ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF AMERICAN SUBURBAN UTILITIES, INC. FOR (1) AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR SEWER UTILITY SERVICE, (2) APPROVAL OF NEW SCHEDULES OF RATES AND CHARGES APPLICABLE THERETO	)	**CAUSE NO. 44676**
PETITION OF AMERICAN SUBURBAN UTILITIES, INC., AN INDIANA CORPORATION, FOR AUTHORITY TO ENTER INTO A TERM CREDIT FACILITY IN AGGREGATE AMOUNT UP TO $5,100,000; (2) ENCUMBER PETITIONER'S ASSETS AS SECURITY FOR SUCH LONG-TERM DEBT; AND (3) AUTHORITY TO USE THE NET PROCEEDS THEREFROM TO REIMBURSE ITS TREASURY AND FINANCE ITS CONSTRUCTION PROGRAM	)	**CAUSE NO. 44700** **APPROVED:** NOV 30 2016

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ORDER OF THE COMMISSION

Presiding Officers:
Angela Rapp Weber, Commissioner
David E. Veleta, Senior Administrative Law Judge

On September 4, 2015, American Suburban Utilities, Inc. ("Petitioner") filed its *Petition and Submission of Case-in-Chief under Ind. Code § 8-1-2-42.7 and Notice of Intent to File Information Required Under Minimum Standard Filing Requirements and Motion Requesting Administrative Notice* ("Petition") with the Indiana Utility Regulatory Commission ("Commission") in Cause No. 44676, seeking authority to increase its rates and charges for sewer utility service and for approval of new schedules of rates and charges. Petitioner filed testimony and exhibits from the following witnesses: Edward J. Serowka, President of Lakeland InnovaTech; John R. Skomp, Partner with Crowe Horwath LLP; and John F. Thieme, Partner with Thieme & Adair CPAs, PC. On October 1, 2015, the Presiding Officers issued a Docket Entry requesting additional information from Petitioner.

On October 30, 2015, Petitioner filed its Petition in Cause No. 44700 requesting authority to enter into a term credit facility in aggregate amount up to $5,100,000 and other related relief. In support of its Petition, Petitioner filed testimony and exhibits from John R. Skomp.

A Petition to Intervene in Cause No. 44676, was filed on November 6, 2015, by Tippecanoe County Citizens Against Rate Increase ("TC-CARI"). The Presiding Officers issued a Docket Entry on December 8, 2015, granting the Petition to Intervene.

A public field hearing was conducted on November 16, 2015 at 6:00 p.m. in the City of West Lafayette. During this public field hearing, members of the public provided oral and/or written testimony in Cause No. 44676.

On January 13, 2016, the Indiana Office of Utility Consumer Counselor ("OUCC") filed its prefiled testimony in Cause No. 44676, consisting of testimony and exhibits from the following witnesses: Charles E. Patrick, Utility Analyst; James T. Parks, Utility Analyst II; and Edward R. Kaufman, Chief Technical Advisor.

On January 20, 2016, the Presiding Officers issued a Docket Entry consolidating Cause Nos. 44676 and 44700. Petitioner filed its rebuttal in Cause No. 44676 on February 5, 2016. The OUCC filed the testimony of Mr. Kaufman in Cause No. 44700 on February 11, 2016, and Petitioner filed its rebuttal in that Cause on February 24, 2016. No testimony was filed by TC-CARI in either Cause No. 44676 or 44700.

On March 8, 2016, the Presiding Officers issued a Docket Entry requesting additional information from Petitioner and the OUCC. Specifically, the Docket Entry included 23 questions for Petitioner and seven questions for the OUCC. On March 14, the Parties filed their responses to the Docket Entry. Petitioner's response included 334 pages of documents. ("Petitioner's Docket Entry Response")

An Evidentiary Hearing was held in consolidated Cause Nos. 44676 and 44700 on March 15, 2016, at 9:30 a.m., in Room 222 of the PNC Center, 101 West Washington, Street, Indianapolis, Indiana. During the Evidentiary Hearing, evidence constituting Petitioner's Case-in-Chief and rebuttal was offered and admitted into the record and its witnesses were offered for cross-examination. In addition, evidence constituting the Case-in-Chief of the OUCC was offered and admitted into the record and their witnesses were offered for cross-examination. In addition, we received into evidence Petitioner's and OUCC's responses to various docket entry questions and Petitioner's responses to the Presiding Officers' questions asked during the hearing. We also received into evidence cross-examination and redirect exhibits offered during the hearing. The OUCC requested additional time to review Petitioner's Docket Entry Response to determine whether they had any further cross-examination. The OUCC did not have any further cross-examination.

The Commission took administrative notice of the following: (1) the Commission's Order dated April 14, 1999, in Cause No. 41254 ("41254 Order"); (2) Petitioner's Response dated February 24, 2014, to Commission's Docket Entry dated February 20, 2014, in Cause No. 44272; (3) the Commission's Order dated April 9, 2014, in Cause No. 44272; and (4) the Commission's Order dated July 22, 2015, in Cause No. 44593.

Having considered all of the evidence presented in this proceeding and based on the applicable law, the Commission now finds:

1. <u>Notice and Jurisdiction</u>. Notice of the hearings in this Cause was given and published by the Commission as required by law. Petitioner is a public utility as that term is defined in Ind. Code § 8-1-2-1(a). Pursuant to Ind. Code §§ 8-1-2-76 through 8-1-2-81, the

Commission has jurisdiction over Petitioner's authority to issue or incur debt. Therefore, the Commission has jurisdiction over Petitioner and the subject matter of this proceeding.

2. **Petitioner's Characteristics.** Petitioner is a public utility incorporated under the laws of the State of Indiana and is engaged in the provision of wastewater utility service in unincorporated areas in Tippecanoe County, Indiana. Petitioner renders such sewer utility service by means of utility plant, property, equipment, and related facilities owned, leased, operated, managed, and controlled by it.

3. **Existing Rates and Relief Requested.** Petitioner's existing basic rates and charges for wastewater utility service were established pursuant to the Commission's Order in Cause No. 41254. Petitioner's current system development charge ("SDC") was established in Cause No. 44593.

Petitioner proposed that its rates be increased in three phases so as to produce additional revenues of $2,155,153, or a 73.56% increase. Phase I would be calculated from the twelve months of operations ending March 31, 2015, as adjusted, with rate base updated to include Petitioner's Big 3 Sewer Project and accumulated depreciation, amortization of contributions in aid of construction ("CIAC"), revenues from customer growth, and capital structure through the approximate date of the Order. Phase II of the increase would be implemented on or about January 1, 2017, to reflect the Klondike Road Project, the addition of chemical phosphorus removal equipment and the Carriage Estates Wastewater Treatment Plant-III ("CE-III") Stage 1 major projects, actual capital structure; actual customer count; actual accumulated depreciation; and amortization of CIAC and additional return, depreciation expenses, and taxes. Phase III would be implemented on or about July 1, 2018, and would update for the same components described above, and would also reflect the CE-III Stage 2 major projects in rate base.

4. **Test Period.** Petitioner proposed a hybrid test period using historic data for the 12-month period ending March 31, 2015, and further historic and projected data through June 30, 2018, as authorized by Ind. Code § 8-1-2-42.7(d)(3). At the Prehearing Conference held in Cause No. 44676, the OUCC opposed Petitioner's proposed test period, contending that it is not consistent with Ind. Code § 8-1-2-42.7 ("Section 42.7") because it would extend for too long. In the Prehearing Conference Order for Cause No. 44676 issued November 18, 2015, we held:

> In this case, the four major projects that Petitioner proposed to implement through phased in rates were the subject of the Commission's Order in *American Suburban Utilities*, Cause No. 44272, 2014 WL 1477992 (IURC Apr. 9, 2014) ("44272 Order"). The 44272 Order granted pre-approval to all four major projects. Thus, the pre-approval provides unique circumstances which help alleviate some of our concerns with having such a long test period and make the use of a hybrid test period that is greater than 12 months appropriate in this case. Furthermore, by using a hybrid test period Petitioner would avoid incurring the additional expense of filing an additional rate case to capture the preapproved major projects occurring further out in the future.

44676 Prehearing Conference Order, p. 2.

As provided in the Prehearing Conference Order, the test year to be used for determining Petitioner's projected operating revenues, expenses, and operating income shall be the 12-month period ending March 31, 2015, and further historic and projected data through June 30, 2018. This is the first case filed under Section 42.7 utilizing a hybrid test period.

5. Evidence Presented.

A. Petitioner's Case-in-Chief. Mr. Serowka stated that Petitioner is a corporation that owns a sewage collection, treatment, and disposal utility operating pursuant to certificates of territorial authority granted by the Commission. Petitioner currently serves outside the corporate limits of the City of West Lafayette. Petitioner has two treatment plants. The County Home Wastewater Treatment Plant is the smaller of the two, which is a 1.0 million gallon per day ("MGD") plant serving in the vicinity of Harrison High School. CE-III is the larger of the plants, has a capacity of 1.50 MGD, and serves the balance of Petitioner's customer base. It is located at 4100 Bridgeway Drive in Carriage Estates Subdivision which is located in Wabash Township, Tippecanoe County, Indiana. CE-III is located in a semi-residential area with subdivisions located east and south of the plant. CE-III is located west of the Carriage Estates Subdivision, north of the Moss Creek Subdivision and is separated from these subdivisions by Indian Creek and a strip of trees. The main service area for Petitioner is the area serviced by CE-III. Approximately 94% of Petitioner's customers are located in this area.

Mr. Serowka stated that Petitioner has approximately 2,600 customers. As of August, 2015, Petitioner serves 5,527 units that house single family residential customers (consisting of homes, mobile homes, and apartments); four schools with a combined faculty and student population of 4,930; 50 individually metered customers; and one service station.

Mr. Serowka also described other meaningful ways to review the customer base that Petitioner services. One of these is Population Equivalency ("PE"), which is an engineering term and is based on the statistical basis that an individual uses 100 gallons of water per day. The current average daily flow for CE-III is 1.82 MGD and the average daily flow for the County Home Wastewater Treatment Plant is 190,000 gallons per day ("GPD"), resulting in a total system average daily flow of 2,010,000 GPD. Dividing this by 100 GPD/person results in a population equivalent of 20,100. A second engineering term which is sometimes used is equivalent dwelling units ("EDU"). An EDU is the average water usage by a single family residence and is 310 gallons per day. Therefore, Petitioner has an EDU total of 6,484 single family residences. This is once again calculated by dividing the average daily flow of 2,010,000 GPD by 310 GPD/single family residence.

Mr. Serowka provided a history of Petitioner's sewage service. Petitioner began operations in 1966 when its initial CTA was issued in Cause No. 31165. In 1986, Petitioner expanded CE-III from 0.423 MGD to 0.76 MGD with a peak wet weather flow of 1.140 MGD. The expansion consisted of adding a new secondary clarifier and converting the existing circular treatment plant into an aeration tank. In 1992, an Agreed Order was issued by the Indiana

Department of Environmental Management ("IDEM") to eliminate chronic bypassing at CE-III and in the collection system. In March 1997, another Agreed Order was entered requiring complete replacement or abandonment (and rerouting of flow to CE-III) of the County Home Wastewater Treatment Plant. The County Home Wastewater Treatment Plant at that time was a 32,000 GPD package plant. It was built in a flood way and suffered a catastrophic failure in 1997 as a result of flooding. At that time, Petitioner lacked access to capital to make the improvements required by the two Agreed Orders, and the ownership was simply unwilling to provide the funding necessary. IDEM also imposed a sewer connection ban.

In July 1997, 100% of Petitioner's common stock was acquired by the current president, Scott L. Lods, and Petitioner began serious work on addressing the requirements of the Agreed Orders. Under Mr. Lods's control, Petitioner filed a general rate case in Cause No. 41254. On April 14, 1999, the Commission issued its Order approving the complete replacement of both the County Home Wastewater Treatment Plant and CE-III and also approving Petitioner's current rates. Petitioner had already replaced the County Home Wastewater Treatment Plant by the time the Order was issued and then followed through and completely rebuilt CE-III to its current capacity, resulting in both Agreed Orders being closed. Petitioner's current rates were put into place on August 15, 2000, after CE-III was placed in service. Since the original stock sale, Petitioner's common stock has since been transferred to a holding company, L3 Corp., which is owned by Mr. Lods.

Mr. Serowka testified that Petitioner completed construction of a new County Home Wastewater Treatment Plant in conjunction with several new proposed developments in Petitioner's service territory. In 2004, Petitioner received a request for service to a major new residential development to be completed by C.P. Morgan. The then existing 100,000 GPD County Home Wastewater Treatment Plant did not have sufficient capacity to allow service for the C.P. Morgan development, and so Petitioner applied for a construction permit for the new plant. In 2005, Petitioner received a request for service from Tippecanoe School Corporation for a new middle school and another major new residential subdivision ("Fieldstone"), both of which were adjacent to its CTA. Petitioner applied for a CTA expansion in Cause No. 42889 to serve these new customers, which was granted on January 18, 2006. Petitioner described the new County Home Wastewater Treatment Plant in its evidence in that Cause and provided a cost estimate. Petitioner commenced construction on the plant because it was needed for these two new major developments plus a third major development that had started before either of these had been announced ("Harrison Highlands"), which was the subject of the CTA expansion granted in Cause No. 42409. Then both the C.P. Morgan and Fieldstone developments were cancelled. Without these developments, the existing flows to County Home Wastewater Treatment Plant were insufficient to bring the new plant on line immediately because it would have been difficult to operate at such low relative flows. With the additional customer growth that has since occurred in the County Home Wastewater Treatment Plant area from Harrison Highlands, the additional capacity from the new County Home Wastewater Treatment Plant is needed. Before the diversion of flows, the average daily flows to County Home Wastewater Treatment Plant was already at 190,000 GPD (i.e., almost double the size of the replaced plant). Mr. Serowka noted that Fieldstone is once again moving forward.

Mr. Serowka described the existing CE-III. CE-III is a continuous sequencing batch reactor ("CSBR") plant with a rated design capacity of 1.5 MGD and a peak flow capacity of 3.75 MGD. During the last rate case, the size of the new plant was one of the most hotly contested issues. The intervenors' engineer proposed an expansion to only 1.0 MGD instead of what was actually built. The problem with this approach was that it would add such a small amount of additional capacity and would ultimately cost much more than simply adding the greater level of capacity required for the 20-year planning horizon. The Commission approved Petitioner's plan, the plant was built to the larger size, and it has lasted almost the entire 20-year horizon. The sewer ban was lifted, and during the ensuing years, flows to CE-III have grown by 920,000 GPD. And because Petitioner sized the plant for the planning horizon, Petitioner has been able to avoid serial capacity additions and therefore has not needed to file another rate case for almost 20 years.

Mr. Serowka explained the major projects in this case. They are the Big 3 Sewer Project, the Klondike Road Project, and the substantial refurbishment of CE-III. Mr. Serowka noted that he will refer to the refurbished and enlarged plant project as CE-III.

