proposed move to single-tariff pricing is reasonable and should be approved. Accordingly, we approve the rate design shown in Petitioner's Attachment SAM-1, as further updated in Mr. Kersey's rebuttal testimony. We further direct CUII to provide all cost of service study workpapers and schedules both on a combined basis and an individual company basis, as part of its next general rate case.

**13. Phase-In of Rates.** When it initiated this Cause, Petitioner proposed to implement its rate increase in two phases. We have already determined the appropriate Phase I rates based on CUII's rate base as of February 29, 2016 and CUII's projected operating expenses for the forward-looking test period. For Phase II, the parties agree that rates should be based on CUII's actual rate base as of September 30, 2017. We find this approach to be reasonable. While there was some disagreement among the parties as to the specific method by which CUII would present its updated rate base, the parties appear to agree that there should be some opportunity for the OUCC and other parties to review and confirm the Company's revenue requirement for Phase II rates. We agree that such an approach is reasonable and necessary.

To that end, all of these projects, once completed, require (1) certification by CUII that the projects have been completed and are in service and (2) proof through appropriate documentation that costs associated with the project have been incurred and paid. We also find that as part of its compliance filing Petitioner should update all components of rate base, including CIAC and accumulated depreciation as well as the depreciation expense associated with the plant additions. As such, CUII should also submit (1) updated plant-in-service by asset account incorporating the plant additions, (2) updated annual depreciation expense incorporating the eligible plant additions, (3) updated accumulated depreciation on Petitioner's authorized rate base, (4) revised revenue requirement, and (5) updated tariffs. Petitioner shall not be permitted to include in Phase II rates cost for plant additions in excess of the amounts forecasted in Petitioner's evidence in this Cause. The OUCC and LOFS shall have 30 days in which to file any objection to the compliance filing.

**14. Petitioner's Investigation, Internal Controls and Capitalization Policy**

**A. Internal Investigation**

Petitioner's Supplemental Case. Mr. Lubertozi testified regarding the Company's internal investigation into invoices from Central Sewer & Water ("CS&W"). He explained that the company engaged in an internal investigation after he and Mr. Kersey discovered issues with CS&W invoices while preparing portions of CUII's rebuttal testimony. Pet. Ex. S1 at 2. Mr. Lubertozi testified that the answers provided by Operations management regarding such invoices were vague and untimely, and after a series of questions, one of CUII's then-current employees admitted that certain of these invoices were prepaid and that work for these prepaid invoices was either not started or not complete. *Id.* He stated that based on this information, CUII engaged in an internal investigation, which involved physical inspection or auditing of invoices to hard assets in four phases. *Id.* at 3. Phase Two revealed that one invoice, CS&W invoice No. 4018, had been prepaid for work that had not been started. *Id.* Mr. Lubertozi explained that, due to this inconsistency, CUII engaged in Phase Three of the investigation which consisted of a physical inspection of all CS&W invoices over \$10,000 from 2012 to present. *Id.* He asserted Phase Three revealed no inconsistencies but added CUII again expanded the scope of the audit to include additional invoices, not previously tested, in Phase Four. *Id.* Like Phase Three, Phase Four revealed no inconsistencies.

Ultimately, Mr. Lubertozi testified that the internal investigation identified nine invoices covering approximately \$230,000 of capital projects that had been invoiced but for which the work had either not been completed or not begun. *Id.* He testified that, as explained in Mr.

Kersey's supplemental testimony, CUII removed the impact from the prepaid invoices from its rate filing, and prepared updated schedules reflecting the corrections CUII identified. *Id.* at 4. Mr. Lubertozzi further testified that CUII intends to provide bill credits for the over-collection associated with its sewer infrastructure charge approved in Cause No. 44646, and will file corrected semi-annual reports, in order to address the investigation's findings. *Id.* at 4-5.

Mr. Kersey also testified regarding CUII's internal investigation. He explained the adjustments CUII made to remove the impact of the prepaid \$230,000 capital projects invoices that were discovered during the internal investigation. Pet. Ex. 2-S at 4. Mr. Kersey testified that CUII proposed a pro forma rate base reduction of \$246,394 to account for the prepaid invoices, and discussed, in detail, the steps used by CUII to calculate this adjustment. *Id.* at 4-6. He further testified that the company compared its pro forma proposed sewer revenue requirement in its case-in-chief to its revised revenue requirement to calculate a reduction of \$32,497 or 1.15% in Phase II rates, and a \$32,483, or 1.17% reduction in Phase I rates, as a result of the investigation. *Id.* at 9-10.

OUCC's Supplemental Case. The OUCC's accounting witness Margaret Stull produced supplemental testimony in response to Petitioner's supplemental case. Ms. Stull asserted CUII's internal investigation was not sufficient. Ms. Stull explained that Petitioner's initial inquiry was limited to year end 2015 transactions for projects greater than \$5,000 and then expanded to include all CS&W invoices over \$10,000 from January 2012 through April 2016. She believed a more thorough investigation would have included periods beginning before 2012. Ms. Stull noted that without direct access to Petitioner's records and employees, relying on discovery and its own efforts, the OUCC was able to uncover additional instances of improperly paid invoices, which Petitioner had not detected in its own inquiry. She noted the OUCC's witness Mr. Parks identified several invoices from periods earlier than 2012 that represented work that was never performed. Ms. Stull asserted a thorough review by CUII, who should be more familiar with its own internal systems and practices as well as its water and wastewater systems, should have identified the other improperly paid invoices as well as the other issues identified by the OUCC.

Ms. Stull gave an example of Petitioner's insufficient internal inquiry. She noted the OUCC conducted an additional field review of the manhole sealing work supposedly performed by CS&W. She noted that despite Petitioner's assertion that it looked for evidence of construction to verify invoices reviewed, there were several manholes that were supposed to have been sealed from the outside by CS&W but a visual inspection clearly revealed no evidence of any construction activity. She said this should have been identified by Petitioner in the course of a more thorough internal inquiry.

Ms. Stull stated the internal inquiry was limited in its scope, and there does not appear to have been any follow-up to verify the accuracy of statements made. For instance, Petitioner stated it had concluded no one benefitted financially from the improperly paid invoices. Ms. Stull pointed out that this conclusion was based on the word of Employee A and the contractor (Response to OUCC Data Request 29.2), and it does not appear from its report that Petitioner made any further effort to verify these statements or determine if indirect benefits occurred. More specifically, she noted Petitioner's investigation report does not indicate it made any further effort to verify the information provided through a private investigator, a review of personal e-mail, or a request for personal financial information. She noted that in response to OUCC Data Request Nos. 29.20 and 29.22, Petitioner explained it did not have access to personal emails or personal financial records (Attachment MAS-32). Ms. Stull said it is unclear why Petitioner did not believe it could ask for

this information from the offending parties or hire a third party to conduct an investigation. If such a step was taken, it was not disclosed to the Commission.

Ms. Stull explained that Petitioner's inquiry did not include investigating whether any prior year invoices were paid prior to the completion of work. Ms. Stull added that the notes from the interviews with Employee A indicate that the prepayment of invoices had occurred in prior years but CS&W had always been able to complete any prepaid work (Attachment MAS-27). Ms. Stull noted that Petitioner did not directly state it investigated the reasonableness of the amounts billed by CS&W nor did Petitioner discuss how that investigation was conducted.

Ms. Stull rejected Petitioner's explanation that it limited the scope of its review because "[t]he majority of capital spending prior to 2012 was subject to multiple rate case audits and review by the OUCC and LOFS." Ms. Stull did not agree that it is reasonable for Petitioner to rely on these OUCC "audits" to justify limiting its own internal inquiry. She explained that, while the OUCC reviewed Petitioner's capital spending as part of its rate case review, the scope of those reviews are necessarily limited. She added that as a practice, the OUCC chooses a representative sample of asset additions, and the OUCC does not and cannot review all of the asset additions to verify they were actually completed.

Ms. Stull agreed that the reductions to rate base proposed by Petitioner in its supplemental testimony are necessary, but she did not agree with Petitioner's proposal that the Commission should conclude that Petitioner's problems are limited to these invoices or that the issues identified are limited to a few relatively minor missteps that Petitioner has identified.

Petitioner's Rebuttal Evidence. Mr. Lubertozzi responded to the OUCC's criticisms of CUII's internal investigation. He emphasized the seriousness with which CUII took the investigation and the speed at which CUII instituted its investigation upon being made aware of a potential problem. Pet. Ex. R1 at 2-3. He again discussed the four-phase process constituting the internal investigation and described, in detail, the inquiries that took place at each stage. *Id.* at 2-4. He stated that, through this internal investigation, CUII was able to confirm that portions of the work invoiced on invoices 3114 and 3115 had in fact been completed; thus, the OUCC's own follow-up investigation only identified two invoices that had not been previously uncovered in CUII's investigation. *Id.* at 4. He further stated that using three different methods, CUII was able to confirm that some work and corresponding amounts contained in Mr. Parks' Table 2 had also been completed. He concluded that Mr. Parks' thorough review in large part confirms the Company's conclusions.

Commission Discussion and Findings. In its testimony, the OUCC made no specific recommendation with respect to CUII's internal investigation. While the OUCC did not recommend the Commission require Petitioner to repeat or expand its internal investigation, the OUCC made several recommendations to remedy deficiencies it identified in CUII's operations, which we will address below. In CUII's rebuttal case, Mr. Lubertozzi responded briefly to the several criticisms Ms. Stull made with respect to CUII's internal investigation, and through its proposed order, CUII asked this Commission to find that the scope of the investigation was reasonable. We decline to make such a finding.

While we decline to order in this Cause any further investigation of Petitioner's rate base additions, we do not agree the evidence supports a finding that the scope of CUII's internal investigation was reasonable.

