ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF MIDWEST NATURAL GAS CORPORATION FOR AUTHORITY TO CHANGE ITS RATES, CHARGES, TARIFFS, RULES, AND REGULATIONS	))))	CAUSE NO. 44880 APPROVED: AUG 16 2017

ORDER OF THE COMMISSION

Presiding Officers:
Sarah E. Freeman, Commissioner
Loraine L. Seyfried, Chief Administrative Law Judge

On November 14, 2016, Midwest Natural Gas Corporation ("Petitioner" or "Midwest"), filed its Verified Petition with the Indiana Utility Regulatory Commission ("Commission") seeking authority to change its existing rates, charges, tariffs, rules, and regulations. On that same day, Petitioner also filed its direct testimony and exhibits. On January 13, 2017, Petitioner filed a Motion to Update Accounting Schedules along with the updated schedules. The Presiding Officers granted the motion on January 24, 2017.

In accordance with the Commission's Prehearing Conference Order dated January 4, 2017, the Indiana Office of Utility Consumer Counselor ("OUCC") filed its case-in-chief on February 20, 2017.[1] Petitioner filed its rebuttal testimony and exhibits on March 20, 2017. On April 6, 2017, Petitioner filed updated accounting schedules and its response to an April 3, 2017 Docket Entry that requested additional information. The OUCC filed revisions to its case-in-chief on April 6 and 10, 2017.

The Commission held an evidentiary hearing on April 11, 2017, at 9:30 a.m. in Room 222 of the PNC Center, 101 W. Washington Street, Indianapolis, Indiana. At the hearing, Petitioner and the OUCC were present and participated. No members of the general public appeared or sought to participate.

Based on the applicable law and evidence of record, the Commission now finds:

1. **Notice and Jurisdiction.** Due, legal, and timely notice of the hearings conducted was given and published as required by law. On January 6, 2017, Petitioner filed proof of notice to customers in accordance with Ind. Code § 8-1-2-61 and 170 IAC 5-1-18(C). Petitioner is a public utility as defined in Ind. Code § 8-1-2-1. The Commission has authority to approve rates and charges for utility service under Ind. Code §§ 8-1-2-42 and -61. Therefore, the Commission has jurisdiction over Petitioner and the subject matter of this Cause.

[1] Although the OUCC prefiled the testimony of Leja D. Courter, the OUCC did not offer his testimony into evidence at the hearing.

2. **Petitioner's Characteristics.** Petitioner is an investor-owned public utility providing natural gas service to approximately 13,895 customers in the following Indiana counties: Clark, Daviess, Greene, Jackson, Jennings, Knox, Monroe, Orange, Scott, and Washington.

3. **Existing Rates, Test Year, and Relief Requested.** Petitioner's current base rates were established in the Commission's November 7, 2012 Order in Cause No. 44063. In this proceeding, the test year for determining Midwest's operating revenues, expenses, and income is the 12 months ending March 31, 2016, as adjusted for changes fixed, known, and measurable, and occurring within 12 months following the end of such test year. Petitioner's cut-off date for determining the used and useful status of its utility plant in service, and the value of its rate base, is June 30, 2016. Based on the Verified Petition, Petitioner's case-in-chief, and Petitioner's Motion to Update Accounting Schedules following the issuance of long-term debt filed on January 13, 2017, Petitioner seeks to increase its rates by 8.81% inclusive of the cost of gas, or additional revenue in the amount of $1,202,201 over pro forma present rate revenue. In addition, Petitioner seeks approval for changes to its existing charges and tariff language.

4. **Evidence of the Parties.**

A. **Petitioner's Case-in-Chief.** David A. Osmon, Executive Vice President of Midwest, generally summarized the relief being sought by Petitioner. In support of Midwest's requested return on equity, he testified that Midwest has become riskier since its last base rate case. He stated that Midwest has added significant investment in utility plant and that its capital structure includes long-term debt. Propane gas is a competitor of natural gas service in Petitioner's service territory. He also testified that the sales reconciliation component, which provided some income protection, no longer exists and the prime rate used by its lender has increased.

Mr. Osmon explained that he is familiar with Midwest's utility plant. Midwest's utility plant in service and the additional plant that will be placed into service by the cutoff date of June 30, 2016, are, or will be, used and useful in providing natural gas service to Petitioner's customers. He expressed his belief that the utility plant in service should be valued at $15,096,841 on an original cost basis. He also testified that when this amount is coupled with working capital, materials, and supplies, the value of Petitioner's rate base would exceed $16,500,000 as of June 30, 2016.