Mr. Serowka provided a brief overview of how these projects relate to the relief granted in Cause No. 44272. In Cause No. 44272, Petitioner filed a petition with the Commission seeking approval of the expenditures necessary to complete these projects as well as an additional project, which is the Cumberland Road Interceptor. The Commission issued its Order in that Cause approving a Stipulation and Settlement Agreement between Petitioner and the OUCC on April 9, 2014. The Big 3 Sewer Project eliminated three 40-year-old lift stations and a 40-year-old 10" sewer. The Big 3 Sewer Project was completed to eliminate the lift stations that were too old to fix, to eliminate a sewer line that was in a deteriorated condition, and to reroute flow from the existing CE-III to the County Home Wastewater Treatment Plant. The original cost estimate submitted in Cause No. 44272 for the Big 3 Sewer Project was $4,143,176. The Commission in Cause No. 44272 approved a Settlement Agreement that pre-approved up to $2,100,000 for this project, which did not include costs for dewatering or easement acquisition. At the time, construction had already commenced via an affiliated construction company, First Time Development Corporation ("First Time"). It was completed pursuant to the affiliated interest contract on file with the Commission, complete with the third-party evaluation of First Time's bid.

Mr. Serowka described the Klondike Road Project as the replacement of a 48-year-old 12" polyvinyl chloride ("PVC") truss pipe in conjunction with a road reconstruction project for Klondike Road. It involves replacing the existing sewer with 3,200 feet of 15" PVC gravity sewer. The original estimated cost presented in Cause No. 44272 was $1,008,441, which did not include dewatering cost or easement acquisition. The Commission approved a settlement preapproving up to $725,000, which also did not include dewatering cost or easement acquisition.

Petitioner has competitively bid the Klondike Road Project, and Petitioner's affiliate is not interested in constructing this Project. Petitioner will be accepting the bid of F & K Construction, Inc. ("F&K"), which is the lowest bidder and is unaffiliated with Petitioner. As such, the total cost is $1,716,100, which does not include easement acquisition costs but does include dewatering. Mr. Serowka expects the project to be placed in service in late 2016.

Mr. Serowka provided an overview of the CE-III. Stage 1 of the CE-III project will address the immediate needs at the plant at an estimated cost of $1,975,200, which excludes the estimate for phosphorous removal estimated at a cost of $1,500,000. Stage 2 will add capacity for the next 20 years. Based on Serowka's exhibit Attachment EJS-10, Stage 2 of the CE-III project is estimated at a cost of $8,024,800. The Commission approved up to $10 million to refurbish CE-III. The estimated cost presented by Petitioner was $19,938,273, and this did not include standby chemical treatment for phosphorous removal as mandated by IDEM. As there had been in Cause No. 41254, there was considerable disagreement about the size of the needed expansion, but the parties stipulated that at least $10 million would be needed. The Commission asked via Docket Entry to explain how the $10 million figure related to the original estimate. Petitioner responded that the $10 million figure did not relate to the actual estimated costs, that Petitioner did not believe the project could be completed for the settled amount, and that $10 million was the minimum level that Petitioner needed in order to be able to start with the project. The Commission ultimately pre-approved that amount, which did not include any costs for phosphorous treatment, either biological or chemical.

Mr. Serowka testified that the Big 3 Sewer Project was completed and placed in service in August 2015. The total cost was $3.5 million, which is the amount of First Time's bid. Mr. Serowka noted that this is less than what this Project would have cost had it been completed by an unaffiliated entity. Mr. Serowka explained that the total cost of the Big 3 Project is $1.4 million more than the pre-approved amount. The cost difference relates to two excluded items: easement acquisition and dewatering costs. Accordingly, the cost has been held to the amount of First Time's bid. The easement acquisition costs were an additional $173,691. Mr. Serowka testified that HWC Engineering noted that dewatering costs can vary greatly due to actual subsurface conditions and that a detailed report may be beneficial. Mr. Serowka noted that Petitioner obtained a geotechnical report. Based upon the geotechnical report, First Time obtained estimates from two sources to provide dewatering services. Mr. Serowka testified that First Time determined to proceed with the Project pursuant to its bid and addressed the dewatering itself as its need was encountered. Mr. Serowka noted that First Time ran pumps to divert the water to ditches and ponds. The pumps ran nearly non-stop throughout the construction, and the dewatering was a considerable obstruction to the construction.

Mr. Serowka noted that there has been an immediate benefit from placing this line in service. By placing this line in service, Petitioner will now be able to divert 150,000 GPD of flow from CE-III to the County Home Plant. This diversion of flow is one of the reasons Petitioner has so far been able to avoid the start of the process towards a sewer connection ban from IDEM.

Mr. Serowka described Petitioner's historical growth rate. In December 2004, Petitioner had 3,896 single family residential structure connections (homes (1,205), apartments (2,086) and mobile homes (605)). Currently, Petitioner has 5,527 single family residential structures (homes (2,278), apartments (2,674) and mobile homes (575)). During that 10-year period, 1,631 single family residential structures were added. That is overall growth over the period of 42%, which when divided by 10.667 years computes to an annual growth rate of 3.9% over more than half of the 20-year planning horizon. If Petitioner continues to grow over the next 20 years at that rate, then the 4.0 MGD capacity is needed. The larger tankage will provide security in case the growth rate exceeds that level.

Mr. Skomp described the relief that is being sought in this case by Petitioner, Petitioner's designated test period, Petitioner's compliance with the Minimum Standard Filing Requirements ("MSFRs"), and the accounting report setting forth the calculation of the proposed rates.

Mr. Skomp testified that Petitioner is seeking authority to increase its rates and charges for sewer utility service and approval of new schedules of rates and charges. Petitioner is proposing to implement its proposed rate increase in three Phases. Phase I would be immediately upon the satisfaction of Petitioner's post-Order compliance obligations following issuance of an Order in this Cause. Phase II would take effect on or after January 1, 2017, to reflect adjustments described later. Phase III would take effect on or after July 1, 2018.

Mr. Skomp noted that Petitioner's last rate case was decided by the Commission in 1999 in Cause No. 41254 using a test year that ended in 1998. The final rates approved in that case were approved in August 2000. Over the course of the last nearly 20 years, operation and maintenance expenses have increased and Petitioner has added significant investments to its rate base. In addition, Petitioner is in the midst of a significant capital improvement program involving four major projects as described previously. Each major project by itself is estimated to cost more than 1% of Petitioner's proposed rate base.

Mr. Skomp opined that the hybrid test period proposed in this Cause starts with 12 months of historic operations commencing April 1, 2014, through March 31, 2015, and then continues on through consecutive months through and including June 30, 2018. The proposed adjustments for projected data are based on the major projects, with rates to be implemented at points projected to coincide roughly with in-service dates for the major projects. Petitioner is proposing to make adjustments based upon projected data for additional return, depreciation expense, and taxes (property and income) associated with the major projects. Also reflected in the rate calculation to be included as part of the compliance filing for each Phase will be additional actual accumulated depreciation, accumulated amortization of CIAC, revenues from customer growth and capital structure.

Mr. Skomp testified that many of the MSFRs are not applicable to a sewer utility or to a closely held corporation such as Petitioner. Nevertheless, Petitioner complied with the MSFRs to the best of its ability.

Mr. Skomp described Exhibit A as Petitioner's balance sheet as of March 31, 2015, December 31, 2014, and December 31, 2013. While the MSFRs would require a balance sheet at the beginning and close of the test year, Petitioner does not prepare quarterly financial statements. Petitioner does not have a similarly prepared balance sheet compiled as of a period 12 months earlier. Accordingly, two additional years of balance sheets are presented on a calendar year basis.

Mr. Skomp described Exhibit B as the income statement for the 12 months ended on each of the balance sheet dates. For the same reason that Petitioner does not present a balance sheet as of March 31, 2014, Petitioner does not have income statements available for the 12 months ended March 31, 2014. Accordingly, calendar year income statements for 2014 and 2013 are presented.

Mr. Skomp noted that Petitioner does not compile a statement of cash flows. Mr. Skomp noted that Exhibit C is the pro forma net operating income statement at present rates. Each of the adjustments are itemized in Schedule C-1. Pro forma net operating income at present rates is calculated to be approximately $257,000. No adjustment for customer growth has been made, because each compliance filing for each of the three Phases will update for actual customer growth at that time.

Mr. Skomp testified as to the individual adjustments set forth in Schedule C-1. Adjustment 1 uses the current number of employees and their current salary and wage levels to compute pro forma employee salaries and wages. The result is an increase of $57,622. Mr. Skomp noted that Petitioner has one managing officer that is paid a salary. The managing officer is Scott Lods who is also the owner of Petitioner. The $194,000 salary that is paid to Mr. Lods is for running Petitioner's day-to-day operations, including all management duties related to employee management, customer relations, utility plant maintenance, expansion of utility services, negotiation with potential development opportunities, and government compliance and relationships. The salary of Mr. Lods is not included in the previously calculated Employee Salaries and Wages and, therefore, needs to be added to obtain a proper total to be included in the pro forma income statement.

Adjustment 2 increases Petitioner's 401(k) match when the pro forma salaries and wages are used. It produces an increase of $1,343. Petitioner provides a bonus to its employees each year which comes in the form of additional contributions to their 401(k) accounts. Since the bonus fluctuates from year to year, the amount paid in the historic year has been used to estimate the amount that will be paid in the future.

Mr. Skomp described Adjustment 3, which produced an annual rent of $54,000 and a pro forma expense increase of $52,100. Petitioner rents the building where its offices are located and where it stores all trucks, equipment, and inventory. The building is owned personally by Petitioner's President, Mr. Lods. During the historic year, very few rent payments were made, which is much different than prior years. Petitioner was in the process of having an appraisal done on the building so that the rent expense could be appropriately calculated. The rent set forth in that appraisal has been included in an Affiliate Agreement that has since been filed with the Commission.

Mr. Skomp noted that Adjustment 4 is intended to amortize rate case expense. Petitioner obtained estimates from all professionals who will be providing services during the course of this rate case. Given the three-Phase process for implementing rates, Petitioner is amortizing these costs over a five-year period. Mr. Skomp said that Adjustment 5 is intended to increase the cost of general liability and vehicle insurance by $5,865 per year based upon an increase provided by the insurer. Mr. Skomp testified that Adjustment 6 is intended to adjust the Commission's annual fee for the pro forma level of operating revenue. Adjustments 7 and 8 compute the net amount of depreciation expense.

Mr. Skomp testified that Adjustment 9 adjusts taxes other than income taxes for the increase in FICA due to the pro forma level of salaries and wages. Adjustment 10 adjusts taxes other than income taxes for additional utility receipts tax using pro forma operating revenue. Adjustment 11 is the difference between property taxes that are actually paid in 2015 and what was paid during the prior year. It captures changes in tax rates and assessed value. Mr. Skomp said Adjustment 12 and 13 captures state and federal income tax based upon the pro forma net operating income. As explained by Petitioner's witness Mr. John Thieme, Petitioner has made the election to become a C-Corporation for income tax purposes due to the overall tax savings therefrom as a result of the Affordable Care Act. The applicable tax rates are applied against pro forma net operating income at present rates.

Mr. Skomp explained that Exhibit D sets forth the calculation of rate base at each of the proposed three Phases of the rate increase. The column labeled "Pro Forma" provides forth the rate base as of March 31, 2015. The column labeled "Completion of Big 3 Sewer Project" presents the rate base to be used for purposes of calculating rates as of Phase I, or on issuance of an Order in this Cause. Mr. Skomp has added the Construction Work in Progress ("CWIP") for the Big 3 Sewer Project as of March 31, 2015, ($2,491,078) and then added the remainder of the $3,500,000 cost for the Big 3 Sewer Project, and subtracted additional accumulated depreciation from March 31, 2015, through the anticipated date of an Order in this Cause to produce a total rate base of $10,130,668.

The next column "Completion of Klondike and CE-III (Stage 1)" computes the rate base that would be utilized for setting rates at Phase II. It starts with the information from the prior column, adds the bid cost for the Klondike work, and the cost of CE-III Stage 1 as provided by Mr. Serowka. The cost of the Phosphorous Removal equipment ($1.5 million) is also included in the calculation of the Phase II rate base. Additional accumulated depreciation anticipated to accrue from the prior column through January 1, 2017, is then deducted to arrive at the estimated rate base for Phase II.

The final column then presents the Phase III rate increase. The difference between this and the prior column is that it adds in the remainder of the $10,000,000 pre-approved CE-III amount and subtracts additional accumulated depreciation through June 30, 2018. It should be noted that for all three Phases, Mr. Skomp proposed to reflect as an offset to rate base the actual CIAC as of that date. So, to the extent additional CIAC is collected, it would reduce the rate base from what Exhibit D currently shows as the estimate. Petitioner's Exhibit No. 2, Attachment JRS-1, page 13 reflects an additional offset to rate base of $37,900 for all three phases, which is associated with Advances for Construction.

Mr. Skomp described Exhibit E. It presents Petitioner's weighted average cost of capital for purposes of its hybrid test year period, and it also presents the anticipated percentage rate increase over current rates that would be required for each Phase given the current estimates of expenses and rate base. Mr. Skomp provided the calculation of Petitioner's weighted average cost of capital. Petitioner's current capital structure is 100% common equity. Petitioner has received a proposal from a bank to loan Petitioner $5,100,000 at a rate of 5.91%. Therefore, the accounting report projects that interest rate into the capital structure for purposes of computing the rates.

For purposes of common equity, Mr. Skomp estimated Petitioner's cost of equity to be 11%. Petitioner has not undertaken the additional expenses of engaging a cost of capital witness to conduct discounted cash flow or capital asset pricing models. For a utility of Petitioner's size, this would be an unwarranted additional expense.

Mr. Skomp based Petitioner's cost of equity upon his review of other recent Orders of this Commission, and based on the fact that Petitioner is much smaller than most other utilities for which there has been a recent common equity finding. Also, Petitioner has a considerable construction program facing it in the very near future that would relate to even greater risk within the cost of the owner's equity. Because the rates at the end of the Phase III increase using an 11% cost of common equity may not be what Mr. Skomp would consider to be affordable, Petitioner has agreed to two dampers on the calculation of the proposed rates for this case. First, for purposes of the three-phase hybrid test period only, Petitioner is holding its cost of common equity to a level that is equal to the bank's proposed interest rate. Under no circumstances could Petitioner's cost of common equity be less than Petitioner's debt security, and so this is an extremely conservative assumption. Second, Petitioner has limited its Phase III increase to the pre-approved amount for CE-III plus the costs of chemical phosphorous treatment as explained by Mr. Serowka.

Mr. Skomp testified that Petitioner is not seeking approval of the full rate increase that could be justified using a higher cost of equity because of concern over affordability and rate shock. Mr. Skomp arrived at a rate that he believed to be affordable by referring to the guidelines from the Environmental Protection Agency ("EPA"). Mr. Skomp compared what those guidelines indicate is an affordable rate with where the rate would be if Petitioner adjusted the rate approved in 2000 for the Consumer Price Index. Mr. Skomp noted that the EPA considers that 2% of median household income is a general guideline for affordability of sewer rates. Mr. Skomp testified that the median household income for Petitioner's service area is a bit difficult to determine because the United States Census data includes data for the Cities of Lafayette and West Lafayette in its Tippecanoe County data. So, the first step to be taken is to estimate what incomes and households would be removed if we exclude those two larger cities from the Tippecanoe County data. As of 2013, the Census Bureau estimates that Tippecanoe County has 66,667 households with a median household income of $44,246. Lafayette is 29,499 households and a median household income of $39,345. West Lafayette has 12,089 households with a median household income of $29,936. The Census Bureau also publishes data of the relative spreads of these incomes across the population, with the percentage of each group falling in various income categories. With those percentages, it is possible to remove the incomes and households for West Lafayette and Lafayette from the larger Tippecanoe County. When that is accomplished, fewer than half of the households in unincorporated Tippecanoe County have an income of less than $50,000, which tells us that the median household income as of 2013 in unincorporated Tippecanoe County was more than $50,000. In fact, the actual median household income would be somewhere between $50,000 and $74,999, and there are 1,581 households with an income in excess of $50,000.