Petitioner's initial inquiry was limited to year end 2015 transactions for projects greater than \$5,000 and then expanded to include all CS&W invoices over \$10,000 from January 2012 through April 2016. Thus, Petitioner drew a line both as to amount and as to time. By those parameters Petitioner excluded all project payments made before 2012 and all invoices paid before 2015 that were smaller than \$10,000. It was left to the OUCC's witness Mr. Parks to identify several invoices from periods earlier than 2012 that represented work that was never performed. It is difficult for us to consider CUII's investigation was adequately vigorous when an individual not acquainted with CUII's internal systems and practices should identify improperly paid invoices that CUII's investigation missed.

CUII's explanation for not delving into invoices on plant placed in service before 2012 is not credible. Petitioner said it limited the scope of its review because "[t]he majority of capital spending prior to 2012 was subject to multiple rate case audits and review by the OUCC and LOFS." We do not agree with Petitioner's reasoning. We agree. A rate case is not a rate base audit. As a matter of practicality, neither the IURC nor the OUCC is in the business of cataloging plant in service to verify their existence.

CUII also described the review performed by the OUCC as "exhaustive." This suggests the OUCC's review was complete. The OUCC has not in this case suggested it has been able to turn over every rock, nor should it be expected to do so. In suggesting that the OUCC's participation in a rate case results in a verification that the plant alleged to be in service has been verified is to imply an impossible and unrealistic standard for both the OUCC and this Commission. It is up to the utility to establish that what it says it has placed in service has been built and placed in service.

In its supplemental testimony, Petitioner attempted to characterize the invoices that were paid for, but not completed as "Prepayments." Petitioner's characterization understates the nature of the problem. Had these invoices simply been a "pre-payment" these projects would have been completed soon after payment was completed. Petitioner's argument that other projects had a higher priority and that is why the "pre-paid projects" were not completed is also not persuasive. If there were other projects that had higher priority, they could have been completed by a different contractor. And if these projects were low priority projects, then we question what was driving Petitioner's employee to make it appear those projects had been done.

In its proposed order, CUII said it could not always physically inspect and confirm that work was done. Petitioner should have processes and procedures in place to make such after the fact inquiries unnecessary. Petitioner clearly failed to do so, which is why its investigation must have involved a level of scrutiny not attained in its investigation.

As the OUCC pointed out, in its visual inspection of manholes alleged to have been repaired, Petitioner failed to notice the lack of any sign of construction activity. We agree with the OUCC that this should have been identified by Petitioner in the course of a more thorough internal inquiry. We also agree with the OUCC that there was little or no effort to verify the accuracy of statements made. For instance, Petitioner concluded no one benefitted financially from the improperly paid invoices based on the representations of those very individuals who would have derived that benefit. Moreover, Petitioner's investigation report does not indicate it made any

further effort to verify those representations. Moreover, there is no evidence CUII investigated the reasonableness of the amounts billed by CS&W.

We must find that CUII's investigation, which it conducted internally, was not sufficiently thorough for us to conclude the investigation was reasonable or complete. In making this finding, we must note that CUII is naturally not adequately motivated to find that it paid for plant it did not receive or that it overpaid for the plant it has placed in service. Such findings lead directly to the reduction of its rate base and a lowering of its return. While we do not require in this order that CUII continue its internal investigation, we leave open the possibility that the OUCC, the LOFS or other party including CUII itself may someday detect more plant in service included in CUII's rate base that was never built or that includes costs that were not prudently incurred.

### **B. Internal Controls**

OUCC's Supplemental Case. In her supplemental testimony, Ms. Stull identified severe deficiencies in Petitioner's accounting and internal control processes and procedures and discussed the impact these deficiencies have on Petitioner's ability to efficiently manage and operate its utilities to provide adequate service to its customers at reasonable rates.

Ms. Stull testified the OUCC's supplemental review and analysis identified additional invoices that were improperly paid and verified the OUCC's assertion in its original case-in-chief testimony that many of the costs (both operating expenses and capital costs) incurred by Petitioner are overstated, excessive, or unreasonable. She added that the OUCC's review highlights inadequacies in Petitioner's accounting processes, internal controls, and management of its Indiana utilities.

Ms. Stull noted Petitioner generally does not bid projects, does not generally procure quotes, does not rely on written agreements for the procurement of services, does not rely on standard cost sheets in place for those vendors used on a regular basis, and in general does not have in place sufficient cost controls to ensure the reasonableness and prudence of rate base additions.

Ms. Stull advised that CUII's parent, Utilities, Inc., has no internal auditor position, and while its parent (Corix) has an internal auditor position, no costs of this position have been allocated to Utilities, Inc. suggesting no internal auditing functions have been performed for Utilities, Inc. Further, Petitioner's external auditors only recently began reviewing or testing Petitioner's internal controls (Attachment MAS-40).

Ms. Stull advised that the main control employed by Petitioner related to paying invoices for materials and services is an invoice review process Petitioner refers to as a "three way match." She explained that the three way match is an internal process within Accounts Payable that approves an invoice for payment (Attachment MAS-41). She explained Petitioner's "three way match" consists of (1) Approval of purchase orders based on delegation of authority, (2) Receipting of the goods and services by employees, and (3) Receipt of an invoice from a vendor. The basic premise of this control is a "segregation of duties," which is a basic tenet of any internal control system. She explained that segregation of duties serves two key purposes: (1) it ensures that there is oversight and review to catch errors and (2) it helps to prevent fraud or theft because, unless there is collusion, improper transactions will be detected. She added that segregation of duties ensures that no employee has the ability to both perpetrate and conceal errors or fraud in the normal course of their duties. She explained that generally, the primary incompatible duties that need to

be segregated are: (1) authorization or approval, (2) custody of assets, (3) recording transactions, and (4) reconciliation/control activity. Ms. Stull testified that if internal control is to be effective, there needs to be an adequate division of responsibilities among those who perform accounting procedures or control activities and those who handle assets. Ideally, separate employees will perform each of the four major duties.

Ms. Stull testified Petitioner's three way match process is flawed. Specifically, the person who prepares the purchase order can also be the person who receipts the goods or services (Attachment MAS-42). Therefore, Petitioner's "three way match" provides little or no assurance that the transaction is valid. She said this internal control process should have prevented the prepayment of the CS&W invoices identified by Petitioner in its supplemental testimony. But because an employee (Employee A) can both create the purchase order and receipt the goods or services, she explained this internal control was subject to failure and in fact did fail. She said these invoices were paid and recorded on Petitioner's general ledger although no goods or services had been provided. Further, she noted this wasn't the first time that invoices were received and paid without the services having been provided.

For example, with respect to invoices from one supplier, the RedZone Robotics, Ms. Stull noted Petitioner did not follow its own accounting procedures and processes in this instance. She explained that even though Petitioner says it never received an invoice from RedZone Robotics for this work that was never performed, Accounting still recorded these costs to the general ledger in January 2016 as though the invoices had been received. Ms. Stull said it is unclear how that occurred and this raises concerns that Petitioner recorded other costs in a similar manner without the receipt of an invoice.

Ms. Stull also maintained that Petitioner's recording of capitalized payroll costs is not transparent or understandable. She identified several issues and concerns with Petitioner's method of recording capitalized payroll costs, including (1) a convoluted accounting process for recording payroll costs and (2) overstating the dollar value of capitalized payroll.

Ms. Stull maintained that Petitioner's process for recording capitalized payroll costs is inefficient, non-transparent, and "backwards" -- meaning that capitalized payroll should be recorded *first* and payroll expense should be recorded *second* to represent the allocation of the remaining payroll costs not capitalized. She asserted that a more transparent and direct way for Petitioner to record capitalized payroll transactions should be implemented. She explained that if Petitioner were to reverse the order in which it records capitalized payroll and payroll expense, it would eliminate the need for confusing adjusting entries.

Ms. Stull recommended the Commission order Petitioner to evaluate its internal controls and accounting procedures and implement improvements that will effectively prevent the occurrences such as those outlined in Petitioner's supplemental testimony and the OUCC's responsive testimony. More specifically, Petitioner should be required to (1) create an Internal Auditor function within Utility's Inc.'s Controller's office, (2) regularly train employees, and (3) review accounting policies and procedures regarding the "three way match" and improve segregation of duties so that the same employee cannot both prepare or approve the purchase order and also receipt the goods or services. She also recommended Petitioner be required to provide a

detailed progress report to the OUCC and the Commission regarding the actions taken by Petitioner to improve internal controls within one year from the date of the final order in this Cause.

Further Ms. Stull recommended the Commission order Petitioner to re-evaluate its cost control measures and implement improvements including, but not limited to (1) using work order or project numbers for every asset or project capitalized, (2) securing economies of scale by, where appropriate, purchasing certain materials in bulk and maintaining inventories of certain materials used on a daily basis, (3) Petitioner purchase materials and supplies in bulk rather than the contractor or vendor purchasing materials on an individual project basis, (4) develop best practices for oversight of vendors and contractors and effective invoice review procedures, (5) implementing a policy that contractors may not pass through costs of materials or labor without providing supporting documentation for the utility's review, (7) implementing a policy requiring detailed, written quotes for projects larger than \$5,000, and (8) creating a document control function within the organization where all bids, quotes, equipment specifications, operations manuals, blue prints, and other pertinent information can be maintained and made available to employees as needed.

Finally, Ms. Stull recommended Petitioner be required to provide a detailed progress report regarding the actions taken by Petitioner to improve cost control practices within one year from the date of the final order in this Cause and further reports or supporting documents may be ordered at that time.