Mr. Skomp noted that the above analysis simply provides a number that can reasonably be assumed to be smaller than median household income as of 2013. That floor was then updated for anticipated growth in the median household income through the anticipated date of Phase III of the rate increase in 2018. Mr. Skomp testified that the actual growth rate in the overall Tippecanoe County median household income over the period 2009 to 2013 was 1.1%.

Mr. Skomp testified that assuming a median household income at $50,000 and then assuming that the growth rate during the recession were to continue through 2018, the median household income would be $52,551. Mr. Skomp noted that using $52,551 as the median household income, the EPA's guidelines indicate that a monthly rate of $88 would be affordable.

Mr. Skomp opined that Petitioner's current residential rate of $47.50 per month became effective in August 2000. Mr. Skomp consulted the Consumer Price Index ("CPI") for All Urban Consumers (CPI-U), and used the commodity and service group Water and Sewer and Trash Collection Services. The CPI-U for this category as of 2000 was 106.5, which results in a December 1997 effective rate of $44.60. Mr. Skomp then applied the July 2015 CPI-U for the same commodity and service group of 213.873. Petitioner's current rate approved in August 2000 restated to today's dollars using the CPI is $95.39. Petitioner's final requested rates would not take effect until July 2018, and so it is necessary to further adjust for anticipated inflation between now and then. If Petitioner's rate had simply increased by the CPI for Water and Sewer and Trash Collection Services, it would be $101.23 by the time of the Phase III rate increase.

Mr. Skomp testified that the EPA guidelines conservatively demonstrate that an affordable rate would be greater than $88 per month for the residents in these parts of Tippecanoe County. Also, simple inflation would produce a rate of over $100 per month. Mr. Skomp noted that Petitioner should endeavor to keep the ultimate proposed rate below $100. With other communities already discussing publicly the future of significant rate increases, implementing the rates over the course of a three-year period and keeping the rate below $100 became the objective. By holding the amount Petitioner would seek to put into rates for CE-III at this time to the pre-approved amount and by limiting the cost of equity to the cost of debt, Petitioner was able to achieve that objective.

Mr. Skomp testified that if there are significant adjustments to be made to the revenue requirements, Petitioner would increase the cost of common equity and/or the plant investment to the level the evidence supports to offset whatever change is being made elsewhere to the revenue requirement.

Additionally, Mr. Skomp described Petitioner's request for Commission approval of long-term debt in a maximum amount of $5.1 million at an annual interest rate not to exceed 7% over a term of 30 years. Mr. Skomp stated that Fifth Third Bank's current parameters would include an annual interest rate of 5.91%; however, Petitioner is requesting approval of a maximum interest rate of 7% in order to allow for some flexibility if changes are needed prior to the closing of the proposed financing. Mr. Skomp testified that Petitioner has no long-term debt recorded on its books. The proposed loan is needed in order to fund a portion of the capital projects which have been approved by the Commission in Cause No. 44272. At the same time, the proposed financing will allow Petitioner to move away from a financial position of 100% equity capital on its books and records. Interest rates for long-term debt are currently at historically low rates and Petitioner is requesting approval to include a $5.1 million loan to its capital funding mix.

Mr. Skomp noted that the proposed loan is a customary and reasonable method of funding capital improvements. He said that a maximum interest rate of 7% and a maximum term of 30 years are both reasonable parameters for a loan with a principal amount of $5.1 million. Both Petitioner and its customers will benefit from a capital structure that contains both equity capital and long-term debt. The improved capital structure will not only help in Petitioner's financial stability but also help its ability to maintain rate stability.

Mr. Thieme explained and supported the income tax plan for Petitioner. Mr. Thieme noted that Petitioner converted to C-Corporation status for the 2014 tax year, after the 2014 income tax returns had been prepared and the impact of the change from S-Corporation status to C-Corporation status could be analyzed. Mr. Thieme testified that by revoking its S-Corporation election, Petitioner would save $20,707 annually at its then-current income levels. Further, any increase in income would also increase the savings from revoking the S election. Mr. Thieme testified that the primary factor driving the savings is the increases in the top income tax rates as part of the Health Care Tax Reform, which also imposed additional income tax on investment income and wages. Revoking the Subchapter S election allowed Petitioner to be taxed at lower corporate tax rates and avoid the additional surtaxes on investment income and wages.

B. OUCC's Case-in-Chief. Mr. Patrick testified that the OUCC proposes an overall rate increase of 16.26%. The OUCC's proposal is based upon adjustments to Petitioner's rates that will occur over three phases. The OUCC's analysis shows a Phase I rate decrease of 28.17% or ($863,849). The OUCC's proposal is based on a cost of equity of 9.50% and a weighted cost of capital of 8.07% to be applied to the OUCC's proposed original cost rate base of $2,542,322. The OUCC proposes a Phase II rate increase over Phase I rates of 15.36% or $338,242. The OUCC's proposal is based on a weighted cost of capital of 8.07% applied to the OUCC's proposed original cost rate base of $4,936,307. For Phase III, the OUCC proposes a 40.31% or $1,024,069 rate increase over Phase II rates, which is based on the same weighted cost of capital and a proposed original cost rate base of $12,158,146.

Mr. Patrick said that Petitioner's rate base consists of utility plant in service ("UPIS"), CIAC, and accumulated depreciation claimed since its last rate case for which it did not support in its case-in-chief filing. Petitioner was also unable to provide basic support to permit the OUCC to validate these rate base additions in discovery. Moreover, Mr. Patrick excluded $98,338 associated with Petitioner's water assets that appear to not be necessary for the provision of wastewater service. Accordingly, Mr. Patrick's pro forma rate base is $6,460,494 less than Petitioner's pro forma rate base. Mr. Patrick noted that Petitioner also recorded $2,533,574 of connection fees as other non-utility revenue, which Mr. Patrick believed should have been recorded as CIAC. However, because the OUCC's proposed utility plant adjustment removed the plant additions associated with these fees, no CIAC adjustment is necessary. Further, Mr. Patrick proposed that Petitioner's Phases I, II, and III rate base should be limited to the amounts for which Petitioner received approval in Cause No. 44272. CIAC adjustments, to include estimated SDCs and connection fees associated with customer growth, should also be included. In contrast, Petitioner seeks to include amounts in excess of the pre-approved amounts in its Phase I, II, and III rate base.

Mr. Patrick testified that the difference between the OUCC's proposed weighted cost of capital and Petitioner's proposal is primarily due to cost of equity. Petitioner proposed a 5.91% cost of equity while the OUCC proposed 9.5%.

Mr. Patrick said Petitioner made no operating revenue adjustments despite its use of forecasted capital additions to establish its rate base in its rate phases. Mr. Patrick proposed operating revenue adjustments to reflect both customer growth during the first 12 months of the test period as well as projected customer growth during the period March 2015 through March 2016. Mr. Patrick noted that the OUCC's proposed operating revenue adjustments result in a revenue increase of $121,855.

Mr. Patrick also pointed out that the OUCC made several adjustments to operating and maintenance expenses including adjustments to Petitioner's payroll, management fees, capitalized items, nonrecurring, and disallowed items. The OUCC proposed a $507,893 reduction to Petitioner's proposed operating and maintenance expenses.

Mr. Patrick explained how Petitioner calculated its proposed pro forma depreciation expense reduction of $111,654 and why the OUCC does not accept it. Instead, he proposed a pro forma depreciation expense reduction of $517,141, which is based on UPIS approved from Cause No. 41254 and other capital adjustments proposed by the OUCC.

Mr. Patrick also explained why he disagreed with Petitioner's proposed Phase I depreciation expense adjustment to increase depreciation expense by $87,500. He explained that instead of using $3.5 million for the total project cost associated with the Big 3 Sewer Project, the OUCC used the $2.1 million amount pre-approved by the Commission, adjusted for easements and plant retirements, which resulted in a proposed Phase I increase to depreciation expense of $53,472. Mr. Patrick also disagreed with Petitioner's Phase I CIAC amortization adjustment of a negative $164,764 due to lack of support. Instead, he proposed a $10,488 Phase I reduction in CIAC.

In regard to taxes other than income, Mr. Patrick disagreed with Petitioner's proposed pro forma payroll tax expense decrease of $9,373 because the OUCC's amount of proposed pro forma salaries and wages differ from Petitioner's by $82,975. Furthermore, he disagreed with Petitioner's proposed pro forma property tax expense of $114,016. Mr. Patrick recommended pro forma property tax expense of $111,694. The difference is due to a calculation error of ($948), and Mr. Patrick's recommendation that the property taxes associated with the horse barn and the office should be shared by First Time because First Time houses its equipment on these properties ($1,374). Mr. Patrick rejected Petitioner's proposed incremental property tax increases for Phases I, II, and III because Petitioner did not consider the timing of property tax assessments and its proposed projects' in-service dates. He explained how property tax assessments are levied and when payments are due (paid two years in arrears). Mr. Patrick also explained that 10% of the true tax value of tangible personal property not placed in service is subject to personal property tax.

Mr. Patrick agreed with Petitioner's methodology used to compute state income taxes, but didn't agree with Petitioner's pro forma amount due to differences in proposed pro forma operating revenues and expenses. Petitioner proposed $11,681 for pro forma present rate state income taxes. However, he proposed $73,659 on a pro forma present rate basis and a decrease adjustment of $56,084 on a pro forma proposed basis resulting in a Phase I amount for state income taxes of $17,575. Mr. Patrick proposed pro forma Phase II state income tax of $30,569 and $72,311 for Phase III.

Mr. Patrick noted that Petitioner proposed pro forma present rate federal income taxes of $48,781. The OUCC disagreed with Petitioner's pro forma amount because the OUCC's adjusted state taxable income is different and the OUCC used a different effective tax rate. The OUCC proposed a pro forma present rate federal income tax of $307,272 on a present rate basis and a decrease adjustment of $230,451 on a proposed basis. The OUCC proposed pro forma Phase II federal income tax of $122,307 and $296,045 for Phase III.

Mr. Patrick testified that Petitioner proposed a pro forma rate base of $7,008,113. However, he proposed a pro forma rate base of $547,619. Mr. Patrick explained that UPIS, CIAC, and accumulated depreciation are the primary elements of Petitioner's rate base, and Petitioner failed to provide meaningful support for any of these elements of rate base for the additions made since its last general rate case either in its direct case or in response to discovery. Petitioner provided no invoices or schedules in its case to support UPIS added since its last general rate case totaling $16,212,079. Petitioner also did not support its CIAC balance of $6,590,571. Mr. Patrick said the OUCC sought support through discovery to identify all added UPIS, as well as to identify all CIAC since its last order. Petitioner stated that it would make the information available to the OUCC during its on-site audit.

Mr. Patrick explained that it is not the OUCC's burden to prove Petitioner's case and it would be just as burdensome for the OUCC to sift through Petitioner's invoices and other records to verify $16 million of improvements. Thus, to compute the rate base proposed by the OUCC, Mr. Patrick started with the elements of rate base approved in Petitioner's last case and added the pre-approved amounts for Petitioner's three major projects less retirements associated with the projects. He added accumulated depreciation for each year since Petitioner's last rate case based on the UPIS proposed by the OUCC. Mr. Patrick also added capital items he found to be expensed in error and CIAC associated with connection fees that Petitioner recognized as other non-utility revenue. Finally, Mr. Patrick noted that Petitioner's improper recording of CIAC affects retained earnings. He recommended a reduction to retained earnings of $2,533,574.

Mr. Patrick explained that the Gross Revenue Conversion Factor ("GRCF") is used to gross up certain increases in expenses and taxes associated with the parties' proposed revenue increase. Thus, any differences in the parties' proposed revenue increase will result in a difference in the gross up of the expenses and taxes in the GRCF. He also explained the differences in the factors used by the parties. He disagreed with Petitioner's proposed 5.91% weighted cost of capital. Mr. Patrick also disagreed with Petitioner's proposal to update its capital structure as part of the compliance filing for each phase, despite that Petitioner presented a static capital structure.

Mr. Patrick said Petitioner seeks the ability to modify its retained earnings balance for each Phase of its proposed increase. He disagreed with the proposal because Petitioner's proposal does not provide the OUCC the ability to review each Phase in detail to determine if adjustments are necessary. Such review would be complicated because Petitioner has not demonstrated that it can properly classify its transactions nor maintain proper records.

Mr. Patrick said the OUCC is concerned with all the elements of Petitioner's revenue requirements (capital structure, customer count, accumulated depreciation, amortization of CIAC, additional return, depreciation expense, and taxes). Petitioner plans to update without any indication that the OUCC will have an opportunity to respond to the filing. He said Petitioner's compliance filings will be more like general rate cases. Mr. Patrick said the OUCC should have the right to review Petitioner's projects for prudency and reasonableness after the projects have been completed per the Settlement Agreement. With respect to the review process, Mr. Patrick asked for no less than 60 days for its review. Mr. Patrick explained that to the extent the projects do not exceed the pre-approved amounts or there is otherwise no disagreement, a hearing will not be necessary.

Mr. Parks recommended that the Commission deny pre-approval of excess project expenditures beyond the pre-approval amounts the Commission approved in Cause No. 44272. Based on the Settlement Agreement in that case, it is premature for a Commission finding in excess of the pre-approved amounts provided for in Cause No. 44272. He said Petitioner has not demonstrated the "actual costs" or that any "excess" was actually incurred. Moreover, the Klondike Road Project may not necessarily be considered the same project as what was pre-approved in that Cause.

Mr. Parks next testified regarding Petitioner's property records. He noted that the discrepancies in the amount and type of collection system facilities suggests that Petitioner does not have an accurate continuing property record system for its assets in service. Petitioner should have an accurate asset inventory including installation year, location, and installed cost. Documentation of installed cost should include invoices for purchased materials, invoices, or time sheets for capitalized labor, capitalized equipment, and rental costs associated with the project, and other permanent records of physical property that are in service. Mr. Parks recommended that the Commission order Petitioner to maintain an accurate Continuing Property Record system in accordance with generally accepted accounting practices.

Mr. Parks noted that IDEM indicates that Petitioner has continuing excessive Inflow & Infiltration ("I&I") in the collection system. Petitioner has not conducted any sort of I&I study within the last five years. Petitioner is operating under an Agreed Order with IDEM regarding sanitary sewer overflows and experienced overflows in 2014 and 2015. It does not appear Petitioner has any active or effective program to identify and remove I&I from its sewers. Mr. Parks recommended that the Commission order Petitioner to improve upon the minimal levels of collection system maintenance and management through the formal development and implementation of an ongoing I&I reduction program to identify I&I sources and address those sources in a cost-effective manner.

Mr. Parks asserted that rather than address I&I and double CE-III capacity to OUCC's recommended 3.0 MGD, Petitioner has chosen to continue ignoring I&I. Petitioner's proposed capacity will increase capital costs and customer rates unnecessarily. He believed that Petitioner has a primary duty under a reasonable standard of care to effectively address I&I in its sewers.

Mr. Parks stated that Petitioner claims it inspects three manholes per week. It does little to document its efforts or make those efforts part of a larger I&I program. Petitioner also does not have the staff or outside consultants tasked with I&I reduction. Mr. Parks noted that Petitioner's pollutant data was half the typical sewage concentrations, confirming the sewage is diluted by clear water. I&I accounts for about half of all CE-III flow. On peak wet days, I&I can be more than 75% of influent flow. Mr. Parks estimated I&I in 2030 will be 1.23 MGD, assuming that Petitioner continues ignoring it and it does not get worse. Petitioner's policy of replacing lift stations with gravity sewers increases construction costs and places sewers into/below the water table where defects present I&I entry points. Mr. Parks said that Petitioner's methodology for justifying its future capacity needs is not appropriate, does not conform to acceptable methodologies for projecting future plant needs, and significantly overstates the future capacity CE-III needs.

Mr. Parks noted the options developed by Petitioner for CE-III as follows: Option 1 was to re-rate the plant to 2.0 MGD and make upgrades needed to replace deteriorated equipment causing operational problems. Option 2 was to upgrade and expand the plant to a capacity of 3.0 MGD. Option 3 was to upgrade and expand the plant to 4.0 MGD, but do not install the additional tanks that would permit the plant to be readily expanded to treat 6.0 MGD. Option 4 was to upgrade and expand the plant to 4.0 MGD, and install the additional tanks that would permit the plant to be readily expanded to treat 6.0 MGD. This option is really a 6.0 MGD plant because nearly all major structures and piping are constructed upfront.

Mr. Parks noted that Petitioner will be constructing the major structures of a 6.0 MGD plant under its current construction permit. These include treatment tanks and piping sized for 6.0 MGD as the design average flow with a peak flow of 12.0 MGD. Some aeration equipment and pumps are being left out so that the near term capacity will be 4.0 MGD. Mr. Parks said it is inappropriate to construct a 4 or 6 MGD plant at this time. Petitioner did not rely on any population projections, instead relying on Petitioner's history of housing unit connections.

Mr. Parks believed that 11,756 people are connected to CE-III, occupying 4,845 housing units (single family homes, apartments, and mobile homes). Petitioner's population connection to CE-III will increase by 7,726 people between 2013 and 2030 and another 4,656 by 2040. The standard planning period for wastewater facilities is 20 years (Ten States Standards). Petitioner has effectively used 2040 as its design year, which is 27 years from its application date of 2013. Mr. Parks projects CE-III connected population will rise from 11,756 people in 2015 to 20,322 people in 8,473 housing units in 2030. The 2030 housing density of 2.4 people per dwelling is consistent with Census data and Tippecanoe County Planning Department estimates. The 2030 population reflects an annual average growth of 3.7% per year for the 17-year period between 2013 and 2030 and is more than three times Tippecanoe County's annual average growth rate of 1%.

Mr. Parks recommended a 3.9 MGD flow, but revised the recommended expansion to 3.0

MGD design average flow / 6.0 MGD peak hourly flow under Option 2. Option 2 reflects a 3.0 MGD average design capacity at an estimated cost of $15.5 million. This option would be sufficient for housing growth to the 2030 Design Year used by Petitioner. The 3.0 MGD design average flow capacity will be adequate for the next 20 years to 2035. If Petitioner undertakes an I&I identification and reduction program to remove I&I sources, the 3.0 MGD capacity would be adequate for additional years beyond 2035. Petitioner selected Option 4, building facilities to treat the 2040 future flows of 6.0 MGD and 12.0 MGD.

Mr. Parks noted that Petitioner did not derive design flows from a population forecast and are fundamentally flawed, leading to construction of unneeded tanks. Petitioner appears to be repeating the same over-design mistake it made with County Home Wastewater Treatment Plant expansion in 2004, which has sat idle for a decade. CE-III is also oversized for organic loading. Mr. Parks again recommended that Petitioner pursue Option 2, doubling CE-III capacity to 3.0 MGD by constructing two additional CSBR tanks of the same size as the current four CSBR tanks. This will be sufficient to treat future flows and loadings over the next 20 years. Petitioner's Option 4 is not prudent, constructing tanks that will not be used and useful.

Mr. Parks stated that construction costs are inflated for the cost of labor, the required labor hours, and for the concrete. Petitioner estimated concrete cost at $900 per cubic yard in 2012 regardless of whether it is in a wall or a tank bottom slab. Thus, Mr. Parks recommends the Commission deny Petitioner's request for approval of expenditures in excess of the pre-approved amount for CE-III expansion.

Finally, Mr. Parks recommended that First Time and Petitioner keep records of all costs incurred during construction of CE-III expansion for materials, labor, equipment, engineering, and project management.

Mr. Parks testified that neither First Time nor Petitioner used a contractor to perform any dewatering for the Big 3 Sewer Project. There is no evidence that any of the costs Mr. Serowka used in his estimate were incurred by First Time. Petitioner should not be allowed to include any of these costs in rate base. First Time failed to maintain records regarding the actual cost for dewatering.

Mr. Parks noted that no formal construction contract was executed for the Big 3 Sewer Project. It is common practice to have a signed contract for construction services. Nowhere in the bid document does it indicate that the proposal/bid from First Time is for the Big 3 Sewer Project. On January 22, 2014, Petitioner received an IDEM construction permit for the Big 3 Sewer Project. Petitioner installed sewer mains that were different in diameter than what was requested and approved in Cause No. 44272. Petitioner's case-in-chief included no explanation for this change. Neither Petitioner nor First Time performed leakage testing on the Project as required by the IDEM permit.

Mr. Parks recommended the Commission exclude Petitioner's excess expenditures for dewatering and unsupported easement acquisition costs for the Big 3 Sewer Project. He also recommended that expenditures associated with it be included in rate base in an amount not to exceed $2,198,046.

Klondike Road Project replaces a 51-year old 12" PVC truss pipe installed in the mid-1960s. The Tippecanoe County Highway Department is widening Klondike Road in 2018. In Cause No. 44272, Petitioner's witness Mr. Beyer stated the existing 12" PVC pipe would be replaced by 3,200 linear foot of 15" PVC SDR-26 that would discharge to an existing 18" interceptor. Petitioner estimated the total project costs at $1,008,441. Mr. Serowka stated the project was competitively bid and that Petitioner would be awarding construction to F&K Construction Inc. for $1,716,000. That cost does not include dewatering. Petitioner offered no further explanation for the significant cost increase.

The OUCC believes the project increased in both length and scope. Petitioner did not obtain a separate construction permit for the project. For design and permitting purposes, Petitioner combined the Klondike Road and Cumberland Road Sewer projects into a single project. The Klondike Road project will exceed in scope and cost as presented in Cause No. 44272. It may not necessarily be considered the same project as was pre-approved. Since the Klondike Road Project has not been completed, the OUCC would consider it premature for a finding that the project should be included in rate base. The OUCC does not recommend any finding that any excess expenditures should be included in rate base.

Mr. Kaufman testified that while Petitioner uses a 5.91% for cost of equity for the revenue requirement, in its testimony Petitioner indicated a conservative estimate for cost of equity is 11.0%. Petitioner also indicated it would increase its requested cost of equity if significant adjustments are made to the revenue requirement, which the OUCC has made.

Mr. Kaufman noted that the OUCC did not complete a detailed analysis of cost of equity. It began with a range of 9.50% to 11.00%, based on a Commission Order in Cause No. 44352-U. The OUCC believes Petitioner's cost of equity should be at the low end of the range and recommends 9.50%. As support, the OUCC examined the difference between cost of debt and cost of equity in Cause No. 44352-U, which was 2.50%. In this Cause, the cost of debt is 5.91% and the OUCC recommends a cost of equity of 9.50%, a difference of more than 3.50%.

Mr. Kaufman testified that Petitioner estimates a forecasted median household income for Petitioner's service territory is $52,551 and 2.0% is $87.59, which implies a rate of $88 per month (Petitioner's proposal) is affordable. However, Mr. Kaufman does not agree with Petitioner's methodology to determine median income, which starts with the household income of Tippecanoe County and excludes the city of Lafayette and the city of West Lafayette. Based upon the OUCC's research, Mr. Kaufman found two areas within Petitioner's territory: one with median income of $29,327 and the other with median income of $110,568. Even using Petitioner's proposed median income means that the utility rates for low-income users would still be unaffordable to more than 50% of Petitioner's ratepayers.

Mr. Kaufman testified that Petitioner's proposed rates would be among the highest for any regulated wastewater utility in the state. Even with the OUCC's recommendations, the rates will be higher than the majority of regulated wastewater utilities.

Mr. Kaufman recommended approval of the financing plan with certain requirements on the issuance of the debt and reporting requirements. On the issuance of the debt, unless Petitioner seeks and is granted an extension, any unused borrowing authority approved in this Cause should expire on December 31, 2016. On reporting requirements, Mr. Kaufman said Petitioner should provide 30 days' notice to the Commission and the OUCC once it has issued the debt authorized in this proceeding. Petitioner should disclose the terms of the new loan, and any annual reporting (excluding tax returns) that Petitioner is required to provide to its lender should also be provided to the OUCC and the Commission. When Petitioner has prepared a statement of cash flow in anticipation of its proposed debt issuance, it should provide a copy to the OUCC.

C. Petitioner's Rebuttal Evidence. Mr. Serowka testified that although the size and length were changed, the scope of the Big 3 Sewer project has not materially changed since Cause No. 44272. It changed from 1,462 feet of 12" and 9,922 feet of 18" SDR-26 pipe to 7,465 feet of 15" and 4,996 feet of 21" SDR 35 pipe. The changes were made due to re-routing of the pipeline, but the objectives remained the same. The size increase was to accommodate future flows. This design will accommodate flows for 25 to 50 years out.

Mr. Serowka stated that Petitioner's proposed total cost for the Big 3 Sewer Project was $3.49 million (per First Time's Bid). The Stipulated pre-approval in Cause No. 44272 was $2.1 million which did not include dewatering, easement acquisition or engineering. No evidence has been provided that construction could not have been completed for less than First Time's bid.

Mr. Serowka testified that the cost of easement acquisition has been computed at a cost of $148,919. Dewatering costs remain at $1.08 million, consistent with First Time's bid. Extensive dewatering has always been anticipated due to the geotechnical report and knowledge of the area. The methodology utilized to estimate the cost for dewatering was similar to Mr. Parks's use of the RS Means manual to estimate concrete. First Time performed the dewatering and incurred the associated costs. First Time provided the lowest cost for dewatering, and Petitioner knew that they would not ask for a change order regardless of any delays encountered.

Mr. Serowka argued that it is reasonable for Petitioner and First Time to not maintain records of actual costs for dewatering because it is not feasible to record the fuel/electricity used for each vehicle or pump. He responded that the purpose of the affiliated agreement with First Time is to allow projects to be constructed without having to absorb costs associated with formal construction contracts, bid bonds, performance, bonds, warranty bonds, payment bonds, project engineering expenses and change orders.

Mr. Serowka disagreed that the 2,400 feet of 10" replacement along CR 50W is not part of the Big 3 Sewer Project. Mr. Serowka noted that the Big 3 Sewer Project is being installed at a greater depth in order to maintain flow in the existing sewer so that it can be easily switched over when construction is complete. The sewer was up-sized to serve a larger area by gravity sewers. INDOT plans for road construction dictated that the sewer be placed in a different location requiring deeper installation.

Mr. Serowka said the Big 3 Sewer Project is the result of open, fair, and competitive bidding. Changes in the length of the project were necessitated by INDOT's road construction plans. He recommended that the F&K bid amount of $1.716 million be included in rate base.

Mr. Serowka disagreed that I&I problem is excessive. He was unclear of what the OUCC wants Petitioner to do and that the OUCC has not included any amount for recovery of costs associated with I&I abatement. Mr. Serowka suspected that I&I cannot be cost-effectively removed.

According to Mr. Serowka, Petitioner does not have a line item in its budget for I&I removal. Televising has exceeded the amounts agreed to in the previous case. Petitioner is a small utility with a small staff. Petitioner committed to televising 15% of its lines each year. He said Petitioner has televised more than that total footage but is not currently at 15% because the system has grown substantially. All sewer pipe is televised before it is placed into service and 80% is new PVC pipe. It makes no sense to televise the percentage committed to in 1999.

Mr. Serowka argued that Mr. Parks's I&I calculations are flawed because he makes assumptions based on EPA guidelines. The calculations were made incorrectly because the standard for new construction assumes 30% I&I. If Mr. Parks had calculated base sanitary flows correctly, Mr. Serowka would have expected the number to exceed 30%. EPA guidelines for estimating base flows are based on flow monitoring or from water consumption data, neither of which are available to Petitioner. Mr. Serowka suggested that locating and remediating I&I can be extremely difficult and projecting the results of such work can be hard to predict.

Mr. Serowka provided calculations regarding average dry to wet weather flow comparisons, which support Mr. Serowka's claim that Petitioner's I&I problem is not excessive. Mr. Serowka's questioned Mr. Parks's calculation that has a higher I&I percent in a severe drought year than in a non-drought year. Mr. Serowka opined that the majority of I&I is coming from the old portions of the system that were in service 20 years ago. Remediation of I&I would require replacement of sewer mains and the laterals. Sump pumps may need to be disconnected from the sanitary sewer, but Petitioner has no legal authority to physically remove them. Mr. Serowka believed that in the Woodmar Subdivision it would be more cost-effective to chemically treat root balls and treat the I&I. He concluded by saying that Petitioner's flows are within the acceptable range of the EPA screening process.

Mr. Serowka said that Mr. Parks included population projections for CE-III at 2030 and 2040, but the correct planning horizon is 20 years. To build a plant based on a 12-year planning horizon, as suggested by Mr. Parks, would be short sighted. Mr. Serowka said incremental costs should also be considered, and it is worth an additional $1 million to hedge against the risk that growth exceeds expectations.

Mr. Serowka testified that none of the projected flows assume I&I reduction due to possible remediation because Petitioner does not believe it can be cost effectively removed. I&I reduction is not going to change the sizing of the plant. The plant should be sized at 4 MGD with the ability to expand to 6 MGD. A smaller plant would necessitate an expansion within ten years. Petitioner is only seeking to include in base rates the pre-approved $10 million plus the undefined cost of phosphorous removal. Phosphorous removal is required by IDEM and no OUCC witness has disagreed.

Mr. Serowka argued that although the two developments that drove the need for construction have been cancelled, the new plant is needed to provide service and is not overdesigned based on projected flows. It has capacity to treat .5 MGD with existing average flows of .19 MGD. Construction of the Big 3 Sewer Project added at least .15 MGD (totaling .340 MGD).

Further, Mr. Serowka noted that one of the two residential developments previously cancelled is now progressing (77,500 gpd). Petitioner has poured the tanks and needs to install additional equipment to take the capacity of the plant to 1.0 MGD. The cost was $2.5 million. Bowen Engineering offered a competitive bid of $2.519 million. Mr. Serowka could disagree with Mr. Parks regarding the cost of concrete but believes the competitive bid speaks for itself. The plant cost was $.504 million more for the two extra tanks. Their installation was a good decision.

Mr. Serowka argued that none of the issues reported by IDEM resulted in an enforcement action except for the August 25, 2013 fish kill event. Petitioner failed to report the spill due to confusion over who was to report the event to IDEM. The overflow at the plant was caused by inadequate capacity at the headworks which is being address in the CE-III Sewer Project.

Mr. Serowka states that the OUCC offered no regulations requiring a utility to maintain continuing property records. Mr. Serowka stated that Petitioner has been less than diligent in maintaining those records. Mr. Serowka failed to see the benefit of establishing such a system nor has the OUCC offered any estimate of the cost to develop/maintain.