Petitioner's Rebuttal Evidence. Mr. Lubertozi responded to the OUCC's criticisms of CUII's internal controls. He testified that, despite the OUCC's contention that its internal investigation uncovered four additional prepaid invoices, CUII's investigation uncovered two of these invoices, CS&W invoices 3114 and 3115. Pet. Ex. R1 at 5. Mr. Lubertozi stated that CUII was able to confirm that portions of work invoiced on these invoices had in fact been complete. *Id.* at 5. Mr. Lubertozi further testified that CUII is not opposed to hiring an internal auditor, as the OUCC suggested; however, he stated that he is not convinced that an internal auditor would have uncovered the prepayment situation, because no audit or auditor could detect all instances of potential fraud. *Id.* at 7. Mr. Lubertozi further questioned whether the benefits of hiring a dedicated internal auditor would outweigh the costs, and pointed out that the OUCC had not included any salary/benefit expense in its schedules for this new employee. *Id.* Mr. Lubertozi also testified regarding CUII's three-way match process. *Id.* at 8. He explained that, due to CUII's organizational structure and Capital Projects Review Team, there are instances when purchase orders are created after the order has been requested or placed with the vendor. *Id.* He stated that while this may not coincide with the three-way match best practice, the goal of the three-way match was achieved, as well as the overall integrity of the process. *Id.*

Mr. Lubertozi also responded to the OUCC's criticisms of CUII's management. Mr. Lubertozi testified that several personnel changes occurred within CUII's management team soon after the prepayment issue was discovered. *Id.* at 9. He stated that approximately three and a half months after the issue was discovered, four local or regional operating employees were no longer employed at CUII. *Id.* These four positions included the Administrative Assistant, Area Manager, Regional Manager and Vice President of Operations and these departures created a vacuum of knowledge or information that was no longer accessible to CUII. *Id.* He also discussed the new and current individuals assuming roles in CUII's management and stated that "CUII's new/current management has brought a renewed energy to CUII with a dedicated focus on delivering service



levels expected by its customer base and its regulators.” *Id.* at 9-10. Mr. Lubertozi further stated that CUII’s management has targeted four areas in need of operational improvement, including, Inflow & Infiltration (“I&I”), Project Management, Procurement and Servicing Water Lines. *Id.* at 10. He described, in detail, the improvements CUII was making in each of these areas; with regard to project management, Mr. Lubertozi stated that CUII recently filled its open Project Manager position which, he testified, has added immediate value to the Company. *Id.* He also described the many changes being made with regard to CUII’s procurement policies, including, new directions to CUII suppliers for providing information on invoices and adjustments to its Purchase Order process. *Id.* at 12. He stated that CUII has also begun analyzing and discussing the potential benefit to customers from moving the servicing of water lines in-house, using CUII employees. *Id.* at 12.

Commission Discussion and Findings. By its own initial estimate, CUII proposed to include in rate base in this case more than \$230,000 for projects that were never begun. Petitioner’s witnesses, including Mr. Lubertozi, President of CUII, and Mr. Kersey, then Manager, Financial Planning & Analysis for CUII, verified under penalty of perjury their case-in-chief testimony was true and correct to the best of their knowledge, information and belief. Mr. Kersey’s and Mr. Lubertozi’s confidence in the accuracy of their rate base investment was misplaced. It is troubling that CUII failed to detect that a significant portion of its rate base additions, on which it sought a return from ratepayers, had never been built. Only after the OUCC filed its case-in-chief did CUII look more closely at its own operations.

Certainly, CUII was surprised it had paid for plant that didn’t exist. The actions of responsible personnel may be described as inappropriate at best. The reaction of current management to this crisis is more troubling. CUII’s own internal processes failed to *prevent* what it came to describe as “potential fraud involving certain invoices.” Lubertozi Rebuttal, p. 2. CUII’s internal processes also failed to *detect* the so-called “possible fraud” after it had occurred. It seems it was only after the OUCC presented its case in chief that CUII initiated its “internal investigation.”

Mr. Lubertozi testified that the three-way process is not designed to detect fraud. Neither is the OUCC’s review of rate cases or the IURC’s review of the evidence presented. Mr. Lubertozi explained that CUII limited the scope of its review to the period after in part because “[t]he majority of capital spending prior to 2012 was subject to multiple rate case audits and review by the OUCC and LOFS.” p. 9, Stull supplemental testimony. Mr. Lubertozi seems to suggest that a rate case is a substitute for a vigorous internal investigation. This basis suggests a lack of understanding of the limitations and the purpose of the ratemaking process. More importantly, it suggests that CUII’s own internal controls are inferior to the scrutiny a utility received in a rate case. The OUCC and the IURC as well as the LOFS should be able to rely on the utility’s processes to have confidence in the utility’s representations with respect to rate base and utility investment. In this case, such confidence proved to be unwarranted. CUII’s lack of focus and seeming reluctance to improve its system to prevent the possibility in the future of any “possible fraud” is unacceptable. In response to the facts that lead to its investigation, Petitioner has done little to change its operations other than replace employees.

It is not enough for CUII to replace employees. To prevent payment for projects not completed or the inclusion in rate base of improvements that do not exist, CUII must establish

internal controls. However, Petitioner did little to change its operations to protect its ratepayers. Petitioner has not shown in this case that it has taken adequate and appropriate steps to prevent the kind of occurrence that required CUII to significantly revise its case. At the Commission's evidentiary hearing, the exchanges between the OUCC and Mr. Kersey show the lack of systemic changes Petitioner has made that will protect ratepayers from the potential of a repeat of the initial filing in this case to include plant in rate base that does not exist:

Q What other steps have you taken to prevent the occurrence that you describe in your report?

A Well, the occurrence was a collaboration between -- talking about the fraud occurrence -- is a collaboration between an employee, maybe a second employee, and the vendor, and so I don't think there's a bulletproof way to ensure that's never going to occur again, but collaborating as a team and making sure that we're staying on schedule and making sure that the invoices that we are receiving make sense, you're not going to -- for example, in this issue that we had, it didn't make much sense to replace all of these different sewer mains around Christmastime or New Year's in such a short period of time. So since checks like that, we do have obviously the internal procedure; we do have the three-way match that we continue to implement, so there's not a whole lot of change in procedure; there's change in personnel; there's new personnel.

Q What is your understanding -- Well, let me withdraw that question. So all you've done is send a notice to vendors, and you've changed the personnel.

A We've changed personnel; we've notified vendors they need to include all of the information on the invoice correct.

Tr. D- 36-37

Throughout this case, CUII has touted its use of the three-way match process, at the same time acknowledging its limitations and ineffectiveness to prevent the precise occurrences that have made this case about Petitioner's operations. Petitioner seems to be resigned to not making meaningful improvements to its internal control process.

Q You're still using the same three-way match process you used before; correct?

A Correct.

Q Now I asked you if you had made any changes, and you indicated that there are -- nothing is foolproof. Do you agree that improvements could be made to your process to prevent this sort of occurrence from occurring again?

A I believe there's always improvements that can be made, but even with other improvements, again, I don't think it's foolproof, so fraud can happen when

multiple employees are collaborating with one another, and I don't think that's avoidable with implementing new processes necessarily.

Q In light of the occurrence of having \$230,000 worth of projects paid for that were not done, did you consider any other steps to prevent such fraud that you have not implemented?

A I'm sure there were other steps considered. I would need to defer to Mr. Lubertozzi; our legal counsel and our CEO had -- most likely had those discussions, and I was not included in those discussions. I'm only aware of what's taken place since then, not alternatives that were considered.

Q Do you know if the utility considered not allowing the person ordering the goods and services to be also the one to acknowledge receipt of those goods and services?

A I'm not aware if that was considered.

Q Do you think that would be an improvement on your processes?

A It's possible. It may cause additional confusion or delays, but it's possible, yes.

Tr. D-37 - 38

Both Mr. Lubertozzi and Mr. Kersey pointed to the three-way match process as an example of their internal controls, but Mr. Lubertozzi has also expressed his belief that the three-way match process is not a designed to prevent the occurrence of fraud:

Q Okay. You would agree that your own internal operations didn't pick up on those discrepancies that Mr. Parks noted.

A Correct. Mr. Parks -- his testimony was one of the things that got us there. The second one was the -- was in his testimony was the sequentially numbered invoices.

Q Okay, and what systems did you have in place at that time that would have allowed you to uncover these discrepancies and issues?

A Well, the three-way match process should allow us to notice those issues, and the three-way match process is really based on the person receiving the goods acting with integrity and only receiving goods that have actually been received by the company.

Q Okay. The three-way match process did not pick up on these things that Mr. Parks pointed out to you.

A Correct, and I would say the three-way match is not really designed to eliminate fraud.

Tr. B- 34 -35

Mr. Lubertozzi also acknowledged that aspects of its internal controls, that the same individual who orders goods and services may also be the person who acknowledges their receipt. Yet CUII does not intend to correct that weakness in its system:

Q Well, one of the reasons why it's not designed to eliminate fraud is that you have the same individual that ordered the services also verify receipt of the services.

A I'm not sure I understand the question, sorry.

Q Well, how does the three-way match system not affect the goal of avoiding fraud? What's the -- Let me ask you a different question. Describe the three-way match program process.

A Sure. So the three-way match process first starts by the creation of a PO, a purchase order, and we do that internally. The second part of the three-way match is you receive an invoice from the vendor, and the third step is the receipt of the goods, and the receipt of the goods is an accounting determination where you have to record that liability or that asset on your books.

Q Okay, and does the three-way match process require three different individuals to participate in the acquisition of goods and services?

A I don't believe so.

Q So in the three-way match process, you could have the same person order the materials and goods and services and also acknowledge receipt of those goods and services and materials; correct?

A That is correct.

Q Do you see a problem with that?

A Well, yes, because it caused a problem in this case, but, no, it's not uncommon for three-way match processes to be done by less than three people.

Q Well, if it had been done by three people, for instance, if another individual besides Employee A had verified the receipt of goods and services, do you think you would have had the same problem?

A We wouldn't have had the same problem?

Q Would you have?

A I don't know I mean, if you have -- there could have been more than one person involved.

Q Well, the problem was -- Okay, it wouldn't work if you had more than one person involved. In this case, did you have more than one person involved?

A We had an employee and an external vendor not understanding our internal processes.

Q Okay, but as far as your employees, you had one employee involved.

A Correct.

Tr. B-35 -37

We find Petitioner should evaluate its internal controls and accounting procedures and implement improvements that will be more effective in preventing the types of occurrences disclosed in Petitioner's supplemental testimony and the OUCC's responsive testimony. More specifically, Petitioner shall (1) create an Internal Auditor function within the Controller's office, (2) regularly train employees, and (3) review accounting policies and procedures regarding the "three way match" and improve segregation of duties so that the same employee cannot both prepare or approve the purchase order and also receipt the goods or services. Petitioner shall provide a detailed progress report to the OUCC and the Commission regarding the actions taken by Petitioner to improve internal controls within one year from the date of the final order in this Cause.

We further find Petitioner should re-evaluate its cost control measures and implement improvements including, but not limited to (1) using work order or project numbers for every asset or project capitalized, (2) securing economies of scale by, where appropriate, purchasing certain materials in bulk and maintaining inventories of certain materials used on a daily basis that are purchased in bulk by Petitioner rather than the contractor or vendor purchasing materials on an individual project basis, (4) develop best practices for oversight of vendors and contractors and effective invoice review procedures, (5) implementing a policy that contractors may not pass through costs of materials or labor without providing supporting documentation for the utility's review, (7) implementing a policy requiring detailed, written quotes for projects larger than \$5,000, and (8) creating a document control function within the organization where all bids, quotes, equipment specifications, operations manuals, blue prints, and other pertinent information can be maintained and made available to employee's as needed. Petitioner shall provide a detailed progress report regarding the actions taken by Petitioner to improve cost control practices within one year from the date of the final order in this Cause and further reports or supporting documents may be ordered at that time.

### C. Petitioner's Capitalization Policy.

OUCC's Evidence. OUCC witness Ms. Stull expressed concern about Petitioner's capitalization policy and the excessive capitalization of operating expenses. Pub. Ex. 1 at 17 and 23. OUCC witnesses raised concerns about the following categories: (1) capitalization of leak repair, (2) labor capitalization policy in general, (3) capitalization of maintenance expenses, and (4) excessive capitalized labor. Ms. Stull testified Petitioner's capitalization policy is clear – capitalize as much cost as you can. As evidence, she pointed to Petitioner's Capitalized Time Guidelines (Attachment MAS-5) which stated "Capitalized time adds to rate base or our investment basis and improves our net income. Any missed capitalized time artificially inflates our expenses and reduces our rate base." *Id. at 23.*

Ms. Stull explained that costs to acquire and put into service long term assets are typically considered capital costs, while ongoing costs incurred for day to day operations or to maintain the current condition of a long lived asset are typically expensed. She added there are also operating costs that are incurred infrequently, and these operating costs should be amortized over the estimated benefit period of the cost. In other words, if a utility paints a tank every twenty years, then it should amortize that cost over a 20 year period. She said these types of operating costs should not be capitalized. *Id. at 15.* Ms. Stull noted Petitioner consistently capitalizes period maintenance expenses it incurs such as well cleaning, GIS mapping, televising of sewer mains, smoke testing of sewer mains, and other routine maintenance expenses of its water and wastewater systems. Ms. Stull added Petitioner capitalized non-capital water costs such as well maintenance and filter media replacement (Attachment MAS-4). *Id. at 22.* Ms. Stull noted that Petitioner also capitalized activities such as replacing light bulbs, replacing fuses, replacing tubing and belts, removing trees, replacing filter media, well-head protection planning, renewing IDEM land application permit, and repairing sewer mains. (Attachment MAS-9 and MAS-17). *Id. at 22- 24, 27 and 45.*

Ms. Stull noted Petitioner's argument for capitalizing certain maintenance expenses is that when a routine operation or maintenance activity results in a decision to address an issue with a capital project, Petitioner includes that routine maintenance as part of the cost of the capital project. For instance, she noted, televising sewer mains is typically expensed as operations and maintenance. But when Petitioner's televising of mains reveals that a section of main should be replaced, Petitioner's practice is to capitalize part of the cost of that televising. *Id. at 17.* Ms. Stull disagreed with that explanation, responding that even if a decision is made to undertake a capital project, routine operating and maintenance activities remain operation and maintenance expenses of the utility and should not be considered as a cost component of an asset. She said the identification of a needed capital project does not change the character of the operating or maintenance activity that was performed. Ms. Stull added that capitalizing operating and maintenance expenses may also result in double recovery since a utility's operating expenses should already include maintenance expenses. Ms. Stull recommended that Petitioner be required to properly record operating expenses in its general ledger and added that whether an activity is booked as operating expense depends on the nature of the activity and not on whether a capital project follows the activity. *Id. at 17-18.*

Ms. Stull argued it is to the ratepayer's benefit to appropriately expense costs rather than capitalize them. She explained that in the short run, it may appear to be less expensive to capitalize a cost rather than expense it, as doing so reduces operating expenses today. But over the long run, ratepayers would pay both a return "on" and a return "of" that cost. Moreover, she noted, the return

“on” these costs will be grossed up for state and federal taxes. *Id. 1 at 15-16.* Ms. Stull explained that capitalizing operating expenses can cause intergenerational rate inequities because ratepayers in the future will be paying a return on and a return of operating costs used to provide services today, and each year the burden gets greater and greater. *Id. at 17.*

Ms. Stull also asserted Petitioner was capitalizing a disproportionately large percentage of employee time – sometimes 50% - 90% of an employee’s time, including high level managers. She stated that, based on her experience, high level manager time is not typically capitalized (at least not in material amounts.) Ms. Stull noted that during the period January 2011 through September 2015, Petitioner capitalized a total of \$490,659 to its consolidated water operations, including \$85,599 of capitalized time, which represents 18.0% of total capital additions. Ms. Stull considered that percentage to be high since Petitioner hires contractors to perform all capital work except for meter installations. Ms. Stull stated Petitioner’s employees do not perform the actual capital work themselves as it is against corporate policy for an employee to enter a trench or confined space (Attachment MAS-6). Petitioner employs contractors to perform such work. Therefore, Petitioner’s employees capitalize any time spent “supervising” the contractor, conducting a site review, working with the contractor and engineer during installation, preparing project status updates, ordering materials, obtaining permits, and other similar administrative functions. *Id. at 23-24.*

As an example, Ms. Stull noted the capitalized time for the new 500,000 gallon ground storage tank approved in Cause No. 44388 was \$34,773, representing 756 hours. Five different [employees] capitalized their time to this project, including 704 hours charged by supervisory and management employees for site reviews or inspections, working with the contractor, meetings, and reviews. One management employee charged 432.5 hours to this project, the equivalent of 54 eight-hour days (Attachment MAS-7). *Id. at 25-26.*

OUCG witness Parks also registered concern with Petitioner’s tendency to capitalize its staff costs. Mr. Parks noted that capitalized emergency leak repairs and capitalized time (“captive”) was an issue in Twin Lakes Utilities, Inc.’s Distribution System Improvement Charge (“DSIC”) application under Cause No. 44646 in 2015. Mr. Parks asserted in that cause that TLUI recorded excessive captive charges for emergency leak repairs. Mr. Parks said captive charges are supposed to be for time spent by CUII staff on capital projects during planning, design, construction, and start-up. Mr. Parks testified costs to acquire and put long-term assets into service are typically considered capital costs, while ongoing costs incurred for day to day operations or to maintain the current condition of a long lived asset are typically expensed. Mr. Parks said it appears CUII capitalizes almost every leak repair whether water main breaks or service line leaks, and whenever any length of pipe is replaced instead of using a clamp, the cost is capitalized. *Pub. Ex. 7 at 68-72.*

Mr. Parks noted that in Cause No. 44646, TLUI indicated that it cost \$91,161 to replace 124 feet of distribution main as a result of 9 main breaks. Mr. Parks noted that more than one third of that amount (\$34,965.44) was for employee captive, even though the utility’s employees do not perform any of the labor on those jobs. Mr. Parks stated that fundamentally, the captive CUII charged was excessive. He explained that the total number of “cap time” hours TLUI charged against water main repairs was 801 hours spread primarily among five utility staff members. At a cost of \$43.65 per hour, he said this equates to 89 hours for each of the 9 water main breaks, most of which were completed by the contractor with a 3 or 4 person crew within one day. He said total crew repair time would range from 18 to 40 hours per leak repair compared to 89 hours per leak

repair for captive. *Id.* Mr. Parks recommended all reasonable and prudent CUII staff time spent addressing water main breaks and service line leaks should be expensed and not capitalized.

Petitioner's Rebuttal Evidence. In rebuttal, Mr. Lubertozi testified that Ms. Stull's comparison of an annual expense to a capital item only looked at the costs over a ten year period. Pet. Ex. R1 at 27. He said that if the expense item was truly ongoing, those costs would continue past the ten years and then customers would clearly pay more than what Ms. Stull depicts. With respect to the OUCC's comments regarding capitalized leak repairs and capitalized time, Mr. Lubertozi stated CUII uses a very straightforward and commonly accepted method when deciding whether to expense or capitalize costs when there is a main break or a leak. He said this method is common in the water and wastewater industry, even in Indiana. Furthermore, he said this method is similar to what is discussed in Mr. Parks' testimony. Mr. Lubertozi explained that when there is a leak or main break and CUII installs one clamp to repair a leak, those costs are expensed. He said when there is a leak or main break and CUII replaces any portion of the transmission or collection system, CUII capitalizes all of the costs associated with that replacement. He said CUII's approach is consistent with CUII's internal policies, as well as GAAP and NARUC's Uniform System of Accounts ("USoA"), and identified specific NARUC USoA instructions that supported CUII's approach. Pet. Ex. R1 at 28-30.