Mr. Skomp provided a lengthy discussion as to why he believes Mr. Patrick's rate base calculations are neither historic nor projected data and should be rejected. Contrary to Mr. Patrick's assertions, he believed Petitioner provided meaningful support for the UPIS amounts shown in the current financial information and used in the calculation of rate base. Mr. Skomp believed the amounts recorded on the utility's books and records are presumed to be reasonable and, as such, the burden shifts to the OUCC to provide evidence and support for any amounts that they wish to dispute. He said Mr. Patrick's assertion that Petitioner bears some burden to present an explanation or reconciliation of rate base additions since the last rate order in its case-in-chief is not correct.

Mr. Skomp also explained that Mr. Patrick's rate base calculations are not drawn in a consistent manner from Petitioner's books and records, they do not reflect Petitioner's UPIS at any point in time, and his calculations fail the very basic purpose of a test year, which is to review all elements of a public utility's operations (revenues, expenses, rate base, and return) as a whole for a specific period of time. Mr. Patrick's calculations simply ignored all rate base additions that Petitioner has made since 1998 for purposes of computing the OUCC's proposed authorized rate base and subsequent return.

Mr. Skomp explained that Petitioner did not provide responses to the OUCC discovery questions regarding rate base additions because it was too broad and not limited in time and materiality. However, Petitioner did not object to making available invoices and other support for rate base additions since the last rate order during the OUCC's on-site audit of the Petitioner's books and records. He stated that Mr. Patrick should have followed up on his rate base concerns during the OUCC's on-site audit, but he did not, which Petitioner confirmed in discovery. Without some form of materiality limit, Petitioner was not going to attempt to prepare a list of every single rate base addition over the last 18 years. Mr. Skomp believed Mr. Patrick could have used Petitioner's Annual Reports filed with the Commission to compile a list of major additions for review during its on-site audit, but he did not. Moreover, Mr. Patrick included all the revenues that generated with the rate base additions he disallowed, which caused a mismatch between revenues and rate base additions. Mr. Skomp concluded that Mr. Patrick's audit approach is not usual or customary. Based on the Rate Case Audit Manual, an auditor should focus on major additions to facilities and not all rate base additions.

Mr. Skomp rejected the OUCC's CIAC adjustments associated with customer growth because it is far superior to adjust CIAC to actual levels instead of attempting to forecast CIAC.

Mr. Skomp accepted Mr. Patrick's adjustments for customer growth through March 31, 2016, payroll and payroll related items, building lease, customer growth expenses through March 31, 2016, general insurance, Commission annual fee, capitalized items expensed, non-recurring items, disallowed items, elimination of management fees, salaries and wages, FICA tax, and utility receipts taxes. While he did not necessarily agree with all the analysis and conclusions that were used by the OUCC and Mr. Patrick to generate these adjustments, Petitioner accepted these adjustments in order to narrow the number of items at issue in the Cause.

Mr. Skomp accepted two of the three customer growth adjustments proposed by the OUCC. He also accepted the OUCC adjustment to normalize revenues for customer changes that occurred during the first 12 months of the test period. While Mr. Skomp accepted Mr. Patrick's adjustment for customer growth through March 31, 2016, he opposed a customer growth adjustment that is projected beyond March 31, 2016.

Mr. Skomp noted that Mr. Patrick forecasted a growth rate that is based solely on the increase in actual revenues for each customer class for the period January through October 2015. He did no further statistical analysis and thus assumed the 10-month growth rate would simply continue into the future. While Mr. Skomp was not necessarily opposed to forecasting growth, he believed Mr. Patrick's method was not a reliable rate making exercise. Moreover, Mr. Patrick's growth rate of an approximate 4.5% is much higher than the growth rate used by OUCC witness Mr. Parks and would support Petitioner's decision to build the 4.0 MGD plant.

Mr. Skomp recommended that the Commission avoid forecasting issues and accept Petitioner's proposal to simply adjust rates for actual growth through its compliance filings.

Mr. Skomp noted that the OUCC accepted Petitioner's proposed rate case expense, but not its proposed amortization period. He believed the OUCC's proposed 10-year amortization period should be rejected and instead five years should be used. Given Petitioner's capital improvement demands, five years is a lengthy amortization period. The statute requires the Commission to perform periodic reviews at least once every four years. To assume that Petitioner can avoid another rate case for longer than five years is unreasonable.

Consistent with Mr. Skomp's recommendation to reject the OUCC's proposed rate base, Mr. Skomp also rejected the OUCC's hypothetical pro forma depreciation expense. The OUCC's calculation ignores a significant amount of Petitioner's utility plant additions. Also, the OUCC included nothing in its proposed revenue requirement for the I&I reduction program it proposed. Mr. Skomp noted that rates should include amounts that will provide the amounts required over and above the reasonable and necessary operating expenses to maintain property in an operating state of efficiency. The OUCC's adjustment failed this requirement.

Mr. Skomp disagreed with Mr. Patrick's CIAC calculations for the same reasons he opposed the OUCC rate base calculations. He explained that the OUCC also included CIAC associated with Petitioner's water utility, which is inconsistent with the Commission's Order in Cause No. 44592. Mr. Skomp stated that even though the parties settled on the notion of allowing the CIAC of the water utility to be transferred to the sewer utility, the Commission disagreed with this provision of the Settlement Agreement.

Finally, Mr. Skomp explained why he disagrees with Mr. Patrick that Petitioner should record its connection charges as CIAC. Petitioner would have expensed any costs of connections over the years and recorded the tap fees and connection charges as revenue. Thus, to the extent that the OUCC would like to retroactively change recorded revenue to CIAC, Petitioner would similarly need to review the books and records to change any corresponding expense items to UPIS. Mr. Skomp believed that while the parties can consider a recommendation as to how future fees might be recorded, a retroactive application of a new standard to only half of the financial transaction is not reasonable.

Mr. Skomp explained that the different numbers for pro forma net operating income as a result of the parties' differences drives the differences in proposed federal income tax. The parties generally agree as to the methodology with one exception. The OUCC used the effective income tax rate whereas Petitioner used the statutory tax rate. Mr. Skomp cited the Muncie Remand Method Order that states that the effective tax rate is simply a mathematical computation with little value in setting utility rates. Mr. Skomp said that Petitioner's method is the correct one.

Mr. Skomp rejected the OUCC's property tax adjustment based on timing. Mr. Patrick's adjustment does not allow Petitioner sufficient time to accrue the funds to pay its property taxes when they become due. For instance, Mr. Patrick did not include property tax expense for the Big 3 Sewer Project in the year of assessment. Instead, he delays recovery of this cost until the first year they are paid, which is 2017. This is incorrect.

Finally, Mr. Skomp accepted the OUCC's proposed 9.5% cost of common equity.

Before discussing the Phase-in mechanisms proposed by the Parties, Mr. Skomp updated the amounts Petitioner seeks in rates for the pre-approved Projects. Petitioner explained that Petitioner is no longer making a request to seek to include extra investment needed to support its originally requested increase. Instead, Petitioner is limiting its request to the $10 million pre-approved for the CE-III plant plus the $1.5 million for treating phosphorous. On Klondike Road Project, Mr. Skomp asked to include the additional costs up to the amount of the lowest competitive bid. This is an additional $966,000. For the Big 3 Sewer Project, Mr. Skomp proposed to include the actual cost of $3.5 million.

Moreover, Mr. Skomp disagreed with the OUCC that no amount of rate base should be added that has not already been pre-approved. Mr. Skomp believed the OUCC's position is inconsistent with the statute. Indiana Code Section 42.7 is very clear that with a hybrid test period, forecasted data can be used. Similar to Petitioner's proposal with respect to customer growth, forecasted data can be used for purposes of evaluating Petitioner's proposal, but actual rate implementation will be based upon actual data. If plant must already be in service to be included, there is no method to review a forward-looking or hybrid test period in phases. Contrary to the OUCC's belief, Mr. Skomp said the Commission's Order in Cause No. 44272 does not prohibit including the extra costs Petitioner seeks pre-approval for in this case.

Regarding the phase-in of rates Mr. Skomp proposed to update the previously pre-approved amounts plus the additional costs for dewatering, easement acquisition, the Klondike Road Project actual bid, and phosphorous removal. At the time of each compliance filing update, Petitioner would also update actual capital structure, actual customer count, actual accumulated depreciation and amortization of CIAC, and additional return, depreciation expense and taxes. While Mr. Skomp agreed to not update retained earnings, other components associated with the terms of Petitioner's financing will need to be updated in the capital structure. Mr. Skomp said that given his proposed methodology, the only points of real contention would be if errors in math occurred in the calculations. Other than allowing the OUCC the opportunity to verify the current number of customer bills, the CIAC receipts, and the dollars invested up to the amounts of Petitioner's estimates presented in its case, there should be no need for discovery. Finally, he said the Commission should be able to approve the Phase II and III tariff sheets without the need of issuing a formal order.

Mr. Skomp explained that the OUCC's approach would require an additional rate case every time a significant investment is made. He also questioned why Mr. Patrick would allude to the Settlement Agreement in Cause No. 44450, when it contains non-precedential language. Mr. Skomp believed Petitioner's proposal is consistent with Ms. Stull's testimony in that case and Mr. Patrick's proposed Phase-in is not.

Mr. Skomp opposed Mr. Parks's recommendation that the Commission order Petitioner to maintain an accurate Continuing Property Record system in accordance with generally accepted accounting practices. A Continuing Property Record system is expensive and is not required of sewer utilities by the Commission rules. Moreover, he said the OUCC allowed no cost recovery in its recommendation. Neither the Commission nor the Uniform System of Accounts require such a system. Thus, Mr. Skomp stated the program should be rejected.

Mr. Skomp did not object to providing notice to the Commission and the OUCC within 30 days of the issuance of the debt authorized in this proceeding, which notice would disclose the terms of the new loan.

Mr. Skomp rejected the OUCC's proposal to provide to the OUCC and the Commission anything that Petitioner is required to provide to its lender excluding tax returns. To the extent the purpose of Mr. Kaufman's recommended reporting is to keep the Commission apprised of

Petitioner's financial condition, Petitioner's Annual Report already serves that purpose. Mr. Skomp did not object to providing the Commission and the OUCC annually Petitioner's reviewed financial statements required to be provided to the bank in connection with the financing. However, Mr. Skomp believed the lender may require more detailed information about Petitioner and on a more frequent basis, some of which may be confidential.

Mr. Skomp rejected the OUCC's proposal that any unused borrowing authority approved in this Cause should expire on December 31, 2016. Mr. Kaufman's proposed expiration does not allow sufficient time to ensure that Petitioner can receive an order in this case with respect to the financing and with respect to rates in Cause No. 44676. Also, Petitioner needs to have time to demonstrate its performance to the bank in time to achieve closing on the financing transaction. Mr. Skomp noted that Petitioner may or may not deem it prudent to wait on closing the loan until after receiving that final order as well. Further, Mr. Skomp testified that Petitioner would agree to an expiration date of December 31, 2018, which is the date recommended for the final phase-in of rates in Cause No. 44676.

Mr. Skomp rejected the notion that in order to comply with the Settlement Agreement in Cause No. 41254, it must issue debt such that Petitioner has at least 40% debt in its capital structure. Mr. Skomp indicated that no one can dictate the terms on which a lender may be willing to finance Petitioner's operations. Mr. Skomp noted that what Petitioner has presented for approval in this case is what it was able to negotiate with the bank.

D. <u>Petitioner's Docket Entry Response.</u> Petitioner's Docket Entry Response included responses to the Presiding Officer's questions and over 300 pages of various documents. The pertinent information provided by Petitioner is summarized below:

Petitioner accepted Mr. Patrick's adjustments for customer growth through March 31, 2016. Petitioner submitted revised schedules in response to the Commission's March 8, 2016 Docket Entry Questions reflecting pro forma operating revenues at present rates of $3,161,319, which reflected Mr. Patrick's adjustments accepted by Mr. Skomp in rebuttal and the movement of connection fees above the line, as indicated in Petitioner's response to Question A.7.

The Commission requested the Petitioner to provide the construction inspectors daily reports for the Big 3 Project expecting the inspector's daily reports would have included an accounting of personnel, equipment, and activities conducted each day on the construction site. Petitioner's Docket Entry Response noted that "Petitioner does not have daily inspection reports but monthly reports."

In response to question Part B(3) concerning CE-III, the Petitioner said "Biological phosphorous removal was proposed for either the 3.0 MGD or 4.0 MGD WWTP [wastewater treatment plant]."

The Commission by Docket Entry requested the invoices and details (limited to invoices exceeding $10,000) for those years and accounts identified by Mr. Skomp. In addition to larger projects, Petitioner's Docket Entry Response itemized a series of smaller purchases, consisting of various work trucks, equipment, pumps, and generators.

In response to the Commission's March 8, 2016 Docket Entry, Petitioner was asked to reconcile the number of connection fees with Petitioner's current customer base. In part, Petitioner responded that "[r]esidential taps would include connections of apartments."

6. Commission Discussion and Findings.

A. Major Projects. In Cause No. 44272, the Commission found that expenditures related to the Big 3 Sewer Project, Klondike Road Project, and CE-III, should be approved and that the inclusion of the new facilities resulting from those projects in Petitioner's rate base in future rate cases should be approved up to the following amounts, which are for construction only (inclusive of Accounting Funds Used During Construction):

Project	Amount Pre-approved
Big 3 Sewer Project	$2,100,000
Klondike Road Project	$725,000
CE-III Project	$10,000,000

The foregoing amounts do not include reasonable costs for dewatering and easement acquisition (including legal, appraisal, and engineering), and phosphorus removal (for CE-III).

(1) Big 3 Sewer Project. Petitioner sought to include in rate base Big 3 Sewer Project costs in excess of the $2.1 million that was pre-approved in Cause No. 44272. Petitioner asked to include in rate base Big 3 Sewer Project costs of $3,499,226, which is the amount charged by First Time, Petitioner's affiliate, for the Project. The $2.1 million pre-approved amount was based on an estimate prepared by Mr. Beyer in Cause No. 44272. In Petitioner's case-in-chief, Mr. Serowka attributed the cost difference to two items that had been excluded from pre-approval: easement acquisition costs and dewatering costs. In rebuttal, Petitioner clarified that it sought to recover $1,080,448 in dewatering costs and $148,918 in easement acquisition costs, which we note when added to the $2.1 million pre-approved falls short of the $3,499,226 requested by approximately $169,860.

Petitioner has the burden in this case to demonstrate its $1.08 million dewatering costs were reasonable and prudently incurred. Petitioner hired its affiliate First Time to work on the Big 3 Sewer Project. First Time relied on the $1.08 million estimate for dewatering costs prepared by Mr. Beyer and presented in Cause No. 44272. In our April 9, 2014 Order in Cause No. 44272, the Commission noted that Mr. Beyer said dewatering costs could be reduced once Petitioner performed a subsurface investigation of the project to determine the necessary dewatering.

We are concerned with the lack of evidence supporting the dewatering costs. No invoices were provided. Also, Petitioner explained that no actual records were maintained concerning the dewatering equipment. In the Commission's March 8, 2016 Docket Entry, the Commission requested the Petitioner to provide the construction inspector's daily reports for the Big 3 Project. We expected that the inspector's daily reports would include an accounting of personnel, equipment, and activities conducted each day on the construction site, because this is the type of information that provides a detailed review of activities and the costs incurred. However, Petitioner's Docket Entry Response said that Petitioner does not have daily inspection reports but monthly reports. The monthly reports provide very general information about First Time's dewatering activities. For example, according to the monthly reports, dewatering activities were conducted between Draw #3 and Draw #9 to 80% of the total quantity specified totaling $864,000. In other words, First Time performed 80% of the estimated dewatering work between two locations at a cost of $864,000. First Time did not provide the personnel and equipment used and specific activities performed. The monthly reports referenced in the Docket Entry Response appear to be information utilized by the project manager to authorize progress payments based on percentage complete as opposed to construction inspection records. Pictures of some of the equipment used were included in the monthly reports, but the pictures and the general information provided in the monthly reports are insufficient to justify the excess expenditures and the ultimate recovery from ratepayers.

Based on the evidence presented regarding dewatering costs on this Project, we are unable to determine that the $1.08 million paid to First Time was reasonable and prudent under the circumstances. However, the evidence indicated that some level of dewatering occurred at the site of the Big 3 Sewer Project. Attachment EJS-3, the engineer's opinion of construction costs from HWC, included a dewatering allowance of $100,000 for dewatering. Thus, we approve a dewatering allowance of $100,000 for the Big 3 Sewer Project.

The easement acquisition costs presented by Petitioner's witness Mr. Serowka were adequately supported in the evidence. In rebuttal, Mr. Serowka explained Petitioner's $148,918 in easement acquisition costs and provided Exhibit EJS-R2 as support. The final costs reflect the actual costs paid by Petitioner to the property owners for the easements. Thus, we approve $148,918 in easement acquisition costs.

Total inclusion in rate base should be limited to $2,351,074 for the Big 3 Project, which includes the $2,155 in capitalized expenses explained below. We also accept the plant retirements associated with this project of $59,182 proposed by the OUCC and not disputed by Petitioner.

(2) Klondike Road Project. The Klondike Road Project was competitively bid and awarded to F&K Construction for $1.716 million. The OUCC pointed out that the cost is almost $1 million higher than the $725,000 pre-approved by the Commission, and the OUCC argued that any amount above the pre-approval amount should be disallowed for recovery. The pre-approved cost did not include engineering, easement, or dewatering costs.

The Klondike Road Project is now expected to be more than twice the cost of the expenditures pre-approved in Cause No. 44272. The OUCC believed the project is substantially different from the Project that was pre-approved in Cause No. 44272. The OUCC also stated that the Project is neither complete nor is in service. Petitioner explained that the pre-approval amount was based on replacement of like infrastructure and the Project was subsequently increased in size to serve a larger area by gravity sewers as a matter of good utility management practice.

We acknowledge that plans sometimes change and field conditions can change quickly based on a particular project. However, the cost increases to the Klondike Road Project are a result of Petitioner's failure to properly conduct, implement, or maintain any sort of master planning program. If Petitioner had a utility master plan and planned appropriately, Petitioner would have been in a position to simply incorporate the build-out flow capacity into its preliminary design in the pre-approval request instead of trying to present their lack of due diligence as a cost overrun. Nevertheless, the excess expenditures were prudently incurred. Although the Petitioner failed to conduct proper due diligence in the pre-approval in Cause No. 44272, ultimately, Petitioner installed the correct infrastructure at the proper depth to serve a larger tributary area.

The larger issue, which is not disputed, is that the Project is neither complete nor in service. Thus, the total $1.716 million cost shall not be included in Phase II rate base until Petitioner has certified that the Klondike Road Project has been placed in service.

Finally, we accept the plant retirements associated with this Project of $24,023 proposed by the OUCC and not disputed by Petitioner.

(3) **CE-III.** In Cause No. 44272, the Commission pre-approved Petitioner's CE-III plant expansion for $10 million. In this Cause, Petitioner requested that $11.5 million be included in rate base related to this project ($10 million in pre-approved costs plus the $1.5 million for phosphorous removal). Petitioner stated the anticipated final cost for the CE-III plant expansion (Stages 1 and 2) is $21,488,273. Petitioner proposed to include $1,975,200 of the CE-III project expansion and $1.5 million in phosphorous removal costs in Phase II rates and $8,024,800 in Phase III rates. The Commission presumes the Petitioner will request additional rate base for costs above the $11.5 million pre-approval amount for the CE-III plant in future proceedings.

The OUCC provided analysis to support its assertion that the proposed expansion of the CE-III plant from 1.5 MGD to 6.0 MGD is unwarranted. The OUCC pointed out that Petitioner is planning for growth that will simply double flows every ten years based on historical growth of housing unit connections between 2004 and 2015 rather than any population projection. Instead, the OUCC's methodology projected the design year population for 2030 by using data from the 2010 US Census, Indiana Business Research Center, Tippecanoe County Planning Department, and Tippecanoe County Transportation Plan, and then subtracts the current year population. Consistent with Ten States Standards, the OUCC multiplied the resulting population by 100 GPD to calculate the flow increase for the projected population growth. The flow increase was added to actual flows to arrive at the 2030 projected flows. Based on this methodology, the OUCC said that 3.0 MGD is the appropriate plant size.

Petitioner responded that the 3.0 MGD plant proposed by the OUCC is barely sufficient over the 20-year planning horizon and that it sees more value in planning for more aggressive growth.

The evidence in this case does not support the investments Petitioner is making regarding the CE-III project because Petitioner failed to project future flows based on any reasonable or acceptable methodology. Rather, the future flows were approximately doubled based on the past 15 years of historical housing development and were not adequately supported. Based on the evidence presented we believe the CE-III plant as proposed will be twice as large as it needs to be. The OUCC applied a growth projection to the Ten State Standards to project future flows. Therefore, the total inclusion in rate base shall be limited to $10,000,000 ($1,975,200 in Phase II and $8,024,800 in Phase III rates).

Petitioner assumed the risk/reward associated with moving forward on the construction of a 6.0 MGD plant. Therefore, the excess expenditures above the amount approved in this Order shall not be included in rate base in future proceedings until Petitioner demonstrates that the excess expenditures are reasonable and prudent, and that the excess capacity is being utilized by its customers. The determination that the plant is used and useful shall be made based on average and peak flows at the plant compared to the plant rating as opposed to simply manipulating plant operations so the new plant components are operated or cycled in a manner that uses all of the new components.

Finally, Petitioner included $1,500,000 in rate base for standby chemical phosphorous removal. The Commission understands that IDEM requires a supplemental chemical removal process in addition to the removal provided by the SBR process itself for the 6.0 MGD treatment plant that the Petitioner proposes. Since the Commission found that the investment in a 6.0 MGD facility is not supported in evidence, the need for the $1.5 million of supplemental phosphorous removal must also be scrutinized. In response to the Commission's March 8, 2016 Docket Entry question Part B(3), the Petitioner says, "Biological phosphorous removal was proposed for either the 3.0 MGD or 4.0 MGD WWTP [wastewater treatment plant]." The Commission understands the supplemental removal is based on the use of a chemical feed system. The cost for the supplemental phosphorous treatment will be $1.5 million regardless of the size of the plant.

Thus, we accept Petitioner's request to include $1,500,000 in rate base, under Phase II rates, for standby chemical phosphorous removal upon the equipment being placed in service. The total amount to be included in rate base for the CE-III project is $11.5 million.

B. Rate Base.

(1) Utility Plant in Service.

(a) Pro forma Present Rate. Petitioner proposed a UPIS amount of $18,628,559 as of March 31, 2015. The OUCC argued that Petitioner did not satisfy its burden of proof regarding the beginning net original cost rate base and calculated its net original cost rate base from the net original cost rate base figure that was used to set the Phase I rates in Petitioner's last rate case, Cause No. 41254. Therefore, the OUCC recommended a UPIS amount of $2,416,480.

In its rebuttal evidence, Petitioner included all of its Annual Reports submitted to the Commission since its last rate case. OUCC witness Mr. Patrick testified that he reviewed those Annual Reports for purposes of his analysis. Those Annual Reports detail by utility plant account number the additions to UPIS for each year. In rebuttal testimony, Mr. Skomp testified that the vast majority of the UPIS additions have been to gravity sewers, and he identified the annual increases in gravity sewers since the last case. Mr. Skomp explained that the gravity sewers that have been added allowed Petitioner's system to grow by approximately ten times, and that these sewers facilitated all of the customer growth and revenue increases since 1999. The Commission's March 8, 2016 Docket Entry requested the invoices and details (limited to invoices exceeding $10,000) for those years and accounts identified by Mr. Skomp. In addition to larger projects, Petitioner's Docket Entry Response itemized a series of smaller purchases, consisting of various work trucks, equipment, pumps, and generators.

Petitioner's Docket Entry Response together with the Annual Reports, provided support for a significant portion of the UPIS added since Petitioner's last rate case. We note that we cannot accept the OUCC's rate base adjustment because we would be ignoring all utility plant additions subsequent to Petitioner's last rate case. Also, the OUCC's recommendation would result in a mismatch of Petitioner's plant investment compared to the revenue it currently generates. It is inappropriate to include revenues from Petitioner's current customer base, but exclude the plant used to generate those revenues. Effective rate making requires that the data used provide an accurate picture of a utility's operations during the period in which the proposed rates will be in effect. *See L.S. Ayres & Co.* v. *IPALCO,* 351 N.E.2d 814,828 (Ind. Ct. App. 1976).

Nonetheless, a review of the cost support provided raised several concerns that warrant further discussion. We note that Petitioner has not filed its affiliate agreement with the Commission for the L3 Corporation, which is contrary to Ind. Code § 8-1-2-49. Specifically, Ind. Code § 8-1-2-49(2) states: "No management, construction, engineering, or similar contract, made after March 8, 1933, with any affiliated interest, as defined in this section, shall be effective unless it shall first have been filed with the commission." Included in Petitioner's Exhibit No. CX-2 were eight invoices from L-3 Corporation. Because an affiliated contract is not on file for this company, we will not recognize the total amount of $70,011 from the L3 Corporation invoices in rates. Moreover, as explained further below, many of the L-3 Corporation's invoices raise serious concerns regarding Petitioner's affiliated relationships.

We also note that the Commission's Order in Cause No. 41254 approved $849,132 in rate base for the completion of the County Home Wastewater Treatment Plant, which Petitioner certified was complete and in service in that case. However, in this case, Petitioner provided affiliated company invoicing that totaled $1,030,100 for the County Home Wastewater Treatment Plant. Petitioner did not provide any evidence explaining the reasonableness and prudency of the additional amount incurred. Therefore, the $180,968 in costs above the amount approved in Cause No. 41254 should be disallowed.

There are two remaining issues concerning UPIS. First, the OUCC proposed that certain items recorded to expense during the first 12 months of the hybrid test period should be capitalized, an issue which Petitioner accepted on rebuttal. We find this adjustment has the effect of adding $84,550 to UPIS, $32,805 of which relates to plant in service as of March 31, 2015, $2,155 to UPIS in Phase I, and $49,590 in Phase III.

In addition, certain water utility assets were retained by Petitioner and not sold to Indiana-American Water Company ("Indiana-American") pursuant to the Commission's Order in Cause No. 44592. These totaled $112,609. The OUCC accepted only the backup generator of $14,271 in rate base, and the Petitioner did not rebut this issue. We agree with the OUCC and find these assets totaling $98,338 are not used to operate the sewer facilities and disallow the remaining in UPIS. In conclusion, we find Petitioner's UPIS as of March 31, 2015, to be $18,424,656.

Each party rejected the other's proposed accumulated depreciation. Because we have not accepted either party's position regarding the calculation of UPIS, we calculated accumulated depreciation as of March 31, 2015, of $5,032,376. This amount is based on the $5,105,583 of accumulated depreciation supported by Petitioner's workpapers and a decrease to accumulated depreciation of $73,208 associated with the utility plant disallowances discussed above.

Petitioner included as an offset to net original cost rate base CIAC of $6,590,571 and advances for construction of $37,900 as of March 31, 2015. The OUCC agreed with the amount for advances for construction but proposed a different number for CIAC of $320,379. We find there are two differences between the parties regarding CIAC. One difference relates to whether contributions would be stated as of March 31, 2015, or as of the amount reflected in Petitioner's last rate case. The other difference relates to whether CIAC associated with the water utility formerly owned by Petitioner but which has been transferred to Indiana-American would be reflected in sewer rates. In addition, if the OUCC's proposed rate base methodology were not accepted, the OUCC added a third issue: whether amounts originally recorded as non-utility income for connection charges should be reclassified as CIAC.

Regarding the first difference, as discussed in Section B(1)(a) above, we have not accepted the OUCC's position to state the rate base as of the amount that was included in Cause No. 41254. Accordingly, we will update CIAC to the current levels as of March 31, 2015, as further adjusted during the phase-in described later in this Order.

We also reject the OUCC's second difference. It is true that the Settlement Agreement in Cause No. 44592 would have required the CIAC associated with Petitioner's water utility be transferred to the sewer utility upon the sale of the water assets to Indiana-American. We rejected that term of the Settlement Agreement, and Indiana-American's journal entry which was submitted as a compliance filing in that Cause confirms that the water related CIAC has now been recorded on Indiana-American's books.

Finally, we do not accept the OUCC's proposed third issue to reclassify Petitioner's past connection charge as CIAC. Based on Petitioner's Docket Entry Response, Petitioner does not capitalize or separately record its costs of connection, and so these costs are embedded in the overall revenue requirement. As such, to appropriately match revenues with expenses Petitioner's connection charges should be reflected as revenues above-the-line and not be recorded as CIAC. Thus, we disagree with the OUCC that Petitioner should reclassify the $2,533,574 of connection charges collected subsequent to its last rate case as CIAC. However, Petitioner should record the $95,000 base period amount as above-the-line revenues, which it did in its Docket Entry Response. Further, Petitioner is directed to begin recording its connection fees and associated cost consistent with the Commission's rules and the NARUC Uniform System of Accounts.

In conclusion, we find that Petitioner's net original cost rate base as of March 31, 2015, is as follows:

Utility Plant in Service	$18,424,656
Less: Accumulated Depreciation	(5,032,376)
Net Utility Plant in Service	$13,392,280
Less: CIAC	(6,590,571)
Less: Advances for Constr.	(37,900)
Net Original Cost Rate Base	$6,763,809

(b) <u>Subsequent Phases</u>. The rate base increases proposed in Phases I through III are primarily driven by the major projects discussed above. The amount of rate base additions for Phase I is $2,291,892 for the Big 3 Project, for Phase II is $3,667,177 for the Klondike Road Project and CE-III (Stage 1), and for Phase III is $9,524,800 for the CE-III (Stage 2).

The OUCC proposed customer growth adjustments for both residential and commercial customers for all three phases for SDCs and connection fees. For each phase, the OUCC proposed two adjustments, which were made for each customer class to project SDCs and connection fees. We accept, in part, the OUCC's recommendation that a customer growth factor should be included for each of Petitioner's Phased in rate increases. As mentioned above, effective rate making requires that the data used provide an accurate picture of a utility's operations during the period in which the proposed rates will be in effect. *See L.S. Ayres & Co.* v. *IPALCO,* 351 N.E.2d 814,828 (Ind. Ct. App. 1976). By freezing, for a historic test period, or predicting, for a forward-looking test period, a utility's operations in a specific time frame, we can observe the inherent interrelationships among rate base, expenses, and revenues. Because Petitioner proposes to capture its estimated future capital investments for each of its proposed Phased in increases, we believe it is reasonable and in the public interest to also estimate customer growth within a test period under review. Moreover, the Commission's GAO 2013-5 explains that projected rate base should match accumulated depreciation and O&M projections. For each phase, the OUCC proposed two adjustments, which were made for each customer class to project SDCs and connection fees.