Mr. Kersey also responded to Mr. Parks' testimony regarding capitalization of leak repairs and explained how the Company distinguishes capital costs from operating costs. Pet. Ex. R2 at 55-56. He noted that Mr. Parks bases his claim on the USoA, but in discovery Mr. Parks did not offer an opinion on whether the accounting treatment of water main replacement under the USoA is dependent on whether the activity was planned or unplanned, or whether the accounting treatment of water main replacement under the USoA is dependent on the length of the replaced main. Pet. Ex. R2 at 57. He further noted that the OUCC did not propose any rate recovery to implement their recommendation to treat main replacements as an expense. Mr. Kersey stated Petitioner's forecasted plant spending to its Transmission and Distribution asset account for water main replacements is \$137,331 per year which consists of \$101,777 in "GL Spending" (Pipe, replacement site restoration) and \$35,554 in capitalized time from Petitioner's operations. Mr. Kersey asserted the total annual forecasted cost of \$137,331 should be added to Petitioner's operating expense in order to establish rates should Petitioner be ordered to expense water main replacements in the future. *Pet. Ex. R2 at 58.*

Mr. Kersey testified Petitioner's policy of capitalizing periodic maintenance expenses is reasonable because the charges are incurred in frequencies greater than one year. Mr. Kersey asserted these charges should be capitalized and included in rate base due to the negative net present value associated with these necessary capital outlays and because these charges are incurred solely for the benefit of ratepayers. Mr. Kersey also presented an analysis (Attachment JPK-R7) that purports to demonstrate the net negative value associated with these periodic maintenance costs. *Id. at 54.*

Commission Discussion and Findings. Mr. Lubertozi asserted "It is a commonly understood practice that a regulatory utility should trade expense for capital whenever possible." *Lubertozi Reb. at 27.* We disagree with that premise. If a utility capitalizes expenses "whenever possible" that will, in the long run, lead to higher utility rates, because in addition to recovering the expense over time, the utility will earn a return on the expense. Moreover, the utility will also have to pay state and federal income taxes on the increased return generated by inappropriately



capitalizing expenses. A utility may benefit from such a practice, but its ratepayers who will supply the higher return will not.

We first address the issue of capitalizing leak repairs. We have previously addressed this issue and indicated the replacement of pipe segments that range from a few feet to a hundred feet or more can be appropriately treated as a capital improvement. *Indiana-American Water Co.*, Cause No. 42351 DSIC-9 at 16 (IURC 5/4/2016). There, we noted that “[i]n cases where a pipe can be effectively and reliably returned to service with a repair clamp, a repair clamp is installed and the work is accounted for as an operating expense, because a capital asset has not been replaced.” *Id.* While Petitioner’s practices appear to conform to this order and to GAAP and the NARUC USoA, there are additional factors that should be considered in determining the practice Petitioner should be required to follow.

Applying Petitioner’s capitalization policy to leak repairs would suggest that “whenever possible,” Petitioner’s staff should elect to repair a leak by replacing some small length of pipe rather than applying a clamp, even if a clamp would suffice. The effect of the capitalization policy may be reflected in Petitioner’s practices. According to Mr. Parks’ supplemental testimony, Petitioner rarely repairs a leak with a clamp. Mr. Parks indicated a clamp repair occurs about once per year. *Pub. Ex. 7 at 71*. Petitioner cites to our finding in Cause No. 42351-DSIC 9 to support its policies and practices. But we do not consider such finding supports Petitioner’s capitalization policy. Petitioner’s capitalization policy does not operate in a vacuum. The policy encouraging capitalization “whenever possible” reflects an environment too focused on higher returns than providing quality service at the lowest prices reasonably possible. Recognizing costs as expenses rather than an opportunity to capitalize *should* encourage utilities making operations more efficient. Utilities, after all, may enjoy the benefits of cost savings through improved operations between rate cases. Capitalizing “whenever possible” does the opposite.

Based on the evidence presented, we find that Petitioner’s leak repair practice is neither prudent nor reasonable. Petitioner is ordered to apply reasonable and prudent leak repair practices. The decision to use a clamp or replace a small section of leaky pipe should not be based on what benefits Petitioner the most but rather on what is the most prudent and reasonable course of action to pursue. Further, Petitioner should maintain support in its accounting books and records on a going forward basis to support and document its decision to replace a small section of leaky pipe rather than clamp the leak and to provide this support to this Commission or the OUCC upon request.

We now address Mr. Kersey’s position that \$137,331 that should be added to Petitioner’s operating expenses should Petitioner be ordered to expense water main replacements in the future. We disagree and find that no additional costs should be included in Petitioner’s operating expenses for leak repairs. The application of Petitioner’s capitalization policy with respect to repairing leaks has not provided credible data on which we may determine a reasonable operating expense, particularly in light of evidence that the cost Petitioner has incurred to repair leaks is inflated. *Pub. Ex. 7 at pp. 68-72*. Petitioner might respond to our finding here to initiate a more comprehensive main replacement program, which may reduce the number of emergency leak repairs, improve service to customers, and if appropriately implemented, provide an opportunity to appropriately earn a return. Because there is no credible evidence on the record regarding the amount of capitalized leak repairs incurred during the base year or the amount planned for the test year, we find no test year operating expense is necessary.

We next address Petitioner's capitalization of maintenance expenses. The two issues addressed by the parties are: (1) capitalization of maintenance expense when it results in the decision to undertake a capital project and (2) the capitalization of periodic maintenance expense because it occurs in frequencies greater than one year. Whether an activity is recorded as an operating expense or a capital cost depends upon the nature of the activity and not on whether a capital project results from the maintenance activity or how often the maintenance expense is incurred.

There are problems inherent in Petitioner's policy of capitalizing maintenance expenses. Capitalization of maintenance expense could lead to double recovery of costs by Petitioner if these expenses are included in operating expense and recovered through rates and then subsequently deferred and amortized by Petitioner.<sup>8</sup> This creates a greater administrative burden on regulators to verify there will be no double recovery as well as potentially higher rate case expense. Also, capitalizing maintenance expenses "whenever possible" would doubtless create intergenerational rate inequities because ratepayers in the future will be paying for operating costs that will have occurred in the past. We also agree with Ms. Stull that the deferral of maintenance expense results in high customer rates in the long run because a return on these costs is included in rates.

We find Petitioner's practice of capitalizing maintenance costs inappropriate. We order Petitioner to properly expense maintenance and other day to day operating costs as incurred regardless of the frequency of the occurrence of the cost or whether a capital project eventually results from the performance of the maintenance activity.

We now address Petitioner's excessive capitalization of labor. The raised two areas of concern discussed by the parties regarding excessive capitalized labor: (1) capitalization of management time and (2) capitalization of non-capital activities.

Regarding the capitalization of employee time, it is a significant red flag for Petitioner to capitalize more hours on a given capital project than the time spent by the contractor performing the actual work. The result of Petitioner's current labor capitalization policy leads to excessive capitalization of employee time. It is evident from the examples provided by OUCC witnesses as well as Petitioner's Capitalized Time Guidelines that employees and management personnel are inappropriately incented to capitalize their time. We find that Petitioner should revise its capitalization policy and its practices to avoid inappropriate capitalization of employee time. Petitioner is also ordered to maintain documentation and provide adequate support for the reasonableness of any capitalized employee time it seeks to include in rate base in its next rate application or infrastructure system improvement charge.

Finally, we find that non-capital activities, such as those identified by the OUCC, should not be capitalized and included in rate base. In particular, Petitioner should stop capitalizing non-capital activities performed by Petitioner's personnel. For a labor cost to be capitalized it must relate to the acquisition of an asset or bringing the long term assets into service. Labor costs related

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<sup>8</sup> We note that maintenance expenses (such as well cleaning) were included in operating expenses allowed In Cause No. 44388 (TLUI). If maintenance expenses deferred by Petitioner since Cause No. 44388 had been amortized and included in Petitioner's operating expenses in this case, it would have led to double recovery of these expenses as Petitioner is already recovering these expenses through its current rates and charges.

to the day to day operations of the utility or to maintain the current condition of a long lived assets should be expensed.

### **15. Management's Response to Quality of Service Issues**

We are once again compelled to review the history of this utility.<sup>9</sup> The case at bar has revealed that through dishonesty, a failure to supervise, faulty accounting procedures and collusion between CUII employees and a contractor who “didn’t understand” that being paid for work he had not performed was against “CUII’s policies”, ratepayers have been charged for work that was never performed. CUII would have us accept that now that the fraud has been identified and new management protocols have been created, all is well. Unfortunately, the most recent misadventures in this case are but another episode in the long-running story of a utility fraught with problems. Absent the work by the OUCC<sup>10</sup> reviewing hundreds of pages of documents, it is unclear if the fraud ever would have been uncovered. The evidence shows the problems have not been remedied.

In Cause No. 34321, the Commission addressed complaints about the quality of TLUI’s service. *In the Matter of an Investigation and Examination and Public Hearing of Complaints Against the Rates and Charges of Twin Lakes Utilities, Inc.*, Cause No. 34321, 1977 WL 419269 (Jun. 22, 1977 Ind. Pub. Serv. Comm’n). We found that many of the complaints arose prior to TLUI’s then-present rates and charges, and that TLUI had since “used its increased revenues to upgrade and improve the quality of its service. The Commission believes that such efforts by the Respondent to improve its service should continue to be made[.]” *Id.* at \*10.

TLUI moved this Commission to expand its certificated area of service in 1979. *In the Matter of the Petition of Twin Lakes Utilities, Inc.*, Cause No. 35611, 1979 WL 445278 (May 18, 1979 Ind. Pub. Serv. Comm’n). Customers expressed their concern about TLUI expanding its service territory because “homeowners had occasional sewage backup problems and that sewage also backed up through the manholes and flowed in the lake at times of heavy rain or melting snow[.]” *Id.* at ¶8. Further, utility personnel “was difficult or impossible to reach in case of trouble, especially on weekends.” *Id.* at ¶9. Nonetheless, TLUI received the requested-for authority.

Once again, in 1990, TLUI’s customers were still experiencing:

problems with discolored water, low water pressure and, on occasions, lack of water....sewage backups in their basements during periods of rain[,]...caused primarily by the surcharges which occur during rains because of infiltration and inflow of rain water into the sewage collection system. The LOFS witnesses also asserted that, on occasion, the surcharges result in overflows from manholes.

*In the Matter of the Petition of Twin Lakes Utilities, Inc.*, Cause No. 39050, 1991 WL 11811764 (Apr. 17, 1991 Ind. Util. Regulatory Comm’n).

After hearing the litany of standard complaints, we found that TLUI had demonstrated failures of elements of its system, including water pressure. After TLUI complained about illegal

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<sup>9</sup> Note that this history does not discuss CUII’s other divisions, IWSI and WSCI, which have also presented us with regulatory headaches in the past, nor does it discuss our denial of CUII’s 2015 DSIC docket, Cause No. 44646.

<sup>10</sup> We commend Mr. Parks for his intensive research and analysis that brought this to light, and it is duly noted that CUII has accepted some (but not all) of the disallowances identified by the OUCC.

connections of sump pumps and rain gutters to its sewers, we ordered TLUI to aggressively address this problem and “identify such illegal connections and [] require their disconnection.” *Id.* at ¶11(a)(D). We also found that TLUI’s promise to annually inspect and clean 10 percent of the sewer mains was inadequate, noting that a “November, 1990 Pitometer smoke testing report identified deficiencies which should be immediately corrected. A preventive maintenance program is needed to check periodically the entire sewer system for damage, water infiltration, cracks, leaks and settling of pipes.” *Id.* at ¶11(a)(C). We ordered TLUI to file a plan within six (6) months to address the problem. *Id.*

In 1993, TLUI again sought a rate increase, and we found that TLUI had complied with the requirements imposed by Cause No. 39050. *In the Matter of the Petition of Twin Lakes Utilities, Inc.*, Cause No. 39573, 1993 WL 160038 (Mar. 10, 1993 Ind. Util. Regulatory Comm’n). But when TLUI next sought a rate increase in 2004, LOFS residents registered complaints regarding “discharges of untreated sewage...which apparently predate installation of a new sewer force main in August, 2003.” *In re Twin Lakes*, Cause No. 42488, 2004 WL 1196669 at ¶5 (Mar. 31, 2004 Ind. Util. Regulatory Comm’n). All of the same problems continued to be ongoing. *Id.* We approved a settlement between TLUI, LOFS and the OUCC, while noting:

Of greatest concern to the Commission and the Intervenor, as well as to Twin Lakes and the OUCC, have been past instances of sewer discharges within the Lakes of the Four Seasons subdivision. Twin Lakes’ installation of a new sewer force main in August, 2003, is anticipated to significantly reduce if not eliminate such discharges.... [TLUI] has committed to invest a total of at least \$500,000 in the aggregate over the period 2003-2007 to further diagnose and remediate residual instances of inflow and infiltration (‘I&I’) into its sewer system, as warranted....[TLUI] further committed to reporting quarterly to this Commission as well as to the OUCC and Intervenor its progress addressing I&I.

*Id.*

We also ordered TLUI to provide all customers with a printed notice “includ[ing] a complete description of Petitioner’s own procedures and standards for handling of customer inquiries and complaints, including any opportunities for appeal available to customers if Petitioner’s initial response is deemed unsatisfactory.” *Id.*

Four years later in Cause No. 43128, we were once more faced with complaints. *In the Matter of the Petition of Twin Lakes Utilities, Inc.*, Cause No. 43128, 2008 WL 294523 (Jan. 16, 2008 Ind. Util. Regulatory Comm’n). While TLUI enumerated multiple projects it had accomplished since the previous rate case, *id.* at \*4, LOFS’ witness Mr. Campbell testified “that between March 31, 2004 and March 15, 2007, [TLUI] received over 90 incident reports from customers involving sewer service. Of those, at least 45 involve complaints of sewage backing up into customers’ homes.” *Id.* at \*11. He noted that a “since 2004, [TLUI] has been cited at least 6 times by IDEM for sewage overflows, and...still has not fixed the problem.” *Id.* Even though the parties eventually settled, we expressed our concerns.

The Commission remains concerned with the overflow problems Petitioner has experienced with its sewer system. The Commission first addressed these problems in Cause No. 39050, 1991 Ind. PUC Lexis 128 (Apr. 17, 1991) (“1991 Order”). In that Cause, we noted the infiltration problems with the sewer system resulted in overflows from manholes and sewage backups into basements. As a result, we

ordered Petitioner to undertake an engineering study of its sewer system and develop a preventative maintenance plan to periodically check the entire sewer system for “damage, water infiltration, cracks, leaks and settling of pipes.” 1991 Order at \*57.

In Petitioner’s last rate case in Cause No. 42488 (Mar. 31, 2004) (“2004 Order”), the Commission approved a settlement by which Petitioner committed to invest \$500,000 into its sewer system to remedy infiltration problems. We stated that the “installation of a new sewer force main in August, 2003, is anticipated to significantly reduce if not eliminate such discharges.” 2004 Order at 4. As part of the settlement approved in the 2004 Order, Petitioner committed to submit quarterly reports as to its progress in addressing the infiltration problems.

In this Cause, Petitioner again is facing continuing infiltration problems, resulting in surcharging manholes, sewer backups into resident’s basements, and untreated sewage flowing into nearby waterways....It is unclear why Petitioner has been unable to resolve the continued problem of infiltration in the fifteen years following the 1992 study, two Orders from this Commission specifically addressing this problem, and a significant amount of resources Petitioner has devoted to this issue.

*Id.* at \*20.

In response, we established a subdocket, but the subdocket did not resolve the problems. At the evidentiary hearing in this case, LOFS introduced a copy of our 2009 order in Cause No. 43128 S-1, in which we bemoaned TLUI’s failure to comply with previous orders:

[T]he evidence suggests that even though the inflow and infiltration problem has been the subject of our regulatory scrutiny for nearly twenty years, Petitioner has failed to follow through on the Commission’s past declarations with respect to this issue. During this time, the Commission has patiently listened to Twin Lakes’ promise to reduce inflow and infiltration into its sanitary sewer. Much to our chagrin, the results have not matched the promises made. This is our last, best, and final attempt to instruct Twin Lakes that immediate and sustained improvements must be made to its system. Absent such improvement, the Commission may need to conduct additional review of Twin Lakes’ operations.

Tr. at C-38; LOFS Ex. CX-13.

Unfortunately, our next case with TLUI was mere repetition. *In the Matter of the Petition of Twin Lakes Utilities, Inc.*, Cause No. 43957, 2012 WL 641631 (Feb. 22, 2012 Ind. Util. Regulatory Comm’n). TLUI witness Mr. Haas stated that CUII

continues to receive significant amounts of [I&I]... because the sewer system is mainly comprised of transite pipe that is prone to failure with age. Mr. Haas stated the majority of this excess water is believed to be the result of [I&I] and a good portion of this is believed to be coming from improper sump pump and roof drain connections.... [CUII planned] an investigation that will include smoke testing of the sewer mains and laterals along with personnel visits to individual premises where improper connections are believed to exist.

*Id.* at ¶6(A).

LOFS witness Mr. Cleveland testified in Cause No. 43957 about sewer discharges onto LOFS property and homes; water quality problems; inoperable and neglected fire hydrants; and “poor and often unresponsive customer service[.]” *Id.* at ¶6(C). Another LOFS witness testified that TLUI’s system did not appear to be adequately maintained, including one of the lift stations in LOFS, with sides that had “rotted away such that raw sewage can leach through the ground and potentially flow into the lakes.” *Id.* We noted that

there was undisputed evidence of abandoned lift stations not properly closed, significant root intrusion, foul odors, inoperable hydrants, discolored water, SSOs and sewage backups into customers’ basements. In one instance, Petitioner testified that a few hundred dollar investment in inflow dishes could have avoided one of the events that causes the customers to continue to have a lack of confidence in the operations of this utility — SSOs. Although we disagree with that specific conclusion, no investment was made to rehabilitate the known inflow sources.

*Id.* at ¶11. Again, we addressed each issue and ordered TLUI to take remediation measures.

In 2014 TLUI brought us another rate request. *In the Matter of the Petition of Twin Lakes Utilities, Inc.*, Cause No. 44388, 2014 WL 1712265 (Apr. 23, 2014 Ind. Util. Regulatory Comm’n). Once again we were regaled with the efforts TLUI had put into its system, *id.* at \*4, and the parties reached settlement. We noted with approval the commitments to “keep the lines of communication open between LOFS and Petitioner, including meeting with LOFS on a semi-annual basis to discuss Petitioner’s capital spend, capital budgeting and options/timing of cost recovery[.]...Petitioner’s procedures for handling complaints and for issuing boil water advisories.” *Id.* at \*10. However, we put strictures on TLUI, ordering it to file “(a) televised line inspection information and Petitioner’s plan for the upcoming year; (b) copies of monthly operating reports and a listing of call-out worksheets; and (c) a report on complaints elevated to the Director of Customer Care.” *Id.*

The historical problems persist to this day. Mr. Lubertozi acknowledged that there had been 26 reports between February and September 2016 of discolored water in the LOFS development (which corresponds to the TLUI system), Tr. at A-35, and 33 complaints of discolored water between October of 2016 and January 27th of 2017. Tr. at A-36. The Karpens, a family who has experienced multiple episodes of discolored water for extended periods of time, have had to resort to bottled water, including a period during the Christmas holidays when they were unable to use their water at all. Tr. at A-41-43. To add insult to injury, Mr. Lubertozi acknowledged that when the Karpens are advised to flush their water system during such problems, they are charged by CUII for the water used during the system flushing. Tr. at A-44.