We discussed connection fees further in the previous section. We accept the OUCC's Phase I residential customer growth adjustments for SDCs of $14,060 through December 31, 2015, and $20,475 for the period January 1, 2016, through March 31, 2016. For Phase I, we also find that an additional adjustment of $20,475 is warranted because Petitioner's Phase I rates are not expected to be in place until sometime after June 30, 2016, which is three months beyond the adjustments proposed by the OUCC. Also, based on the estimated dates for Phase II and Phase III rates, we find it appropriate to increase CIAC for additional SDCs to be recorded of $40,950 and $122,850, respectively as shown below:

Projected SDC	Phase I	Phase II	Phase III
Estimated Additional Customers per Month	7	7	7
Times: Number of Months	3	6	18
Number of Additional Customers	21	42	126
Times: SDC	$ 975	$ 975	$ 975
Additional Estimated CIAC	$ 20,475	$ 40,950	$ 122,850

However, we do not accept the OUCC's adjustments for SDCs associated with Petitioner's commercial customers of $5,285 because the OUCC provided no explanation to support this adjustment.

The only other adjustments needed to Phases I through III for rate base are associated with the Cause No. 44593, where the Commission approved Petitioner's SDC. In that case, we authorized Petitioner to begin amortizing CIAC as an offset to depreciation expense. In this case, there was no dispute over how CIAC is to be amortized, just issues surrounding how much CIAC should be amortized. Based on the amount of CIAC approved for each Phase, the Commission finds accumulated amortization of CIAC for Phase I is $207,674, for Phase II is $291,256, and for Phase III is $546,608.

Based on the foregoing, we find Petitioner's estimated rate base subject to the further directives below are as follows:

	Phase I	Phase II	Phase III
Gross Utility Plant in Service	$20,716,548	$24,383,725	$33,908,525
Less: Accumulated Depreciation	5,553,710	5,787,404	6,669,502
Net UPIS	15,162,838	18,596,321	27,239,023
Less: Net CIAC	6,437,906	6,395,274	6,262,773
Advances for Construction	37,900	37,900	37,900
Total Original Cost Rate Base	$8,687,032	$12,163,146	$20,938,351

C. Cost of Capital. Petitioner did not submit a traditional study of its cost of common equity. Mr. Skomp testified that based on his 30 years of experience and prior common equity analysis, review of recent Commission findings of the cost of common equity in recent orders, and consideration of Petitioner's size and considerable construction program, he would conservatively estimate Petitioner's cost of common equity at 11%.

Mr. Kaufman also did not conduct a traditional cost of common equity study. He disagreed with Mr. Skomp's testimony of 11% as conservative. He testified that the range of common equity cost for Petitioner was 9.5% to 11%. Mr. Kaufman noted that Petitioner should be at the bottom end of this rage, or 9.5%. Petitioner did not challenge this testimony in rebuttal. Thus, based on the evidence offered in this proceeding, the Commission finds 9.5% to be a reasonable cost of common equity. Mr. Kaufman did not challenge Petitioner's 5.91% cost of debt, which was based on the loan terms Petitioner received from Fifth Third Bank.

Mr. Kaufman said Petitioner's proposed capital structure 66.7% equity: 33.3% debt, is below the agreed upon 40% debt level Petitioner is to strive to maintain pursuant to the settlement agreement in Case No. 41254. The Commission finds that Petitioner's capital structure is not sufficiently far off from what is required by the settlement agreement in Cause No. 41254. Achievement of a 40% debt level cannot happen immediately, and Petitioner is progressing in the proper direction. We expect the Petitioner to continue to do so and achieve a 40% debt level.

We find that Petitioner's capital structure and weighted cost of capital is as follows:

Class of Capital	Pro Forma Amount	% of Total	(%) Cost	Weighted Cost
Long-term debt (as authorized herein)	$5,100,000	33.27%	5.91%	1.97%
Common equity (as of March 31, 2015)	10,230,394	66.73%	9.50%	6.34%
Total	$15,330,394	100.00%		8.31%

D. Authorized Net Operating Income. Applying the cost of capital of 8.31% to the rate base of $8,687,032 in Phase I, $12,163,146 in Phase II, and $20,938,351 in Phase III, we find that Petitioner, subject to the further directive as explained below, is allowed to earn a Net Operating Income ("NOI") of $721,893 in Phase I, $1,010,756 in Phase II, and $1,739,978 for Phase III.

E. Operating Revenues.

(1) Revenues. Petitioner proposed in its case-in-chief pro forma operating revenues of $2,944,464 at present rates as of March 31, 2015. OUCC witness Mr. Patrick presented an adjustment to pro forma operating revenues to reflect customer growth during the period March 2015 through March 2016. In his rebuttal testimony, Mr. Skomp indicated that for purposes of narrowing the number of items at issue in the case, Petitioner accepted Mr. Patrick's adjustments for customer growth through March 31, 2016. Petitioner submitted revised schedules in response to the Commission's March 8, 2016 Docket Entry Questions reflecting pro forma operating revenues at present rates of $3,161,319, which reflected Mr. Patrick's adjustments accepted by Mr. Skomp in rebuttal and the movement of connection fees above the line, as indicated in Petitioner's response to Question A.7.

We have already accepted Petitioner's position regarding connection charges of $95,000. There are no remaining disputed issues concerning pro forma present rate revenues. Based upon the evidence, we find Petitioner's pro forma operating revenues at present rates to be $3,161,319.

For Phases II and III, Petitioner recommended that each compliance filing reflect actual customer growth at that time. The OUCC disagreed with Petitioner's recommendation. The OUCC believed that because Petitioner forecasted capital additions to establish its rate base in its rate Phases, an estimate for customer growth should also be forecasted. In rebuttal, Mr. Skomp disagreed with projected customer growth through Phases II and III.

We agree with the OUCC. As mentioned above, to properly match revenues with capital improvements, it is reasonable and in the public interest to estimate associated customer growth. Forecasts that only focus on one element of Petitioner's overall revenue requirement is neither reasonable nor serves public interest. Excluding revenues associated with customer growth from the Commission's overall Phase II and Phase III increase would result in an overstatement of the additional revenues Petitioner requires. It would also be inconsistent with the principle in ratemaking that revenues should match plant investment.

However, neither party sponsored customer growth adjustments associated with Phases II and III. Thus, we adjusted Petitioner's revenues by using the number of customers projected in Phase II and Phase III CIAC adjustments found above. The Phase II revenue increase is $6,983, and the Phase III revenue increase is $56,858 for unmetered residential customer growth. These adjustments will be subject to updates in Petitioner's compliance filings as explained further below. Finally, we find that if Petitioner chooses to use a hybrid or forward looking test period in its next rate case, it shall provide a customer growth forecast.

(2) <u>Operating Expenses</u>. Petitioner proposed in its case-in-chief total pro forma operating expenses (including depreciation, taxes, and income taxes) of $2,730,478, which did not include the after-tax impact of property taxes and depreciation expense on the Big 3 Sewer Project. The OUCC proposed total operating expenses (including depreciation, taxes, and income taxes) of $2,296,946. The OUCC proposed adjustments to Petitioner's proposed expense levels for Salaries and Wages, 401K Match, Building Lease, Expense Normalization, Rate Case Expense, General Insurance, IURC Fees, Capitalized Items Expensed, Non-Recurring Items, Disallowed Expenses, Management Fees, Depreciation Expense, and Tax Expense. On rebuttal, Petitioner accepted all of these adjustments except for the adjustment to the amortization of rate case expense, depreciation expense, and income and property taxes. These contested items are discussed below along with the building lease.

(a) <u>Rate Case Expense</u>. Petitioner has requested $430,000 in rate case expense. The OUCC did not oppose any of the rate case expense presented by Petitioner in this proceeding. Thus, we turn our attention to the appropriate amortization period to use for the recovery of Petitioner's rate case expense. Petitioner proposed to amortize rate case expense over a period of five years. The OUCC proposed an amortization period of ten years, citing the fact that it has been over 16 years since Petitioner's last base rate case. In rebuttal, Mr. Skomp testified that even the proposed five-year amortization period is lengthy, but appropriate given the hybrid test period in this case. However, he stated it is unreasonable to assume that Petitioner would be able to avoid another rate case for longer than five years.

We agree with the OUCC that usually the amortization period is established based on the time that has passed since the utility's last rate case. It has been 16 years since Petitioner's last rate case. However, because of the evidence presented in this case, we believe Petitioner's next rate case may be sooner rather than later. Thus, we find that a five-year amortization period is appropriate in this case.

In the event the five-year amortization period for rate case expense expires prior to Petitioner filing its next rate case or Petitioner has fully recovered its rate case expense through rates, Petitioner shall reduce its monthly recurring rates and charges in order to reflect that it has fully recovered the rate case expense approved in this Cause. Within 30 days prior to the date Petitioner expects to fully recover its rate case expense or five years from the date of this Order, whichever comes first, Petitioner shall file a new schedule of rates and charges reflecting the net effect of the expense reduction for rate case expense to its overall Phase III revenue requirement approved herein.

(b) Building Lease. Petitioner proposed to increase its test year expense for monthly rent associated with an affiliated contract dated March 31, 2015. Petitioner proposed pro forma rent expense of $54,000. Mr. Skomp testified that the building houses Petitioner's offices and stores all trucks, equipment, and inventory. The building is owned by Petitioner's president, Scott Lods. The new lease provides for approximately 1,380 square feet of office space, as well as a steel frame shop building, a restroom, and a locker room. That is more than 10,500 square feet for the entire building. Petitioner explained in testimony that the previous office space was only 1,275 square feet. Insufficient evidence was provided to support the need to lease a shop building that is more than five times the size of Petitioner's previous facility. Thus, we will rely on Petitioner's old lease to determine the appropriate amount to provide in rates for building lease expense.

On October 1, 2015, the Commission issued a Docket Entry requesting that Petitioner provide the lease agreement referenced on page E-3 of Petitioner's 2014 Annual Report. On October 13, 2015, Petitioner filed Attachment IURC DE 1-14, a lease agreement dated June 10, 1998. The lease agreement was for yearly rent of $12,480 for an 864 square foot office, an 1,800 square foot garage space and outside storage for total square footage of 2,664. Multiplying 2,664 square feet by the per-square-foot value of $4.50 provided on page 2 of Attachment JRS-2 (Facility Lease Rates), yields an annual lease rate of $11,988.

(c) Depreciation Expense. The difference between the parties' positions on depreciation expense is attributable to UPIS as of March 31, 2015, and the amount of the major projects included in UPIS for Phases I through III. Based on our findings for UPIS as of March 31, 2015, and the amount of major projects to include in UPIS for Phase I through Phase III, we find depreciation expense for Phase I is $516,256, for Phase II is $607,935, and for Phase III is $846,055.

(d) CIAC Amortization. In Cause No. 44593, we authorized Petitioner to begin amortizing CIAC as an offset to depreciation expense. There was no dispute over how CIAC is to be amortized just issues surrounding how much CIAC should be amortized. We resolved this issue previously. Accordingly, we find that pro forma CIAC amortization for Phase I is $166,140, for Phase II is $167,163, and for Phase III is $170,235. These amounts will be updated to actual as discussed below.

(e) Property Taxes. Petitioner explained that property tax expense would be adjusted for Phase I to include property tax expense accrued on the Big 3 Sewer Project. In Phase II, property tax expense would be adjusted to reflect additional accruals on the Klondike Road Project and Stage 1 of construction of CE-III, as well as the cost of chemical phosphorus treatment. Phase III would then include property tax expense accrued up to the remaining pre-approved amount of CE-III.

The OUCC proposed two adjustments to Petitioner's property tax expense. First, Mr. Patrick proposed to eliminate $2,321 from 2014 property tax bills due to calculation issues, which Petitioner did not oppose. Second, at each Phase, Mr. Patrick proposed to reduce the adjustment to property tax expense based upon the timing of property tax assessments. Because property taxes are paid two years in arrears, Mr. Patrick proposed to include only property tax payments on the CWIP for Big 3 Sewer Project in Phase I. He then proposed to include full property tax expense on the Big 3 Sewer Project and only CWIP payments on the Phase II improvements in Phase II. Finally, for Phase III, he proposed to include full property tax payments on the Big 3 Sewer project and Phase II improvements, but only property tax expense on the CWIP for the Phase III improvements.

Petitioner opposed the OUCC's limitation based upon timing. Mr. Skomp testified that while property taxes are paid in arrears, the expense for property tax is accrued in the year of assessment. Accordingly, because the assessment date is now January 1 of each year instead of May, property tax expense on the Big 3 Sewer Project, the Klondike Road Project, and the Stage 1 CE-III improvements, will be assessed on at the end of 2016. Property tax expense will be assessed on the Stage 2 CE-III improvements at the end of 2018.

Based on the evidence offered during this proceeding the property tax expense for the Big 3 Sewer Project, Klondike Road Project, and CE-III Stage 1 project will be assessed during the hybrid test period. However, the CE-III Stage 2 project will not be completed and in service until sometime during the first half of 2018, resulting in a property tax assessment date of January 1, 2019. Because there will not be an assessment on the CE-III Stage 2 plant additions until January 1, 2019, the property tax associated with this project should not be included in the revenue requirement. Instead, the amount of property tax associated with CE-III Stage 2 is limited to 10% of the CWIP amount.[1] Based on the foregoing, we find property tax expense for Phase I is $131,986, for Phase II is $164,005, and for Phase III is $172,278.

(f) <u>Federal and State Income Tax</u>. Petitioner's witness Mr. Thieme testified that, due to cost increases resulting from the Affordable Care Act, federal income tax is reduced for Petitioner and its shareholder if Petitioner is a C Corporation. As a result, Petitioner elected C corporation status beginning with the 2015 tax year. The only difference between the parties concerning federal and state income tax expense for ratemaking purposes related to pro forma NOI at each Phase and the appropriate federal income tax rate to use. Mr. Skomp proposed to use the statutory federal income tax rates; Mr. Patrick instead proposed to use the effective tax rate. We would note that in this case Mr. Patrick used the statutory rate in the calculation of pro forma taxes but then used the effective tax rate in his calculation of taxes for each Phase. We find that the statutory tax rate should be used. Nevertheless, the effective tax rate and the statutory tax rate are the same; this finding has no effect on the tax numbers offered by Mr. Patrick.

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[1] Article 4.2. Assessment of Tangible Personal Property, 50 IAC 4.2-6-1.

We find pro forma federal and state income tax expense at present rates as of March 31, 2016, is $311,115. The proposed federal and state income taxes for Phase I are $344,898, for Phase II are $482,186, and for Phase III are $828,692. Federal and state taxes will be updated at the time of the submission of Petitioner's compliance filings for each Phase.

(3) Net Operating Income. Based upon the evidence and the determinations made above, we find Petitioner's adjusted operating results are as follows:

	Phase I Present Rates	Phase I Proposed Rates	Phase II Proposed Rates	Phase III Proposed Rates
Operating Revenues	$3,161,319	$3,250,758	$3,807,979	$5,147,160
O&M Expenses	1,615,982	1,616,078	1,616,671	1,618,053
Depreciation/Amortization	350,116	350,116	440,772	675,820
Taxes Other Than Income	216,521	217,773	257,594	284,616
Federal & State Income Tax	311,115	344,898	482,186	828,692
Total Operating Expenses	2,493,734	2,528,865	2,797,222	3,407,182
Net Operating Income	$ 667,585	$721,893	$1,010,756	$1,739,978

In summary, we find that with appropriate adjustment for ratemaking purposes, Petitioner's annual NOI under its present rates for wastewater service is $667,585. Petitioner has not proposed a fair value that differs from the net original cost of its rate base or a fair return that differs from its weighted average cost of capital. Based on our determination of net original cost of its rate base for Phase I of $8,687,032, a return of $721,893 is required based on a cost of capital of 8.31%. Thus, a present rate NOI of $667,585 represents an under-recovery. We find that Petitioner's present rates are unreasonable and should be increased.