As shown in LOFS CX Ex. 5, the Commission’s final Order in Cause No. 39050, paragraph 11, LOFS experienced manhole surcharges as far back as 1991. Tr. at A-66. As acknowledged by Mr. Lubertozi, there were numerous manhole surcharges reported to IDEM; 16 between April of 2014 and December of 2015, Tr. at A-67, and another five manholes between June of 2016 and August of 2016. Tr. at A-68. One manhole surcharged eight times between April 2014 and December 2015. Tr. A-74-77. CUII did not report any work on this manhole, Tr. A-82, and Mr. Lubertozi acknowledged that when it overflows, sewage flows directly into Lake Holiday. Tr. at A-83. Mr. Lubertozi blamed the surcharges on “ditches not being cleared completely and water getting into the system and illegal connections from downspouts into the sewer system[.]” Tr. A-84. Mr. Lubertozi maintained that CUII was providing environmentally safe service when there

were sewage backups in homes, but he wasn't saying "it's a safe environment for a customer to be in." Tr. at A-91. When asked how it was environmentally safe, Mr. Lubertozi stated that "there's multiple reasons for why sewer backs up into homes, and it's from illegally connected downspouts, from not having the ditches cleaned, and I&I that continues to be an issue in this service territory[.]" Tr. at A-92. However, when pressed for evidence that illegal connections were responsible for the surcharges, Mr. Lubertozi stated only that he had seen downspout connections. Tr. at A-93. Absent from CUII's testimony was any evidence that CUII had taken any action to remedy the connections alleged to be at fault.

Mr. Lubertozi acknowledged that LOFS customers had been experiencing sewer overflows for 25 years and that it was the utility's responsibility to deal with I&I. Tr. at A-94. He also stated that CUII had "made significant improvements in that quality of service which was referenced in this Commission's last Order." Tr. at A-95. When asked what would stop sewage back-ups, Mr. Lubertozi said it would take investment by CUII of probably \$7 million, elimination and disconnection of all rain downspouts attached to the sewer system, and making sure that all of the ditches in LOFS were cleared and allowed storm water flow. Tr. at B-26. But when asked whether CUII had asked customers to disconnect downspouts, or to clear ditches, Mr. Lubertozi did not know. Tr. at B-27.

When pressed by counsel for LOFS, Mr. Lubertozi said the following:

Q: Would the company agree to a performance metric or standard that is based on the number of complaints?

A: No. I think that would be a broader conversation for all of the utilities in the State of Indiana, not just CUII.

Q: What about a performance metric not based on the number of complaints but perhaps based on the number of actual overflows reported to IDEM?

A: And I would -- my response would be exactly the same, which was no; that's where I would draw the line.

Tr. at B-25.

A: [CUII will do] As much as we can on the downspouts and the ditches, yes, but we are committed to spending the capital where necessary to make the improvements to the system. I don't think that -- I think customers deserve a better quality of service. No one deserves to have sewer backups in their basement, and I've -- we've told that to the team, and we need to move forward with a plan that can eliminate that from happening.

Q: When can these customers expect that you'll remedy the sewage backup within their homes?

A: I would hope that the ones that we're talking about here today for the sewer backups that we could have some plan in place -- excuse me, a plan in place with approval from this Commission and the OUCC to move forward I would say within 2017.

Tr. at B-28.

Mr. Lubertozzi first stated that an additional proceeding requesting approval from the Commission to fix specific problems would be necessary, Tr. at B-31, but then acknowledged that a utility does not need additional approval to fix problems. Tr. at B-33.

Mr. Lubertozzi stated that CUII began reviewing the CS&W invoices after Mr. Parks' identified what he believed to be discrepancies. B-34-35. Mr. Lubertozzi stated that CUII had not changed its three-way match system for verifying payments. CUII's defense of its "three way match" (which failed to identify the "prepaid" invoice issue) is that it was not designed to identify fraud. Tr. at B-35-37. CUII does not believe that any particular management control process could be adopted that would guarantee fraud could not happen. CUII's new vendor guidance and invoice requirements, trying to get two layers of personnel involved with the capital project review team, and increased communication with the field personnel are improvements. Tr. at B-37-38. We strongly encourage CUII to pursue these steps and any others which it believes will help minimize the possibility of fraudulent activity in the future.

The OUCC identified a number of discovery responses for which Petitioner provided either incomplete or no information. CUII's failure or inability to answer questions no doubt was complicated by employee turnover, but that is not the end of the story. Like CUII's "three way match" that allowed for fraudulent transactions to be approved, CUII's information management leaves much to be desired. For example, Ms. McCutchan testified that she had additional documents on CUII's various tanks, but had not produced all of them, and it was unclear whether CUII ever sought the information to provide in response to data requests. Further, it was through the OUCC's examination of CUII's invoices that the fraud was discovered, and CUII can hardly have been surprised that the OUCC would continue to ask questions once CUII acknowledged the fraud.

This is not the first time we have chided TLUI, and the last rate order in Cause No. 43957 said it starkly:

We have recognized a utility's obligation to provide adequate service in exchange for recovery of investments through rates. *See Twin lakes Utilities, Inc.*, Cause No. 43128 S1, at 12 (Nov. 12, 2009) ("Commission would suggest that Petitioner reconsider its duty as a public utility to provide adequate service in exchange for receiving appropriate rate relief--Petitioner appears to be too focused on the second half of that equation.") If Twin Lakes cannot provide water and sewer service to its customers adequate for the purposes reasonably expected by its customers, it is this Commission's responsibility to speak directly to the utility's management, through our Orders, to send a message that service must improve. As we noted in Cause No. 43128, this message has been repeated for more than a decade, with limited improvements noted.

*In the Matter of the Petition of Twin Lakes Utilities, Inc.*, Cause No. 43957, 2012 WL 641631 at § 7.B.

In the absence of concrete improvement, represented by actual correction of the problems that have plagued this utility for forty (40) years – sewer discharges, I&I, and water quality - we will be compelled to declare CUII a troubled utility and take action pursuant to I.C. ch. 8-1-30, *et seq.* CUII must report to the Commission and all parties the following: (a) all projects it undertakes to remedy the persistent problems, which must include time-stamped photographs documenting actual work performed; (b) CUII must competitively bid projects and provide copies of bids and



contractor responses; (c) hire a third-party auditor to do a thorough review of CUII's books. This in particular is necessary because we are not convinced that all of CS&W's "prepaid projects" have been fully accounted for; CUII's own investigation report contains an admission that the "prebilling" had been going on for approximately four (4) years.<sup>11</sup>

**16. Sales Tax Refund.** Since its last rate, CUII received a total of \$53,196 in sales tax refunds consisting of \$24,156 from the Indiana Department of Revenue and a \$29,040 credit from Indiana-American. (See Attachment MAS-2.) The OUCC's accounting witness Margaret Stull asserted customers of Community's IWSI division should receive the benefit of the refund of sales tax IWSI had ultimately paid to the Indiana Department of Revenue. Ms. Stull explained that until recently IWSI paid sales tax on all water purchased for resale from Indiana-American. Ms. Stull explained that these tax payments were made because IWSI had neglected to file the paperwork necessary for the sales tax exemption on water purchased for resale. But, as Ms. Stull noted, IWSI corrected this omission in 2014 by filing the proper paperwork with the Indiana Department of Revenue. In January 2015, IWSI revised its water tracker downwards to reflect the elimination of that expense. As to sales taxes that had already been paid, Ms. Stull noted that CUII received a \$24,156 refund from the IDOR as well as \$29,040 credit from Indiana-American. (See Attachment MAS-2.) Ms. Stull proposed the total sales tax refund of \$53,196 should be returned to IWSI's customers who paid the taxes through their rates. She explained the sales tax had been included in IWSI's cost of purchased water and included in IWSI's revenue requirement. Therefore, IWSI customers paid these sales taxes through their water rates, and these customers should receive the refund. Ms. Stull said the refund should be returned to IWSI's customers through a one-time payment or credit and should be implemented as soon as reasonably possible. Ms. Stull concluded by inviting CUII to suggest a methodology as to the specific mechanics of the refund.

CUII rejected that invitation by disagreeing that the refunds should be credited to IWSI customers at all. CUII's witness Mr. Lubertozzi asserted that issuing the refund would be retroactive ratemaking. He stated that in the Company's last rate case the Commission set a total just and reasonable revenue requirement designed to generate a certain authorized return on equity, but asserted this Commission and the OUCC is fully aware that a Company's returns will never match the returns that the Commission authorized. Mr. Lubertozzi noted Petitioner has never earned its authorized rate of return, even with these amounts included.

Also, Mr. Lubertozzi asserted requiring the refund to be paid to IWSI's customers would be a taking of a utility's property. He added that just as the Company's returns are not guaranteed, expenses are not guaranteed to stay the same, increase or decrease. Mr. Lubertozzi asserted that here the OUCC has identified one area in which expenses were lower than otherwise expected, but it ignores other instances in which expenses increased. He stated it is unreasonable in this instance to retroactively adjust rates to capture one issue while ignoring the rest.

Commission Discussion and Findings: In IWSI's prior rate cases, IWSI included in its revenue requirement an expense it ultimately did not pay. CUII's affiliate failed to recognize and apply for a sales tax exemption to which it was entitled. Accordingly, CUII's IWSI ratepayers

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<sup>11</sup> As noted by Mr. Parks, "Employee A told Steve Lubertozzi, Jim Andrejko, Jim Devine, and Justin Kersey that he believed he "started doing this maybe 4 years where they 'stretched the truth.' Then it just compounded." (Emphasis added)" Public's Ex. 7, Supplemental Testimony of James Parks, p. 42.

paid higher rates for an expense that did not really exist. CUII secured a refund of \$53,196 because it finally applied for the exemption. The OUCC maintains the refund Petitioner received should be provided to Petitioner's IWSI division ratepayers, who paid higher rates as a result of Petitioner's unnecessary collection of the tax. It is logical and equitable that IWSI's customers, whose rates included the tax that was ultimately not due, should benefit from the refund – particularly when the expense had been included in the revenue requirement through a lack of diligence on the part of the utility. Another way of viewing the matter is that the utility should not receive the windfall of the refund when the windfall was caused by its own failure to apply for the exemption. This is not the case of a utility including in its revenue requirement various expenses that it was later able to avoid through improved operations and cost-saving measures. The expense included in IWSI's revenue requirement should never have been included and would have been excluded from the beginning through appropriate management decisions and actions. Allowing CUII to retain the refunds it secured would be to allow CUII to benefit from its own negligence and poor management. Nor is CUII penalized by not being permitted to retain funds that would only be described as a windfall. The rightful owners of this found money are the ratepayers who paid higher rates for a tax that was never due.