(4) Authorized Rate Increase for all Phases. Based on the evidence presented in this Cause, we find that Petitioner shall increase rates and charges in Phase I by $89,439, or a 2.92%, resulting in total annual operating revenues of $3,250,758. This overall increase is based on Petitioner's rate base as of March 31, 2015, as adjusted for Petitioner's Big 3 Sewer Project and projected customer growth. This revenue is reasonably estimated to afford Petitioner the opportunity to earn NOI of $721,893 as shown above. For Phase II, we find that Petitioner shall increase rates and charges by $550,238, or 17.40%, resulting in total annual operating revenue of $3,807,979. For Phase III, we find that Petitioner shall increase rates and charges by $1,282,324, or 34.02%. Both Phase II and Phase III are subject to true-up based as directed below.

F. Phase-In of Rates. Petitioner is proposing to make adjustments to its revenue requirement in Phase II and Phase III through a compliance filing based on the actual cost of projects, additional actual accumulated depreciation, actual accumulated amortization of CIAC, revenues from actual customer count, and the actual capital structure.

Prior to implementing the authorized rates for each Phase, we find that Petitioner shall provide certification that the new plant is in service and verification that the construction costs have been incurred and paid. Petitioner shall also file a report with the actual and approved amount of plant for the major projects by plant account. Any proposed adjustments to the costs associated with Petitioner's major projects will be limited to the project costs approved in this Cause. Petitioner shall also update accumulated depreciation, depreciation expense, property tax and income tax expense to account for the actual cost of the major projects to the extent actual costs do not exceed the approved amounts herein. Petitioner will not be allowed to update retained earnings/owner's equity. For customer count, Petitioner shall provide the actual customer count with an explanation on how it arrived at that figure. Similarly, for CIAC, Petitioner shall provide the actual amount of CIAC and an explanation on how it arrived at that figure. Petitioner shall update operating revenues, CIAC, and the Amortization of CIAC based on actual results. Petitioner shall also provide updated rate schedules and tariff sheets. If a material difference exists between the actual cost of the major project and the cost pre-approved, Petitioner shall file evidence to support the reasonableness of the material difference. After each submission, the OUCC and Intervenors shall have 30 days to review the compliance filing and submit any objections. We expect the parties to work cooperatively to answer any questions that may arise.

G. Financing. In its case-in-chief in Cause No. 44676, Petitioner indicated it would file a petition to seek approval of the $5.1 million debt issuance included in the proposed pro forma capital structure at a rate of 5.91%. That petition was filed on October 30, 2015, under Cause No. 44700. That Cause was consolidated with Cause No. 44676 pursuant to Docket Entry issued January 20, 2016.

We find that Petitioner's proposed financing as described in this proceeding is advantageous, necessary, and in the public interest for Petitioner and its customers. While we encourage Petitioner to pursue opportunities for additional long-term debt, the long-term debt authorized herein will move Petitioner toward a more reasonable ratio of debt to equity and will result in a reasonable total outstanding capitalization in relation to the total value of Petitioner's property and will not be in excess of the fair value of Petitioner's property used and useful for the convenience of the public. The issuance of the long-term debt authorized herein is in accordance with the provisions of the laws of the State of Indiana relating to the issuance of securities by public utilities.

The reporting requirement recommended by Mr. Kaufman specifically related to providing to the OUCC and Commission what Petitioner provides to Fifth Third Bank is unnecessary because the Commission receives similar information in Petitioner's Annual Report to the Commission. However, Petitioner shall provide notice to the Commission and the OUCC within 30 days of the issuance of the debt and terms of the loan authorized in this proceeding.

We find that Petitioner's proposed financing program is approved and authorized by the Commission, and a certificate of authority should be issued to Petitioner granting the financing authority requested. Petitioner's financing authority shall expire on December 31, 2018.

H. Accounting, Operational, and Engineering Issues.

(1) Accounting Records. The OUCC noted the discrepancies in the amount and types of infrastructure suggesting Petitioner does not have an accurate continuing property record. Petitioner did not verify that they maintain these records. Instead, Petitioner responded that the OUCC does not cite any regulation requiring such a system.

A review of the invoices provided in Petitioner's Exhibit 6, CX-2 and CX-3 brings into question the adequacy of Petitioner's records. The National Association of Regulatory Commissioners' ("NARUC") Uniform System of Accounts is clear:

> Each utility shall keep its books of account, and all other books, records, and memoranda which support the entries in such books of account so as to be able to furnish readily full information as to any item included in any account. Each entry shall be supported by such detailed information as will permit a ready identification, analysis, and verification of all facts relevant thereto.

NARUC Uniform System of Accounts for Class A Wastewater Utilities, 1996, p. 15 Accounting Instruction 2.

We expect Petitioner to comply with NARUC's Accounting Instruction 2. Furthermore, in all future proceedings, Petitioner shall provide records sufficient to support all major plant investments, including, but not limited to a detailed project description, the basis or need for the project, cost estimates (including material quantities), bids, and invoices that are broken out in sufficient detail to allow an auditor adequate information to verify the reasonableness of the project and the amounts paid.

(2) Affiliated Transactions. A review of the invoices provided through Petitioner's Exhibit 6, CX-2 and CX-3 also raises serious concerns regarding Petitioner's relationship with its affiliated companies. At the hearing, the Presiding Officers questioned Mr. Skomp regarding the backhoe with a serial number T0310SG924411, as shown on several of L3 Corporation's invoices, an affiliated company. Based on the invoices received, the serial number shown was for a backhoe Petitioner purchased on Invoice Number 2200152 dated September 30, 2003, for $67,250 from Holt Equipment Company. The Commission asked Mr. Skomp "[I]f you could explain if the backhoe was being put into rates ..., why was it then also leased by an affiliate back to the utility?" Mr. Skomp answered "That I do not know." Hr.Tr., p. B-107. It appears that Petitioner is paying for equipment it already owns. Furthermore, Petitioner appears to be allowing its non-utility affiliates to use equipment paid for by Petitioner's ratepayers.

Moreover, the L3 affiliate invoices totaling approximately $70,011 were only a few of a handful of affiliate invoices received that provided more project detail than just the date of the invoice, the project name, the amount being requested, and the total amount invoiced to date for the specific project. We believe the documentation Petitioner maintains from its affiliate lacks sufficient details for an auditor to determine the reasonableness of the amount requested for recovery. Further, we are concerned with the lack of documentation maintained by Petitioner. Therefore, Petitioner shall require First Time or any other affiliated company to submit detailed invoices for all costs including unit costs for structures, materials, labor, equipment, and engineering, which should be compared to the cost estimate or contract entered into by Petitioner to complete the work. We expect to receive this level of detail regardless of whether the work performed was done so under a lump sum or time and materials contract.

The Commission concludes that the affiliate transaction process prescribed for Petitioner in the final order for Cause No. 43294 (Jan 23, 2008) may not be adequate in insuring that the affiliated transactions are competitive, reasonable, and in the public interest. The affiliate contract between Petitioner and First Time Development Corp. is set to expire in January of 2017. The Commission shall address these issues upon the filing of Petitioner's next affiliate contract provided to the Commission for review pursuant to Ind. Code § 8-1-2-49(2)(g).

(3) **Inflow & Infiltration.** The OUCC suggested Petitioner has a substantial I&I problem and that unabated I&I has unduly affected the cost/sizing of the CE-III expansion. Petitioner asserted that it is unclear regarding what action the OUCC wants Petitioner to take, that the OUCC has provided no rates to implement any sort of program, and that Petitioner is small and does not have the appropriate staffing to implement any sort of abatement program. Petitioner denied that maintenance and management are at minimal levels, says that televising 15% of the system every year is unrealistic because the utility televises all lines when accepted, and asserted that the OUCC's calculation of I&I is erroneous because it is not based on a flow monitoring study or metered water use. Petitioner believed that it is more cost efficient to treat I&I than it is to eliminate it.

The Commission finds the Petitioner's belief that I&I is more cost effective to treat than to eliminate very concerning considering that the Petitioner has failed to quantify the extent of its I&I problem through flow monitoring or any other measured means. The Petitioner has been operating under an Agreed Order with IDEM, on and off, since approximately 1992 which has been a direct result of the Petitioner's inability and/or unwillingness to acknowledge its I&I problem. The Petitioner continues to estimate I&I as opposed to measuring what is actually present in the system.

We agree with the OUCC that Petitioner must improve the minimal levels of collection system maintenance and management through the formal development and implementation of an ongoing I&I reduction program to identify and address I&I sources. Within six months of the Final Order in this Cause, the Petitioner shall file with the Commission and OUCC a written I&I abatement program. The program shall include a program for measuring actual I&I within the system and documentation regarding its O&M practices that identify and quantify sources of I&I that will be considered for repair in the Petitioner's capital improvement plan.

(4) **Non-Recurring Charges.** The Commission asked in the March 8, 2016 Docket Entry for Petitioner to reconcile the number of connection fees with Petitioner's current customer base. In part, Petitioner responded that "[r]esidential taps would include connections of apartments." We disagree with how Petitioner is calculating connection fees. Petitioner's connection fee approved by the Commission is based on a connection for a single family dwelling. Typically, all other types of connection fees are billed at cost. However, there is no language in Petitioner's current tariff to address connections other than residential. Thus, within 60 days of the date of this order, Petitioner shall file a 30-day filing to update its non-recurring charge for connection fees to include language explaining that its connection fee per residential connection is $760. However, for all other connections the connection fee will be charged based on actual costs.

(5) **Need For a Comprehensive Masterplan.** The evidence presented in this matter makes it clear that Petitioner is in need of a comprehensive masterplan to guide future development of its system. We expect the masterplan to demonstrate a planning effort that takes a long-range view of the development of the system. Further, we expect Petitioner to revisit those plans on an annual basis and revise them accordingly. Such a format will insure that the plan is both reviewed and updated every year to address the needs of a continuously evolving utility.

7. **Reconciliation of Interim Rates.** On May 27, 2016, Petitioner filed temporary rates to be effective June 30, 2016. Pursuant to Ind. Code § 8-1-2-42.7, Petitioner shall perform a reconciliation and implement a refund, in the form of a credit on customer bills rendered on or after the date of this Order.

Within sixty (60) days from the issuance of this Order, Petitioner shall file a reconciliation of its temporary rates implemented in 2016. Petitioner shall calculate the difference between the revenues collected during the time Petitioner's temporary rates were in effect and revenues that would have been collected during that same time period had the final Phase I rates approved in this Order been applied.

Upon approval of the reconciliation, the overcharge shall be refunded to each customer overcharged during the temporary rate period along with the applicable taxes and at the average annual prime interest rate of 3.5%. For overcharged customers currently on Petitioner's system, a credit shall be issued on the overcharged customer's bill in six (6) equal monthly installments. For overcharged customers that have left Petitioner's system, a refund check shall be issued to the customer's last known address.

8. **Confidentiality.** Petitioner filed a motion for protective order showing documents to be submitted to the Commission in response to certain Docket Entry questions were to be treated as confidential and protected from disclosure to the public under Ind. Code § 5-14-3-4 and Ind. Code § 8-1-2-29. The Presiding Officers granted Petitioner's motion via Docket Entry dated October 28, 2015, finding such information to be preliminarily confidential after which such information was submitted under seal. We find all such information is confidential and is exempt from public access and disclosure by the Commission under Ind. Code § 5-14-3-4 and Ind. Code § 8-1-2-29.

IT IS THEREFORE ORDERED BY THE INDIANA UTILITY REGULATORY COMMISSION THAT:

1. For phase I rates, Petitioner is authorized to adjust and increase its rates and charges for sewer utility service to produce an increase in total operating revenues by approximately 2.92% in accordance with the findings herein which rates and charges are expected to produce annual net operating income of up to $721,891.

2. For Phase I rates, Petitioner shall file new schedules of rates and charges with the Water/Wastewater Division of the Commission on the basis set forth above. Such new schedules shall be effective upon approval by the Water/Wastewater Division and shall apply to sewer service from and after the date of approval.

3. Upon filing of the phase-in submission for Phases II and III, respectively, as described in Finding Paragraph 6.F, Petitioner is authorized to implement a second and a third phase to the initial increase authorized herein, on or after January 1, 2017 and July 1, 2018, respectively, with the Phase II increase calculated to produce total net operating income of $1,010,756; and the Phase III increase calculated to produce total net operating income of $1,739,978, with both Phases II and III further adjusted for additional CIAC and amortization of such additional CIAC as an offset to depreciation expense from system development charges as described in Finding Paragraph No. 6.B(1)(a). The new schedules of rates for Phases II and III shall each be effective upon approval by the Water/Wastewater Division and shall apply to sewer service from and after the date of approval.

4. Petitioner is authorized to issue long-term debt on terms consistent with the financing Petition and testimony admitted at the hearing in this Cause and to use and apply the cash proceeds arising therefrom for the purposes stated in Petitioner's petition and testimony. In particular, Petitioner is authorized, during the period expiring on the earlier of our Order in Petitioner's next financing case or December 31, 2018, to enter into a term credit facility in aggregate amount of up to $5,100,000 with a maturity date of up to 30 years from the date of closing at a fixed rate of interest of up to 7%.

5. To the extent long-term debt issued pursuant to the authority granted herein is secured, Petitioner is authorized to execute and deliver such mortgage, indenture and other evidence of encumbrance or lien on Petitioner's assets as necessary and appropriate to effectuate the issuance of secured long-term debt and thereby encumber Petitioner's assets. Petitioner is further authorized to execute and deliver promissory notes and other transaction documents and evidences of indebtedness as are necessary and appropriate to effectuate the issuance of such long-term debt.

6. There is issued to Petitioner a Certificate of Authority for the issuance of securities, upon the terms and conditions, of the character, for the consideration, in the manner and for the purposes set forth in this Order.

7. Within 30 days after issuance of the long-term debt, Petitioner shall submit a report to the Commission with a copy to the OUCC describing the terms of the financing. Petitioner shall also provide the Commission and the OUCC a copy of the annual reviewed financial statements required to be provided to Petitioner's lender in connection with the financing authorized herein.

8. Within 30 days after the issuance of this Order, Petitioner shall file a 30-Day filing to update its connection charge.

9. Petitioner shall implement a refund consistent with Ind. Code § 8-1-2-42.7 as described in Finding Paragraph 7.

10. The information filed by Petitioner in this Cause pursuant to its Motion for Protection and Nondisclosure of Confidential and Proprietary Information is deemed confidential pursuant to Ind. Code § 5-14-3-4, is exempt from public access and disclosure by Indiana law,

and shall be held confidential and protected from public access and disclosure by the Commission.

11. To the extent this Order requires future actions or filings, those requirements may be modified for good cause by the Presiding Officers.

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

<u>STEPHAN, FREEMAN, HUSTON, WEBER, AND ZIEGNER CONCUR</u>:

APPROVED: NOV 30 2016

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

Brittany Webb acting for

Mary M. Becerra
Secretary of the Commission