Petitioner asserted in its rebuttal case that the prohibition against retroactive ratemaking prevents the Commission from requiring this money be credited to rate payers. We disagree. The prohibition against retroactive ratemaking does not apply. Providing the refund to the IWSI customers is not retroactive ratemaking. The rule against retroactive ratemaking has been interpreted to serve as protection for ratepayers. In discussing the policy goals against retroactive ratemaking, the Commission stated three functions served by the rule:

The rule against retroactive ratemaking serves three basic functions, namely: (1) protection of the public by ensuring that current customers will not be required to pay for the past deficits of utilities through their future rates, (2) preventing utilities from employing future rates to protect the financial investment of their stockholders, and (3) requiring utilities to bear losses and enjoy gains depending on their managerial efficiency. *Public Service Comm'n. v. City of Indianapolis*, 235 Ind. 70, 131 N.E.2d 308, 315 (1956); *Indiana Gas Co. v. Office of Utility Consumer Counselor*, 575 N.E.2d 1044, 1052 (Ind. Ct. App. 1991); *Town of Kingsford Heights*, 1987 Ind. PUC LEXIS 335, Cause No. 37999, at \*32-43 (IURC March 18, 1987).

(*NIPSCO*, Cause No. 39723 – 11/2/94, p. 30).

We noted in Cause No. 39723 that one of the interests served by prohibiting retroactive ratemaking is requiring utilities to bear losses and enjoy gains depending on their managerial efficiency. What Petitioner has proposed in denying the refund to its ratepayers turns this interest on its head. Petitioner proposes to enjoy a gain caused by its own *mismanagement* in failing to more promptly apply for its exemption. Petitioner's IWSI customers were harmed by that delay in the form of higher rates. It is only just and proper that Petitioner not be permitted to retain the monies it has received because of its omission.

Moreover, the Courts of this state have held that the Commission may order refunds without implicating retroactive ratemaking. In *Airco Industrial Gases v. Indiana Mich. Power Co.*, 614 N.E.2d 951, 954 (Ind. Ct. App. 1993), the Commission had determined that the tariff filed by an electric utility was not in compliance with the Commission's order. Thus, the utility

collected and retained monies from ratepayers to which it would not have been entitled but for the inappropriate tariff. The Court of Appeals held that the Commission did have the authority to determine a customer is entitled to a refund or credit. The Court of Appeals held the Commission would not be engaging in retroactive ratemaking by granting Airco's request for an appropriate refund or credit. Id at 954. In *Airco*, the Court held that allowing the utility to retain funds was at least unreasonable. Id. In this Cause, we find it is unreasonable for CUII to retain the refund it received. CUII should issue one-time credits to its IWSI customers, in an amount that will equal the amount refunded to CUII. Within forty-five (45) days of this order, CUII shall present to the Commission a proposal for crediting or otherwise returning to its IWSI ratepayers the tax refunds it received. In advance of that filing, we encourage CUII to work with the OUCC to establish an appropriate mechanism to meet this requirement.

**17. Confidentiality.** CUII filed motions for Protection and Nondisclosure of Confidential and Proprietary Information on December 15, 2015 and June 27, 2016 which were supported by affidavits showing documents to be submitted to the Commission were trade secret information within the scope of Ind. Code §§ 5-14-3-4(a)(4), (9), and 24-2-3-2. The Presiding Officers issued Docket Entries on January 29, 2016 and October 24, 2016 finding such information to be preliminarily confidential, after which such information was submitted under seal. No party objected to the confidential and proprietary nature of the information submitted under seal in this proceeding. We find all the information is confidential pursuant to Ind. Code § 5-14-3-4 and Ind. Code § 24-2-3-2, is exempt from public access and disclosure by Indiana law and shall continue to be held confidential and protected from public access and disclosure by the Commission.

**IT IS THEREFORE ORDERED BY THE INDIANA UTILITY REGULATORY COMMISSION that:**

1. Petitioner is hereby authorized to increase its water rates and charges to produce additional operating revenue of \$374,861, or 18.48%, to produce in Phase I total annual operating revenues of \$2,437,158 and net operating income of \$503,359.

2. Petitioner is hereby authorized to increase its wastewater rates and charges to produce additional operating revenue of \$245,292, or 10.79%, to produce in Phase I total annual operating revenues of \$2,523,260 and net operating income of \$630,789.

3. CUII is authorized to implement a second phase (Phase II) as set forth in Ordering Paragraphs 4 and 5 below and as directed in section 13 above.

4. For Phase I, Petitioner shall file new schedules of rates and charges in this Cause for approval by the Water/Wastewater Division of the Commission on the basis set forth above. CUII's new schedules of rates and charges shall be effective upon approval by the Water/Wastewater Division.

5. For Phase II, within 30 days after September 30, 2017, CUII shall file new schedules of rates and charges in this Cause to update its rate base as of September 30, 2017. CUII shall include a schedule by NARUC subaccount detail of the actual utility plant in service as of September 30, 2017. As part of its compliance filing Petitioner shall update all components of rate base, including

CIAC and accumulated depreciation as well as the depreciation expense associated with the plant additions. As such, CUII shall submit (1) updated plant-in-service by asset account incorporating the plant additions, (2) updated annual depreciation expense incorporating the eligible plant additions, (3) updated accumulated depreciation on Petitioner's authorized rate base, (4) revised revenue requirement, and (5) updated tariffs. Petitioner shall not be permitted to include in Phase II rates cost for plant additions in excess of the amounts forecasted in Petitioner's evidence in this Cause. The OUCC and LOFS shall have 30 days in which to file any objection to the compliance filing.

6. Petitioner rates will be calculated using the current Commission composite water and wastewater depreciation rates.

7. Petitioner shall provide refunds to its IWSI customers as described in Section 16 of this order.

8. Petitioner shall revise its capitalization policy and its practices, so that it avoids inappropriate capitalization of employee time. Petitioner is also ordered to maintain documentation and provide adequate support for the reasonableness of any capitalized employee time it seeks to include in its rate base in future rate applications, infrastructure system improvement charges, and any other regulatory relief where Petitioner can recover capital costs between rate cases.

9. Within six (6) months of the date of this Order, CUII shall competitively bid all projects for more than \$5,000 and provide copies of bids and contractor responses with its Semi-Annual Reports; expense all emergency water main breaks and service line leak repairs, including all pipe replacements regardless of length; and expense time spent addressing water main breaks and service line leaks and provide detailed descriptions of the work performed.

10. Petitioner shall document in its Semi-Annual Reports all projects it undertakes to remedy infiltration and inflow, sewer backups into homes, manhole and sewer discharges, and water quality, which must include time-stamped photographs documenting actual work performed.

11. Petitioner shall hire a third-party independent auditor to review of its books.

12. Petitioner shall re-evaluate its cost control measures and implement improvements including, but not limited to:

(a) using work order or project numbers for every asset or project capitalized;

(b) securing economies of scale by, where appropriate, purchasing certain materials in bulk and maintaining inventories of certain materials used on a daily basis that are purchased in bulk by CUII/Utilities, Inc. rather than the contractor or vendor purchasing materials on an individual project basis;

- (c) developing best practices for oversight of vendors and contractors and effective invoice review procedures;
- (d) implementing a policy that contractors may not pass through costs of materials or labor without providing supporting documentation for the utility's review;
- (e) implementing a policy requiring detailed, written quotes for projects larger than \$5,000, and
- (f) creating a document control function within the organization where all bids, quotes, equipment specifications, operations manuals, blue prints, and other pertinent information can be maintained and made available to employees as needed. Petitioner shall provide a detailed progress report regarding the actions taken by Petitioner to improve cost control practices within one year from the date of the final order in this Cause.

13. Petitioner shall have an individual at the executive level verify under oath that the semi-annual reports have been prepared under their direction or supervision and that the information submitted is, to the best of their knowledge and belief, true, accurate, and complete.

14. Petitioner shall take the following actions regarding its sewer system and report on progress with each in its Semi-Annual Reports:

- (a) resume cleaning, inspecting and televising 10% of its sewer system annually, determining which portions of its system need to be cleaned and televised more frequently;
- (b) create a comprehensive sewer and manhole repair tracking form, including both future and previously completed work;
- (c) stop capitalizing without regard to length of pipe, all emergency water main breaks and service line leak repairs;
- (d) expense time spent addressing water main breaks and service line leaks and provide detailed descriptions of the work performed; and
- (e) develop and implement an effective Asset Management program for its sewer systems that prioritizes sewer and manhole replacement projects.

15. CUII shall report on its implementation of matters ordered in this Cause in each Semi-Annual Report to be filed with the Commission and the parties.

16. The Confidential Information filed under seal in this Cause shall continue to be treated by the Commission as confidential and not subject to public disclosure.

17. This Order shall be effective on and after the date of its approval.

**ATTERHOLT, FREEMAN, HUSTON, WEBER AND ZIEGNER CONCUR:**  
**APPROVED:**

I hereby certify that the above is a true and correct copy of the Order as approved.

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Mary Becerra  
Secretary of the Commission

**CERTIFICATE OF SERVICE**

This is to certify that a copy of the foregoing *Indiana Office of Utility Consumer Counselor's Proposed Order* has been served upon the following counsel of record in the captioned proceeding by electronic service on April 19, 2017.

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