Finally, Mr. Osmon described the proposed changes to Petitioner's tariff language, which includes: changes to the reconnection charge and language for the monthly service charges applicable to grain dryers on Sheet No. 8; elimination of the collection of unpaid bills by servicemen on Sheet No. 8; elimination of the charge for credit card processing on Sheet No. 9; changes to the curtailment priority that move confined animal and plant facilities behind industrial and commercial customers not involved with such agriculture facilities on Sheet No. 10; elimination of the Interruptible Tariff (Rate D) due to migration of customers to the existing Firm Industrial Tariff (Rate C); changes on Sheet Nos. 30 and 32 for establishing unaccounted-for gas percentages; and changes to language on Sheet No. 30 regarding monthly meter reading

to recognize that due to holidays, Petitioner may not always be able to read meters on the first day of the calendar month.

Bonnie J. Mann, a Certified Public Accountant with London Witte Group, LLC, explained that she reviewed Petitioner's financial records to determine the appropriate level of revenue required to recover Petitioner's current cost of service and what adjustments to those costs should be made for the purpose of establishing new rates and charges. Ms. Mann explained each adjustment made to Petitioner's March 31, 2016 test year amounts. She provided her calculation of Petitioner's original cost rate base as of June 30, 2016, and described Petitioner's capital structure. Ms. Mann concluded that Petitioner's rates and charges should be increased by 8.67% over pro forma rate revenue, including the cost of gas, for an additional $1,183,608 as set forth in Exhibit 4, Schedule C-1.[2]

John A. Boquist, Ph.D., a Professor Emeritus at the Indiana University Kelley School of Business, testified regarding Midwest's proposed cost of common equity capital and proposed return on equity. Dr. Boquist identified the factors that should be considered in determining the cost of common equity capital and the information he relied on to form his opinion for Midwest. He testified that he used two models to estimate the cost of common equity for Midwest—a discounted cash flow ("DCF") analysis and a capital asset pricing model ("CAPM") analysis. Dr. Boquist explained his analysis using the two models and stated that the DCF and CAPM analyses result in a range of returns from 10.57% to 13.94%. Based on this range, Dr. Boquist recommended an 11% cost of common equity capital for Midwest, noting that a higher request could be supported by giving more weight to the CAPM rather than the DCF result.

Kerry A. Heid, an engineer and independent rate consultant, testified regarding the cost of service study ("COSS") that he performed for Midwest. He stated that the COSS was structured to provide revenue and operating income amounts and associated taxes to compute the rate of return on rate base for each rate schedule at both present and proposed rates. He noted that Petitioner was proposing a 25% reduction in interclass subsidies. He testified that in his proposed rate design, the monthly service charge for Rate A-General Service, which includes all residential customers, would remain the same. The monthly service charge for Rates B-Commercial Services, C-Industrial Service, and E-Transportation Service would each increase. The monthly service charge for Rate STS-School Transportation Service would continue to match Rate A or B depending on the meter size of the customer. In addition to the changes in rates and charges based on his COSS, Mr. Heid recommended additional tariff changes to eliminate the Energy Efficiency Rider (Sheet No. 70) since the program no longer exists and to change the normal degree days on Sheet No. 60 to correspond with the new National Oceanic and Atmospheric Administration's ("NOAA") 30-year normal heating degree days.

B. <u>OUCC's Case-in-Chief.</u> Farheen Ahmed, a Utility Analyst II with the OUCC, addressed Petitioner's pro forma operating revenue and expenses, rate base, capital structure, and need for a rate increase. She also addressed Petitioner's proposed tariff revisions relating to reconnection charges and the NOAA averages for the normal temperature adjustment

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[2]This requested additional revenue was changed to 8.81%, or an additional $1,202,201, by Petitioner's updated accounting schedules filed on January 13, 2017.

("NTA"). Ms. Ahmed testified that the OUCC's review supports Midwest's need for an increase in annual revenue of $551,910, which represents a 7.66% rate increase.

Ms. Ahmed agreed with Petitioner's proposed adjustments relating to: elimination of gas cost adjustment ("GCA") revenue; elimination of Tariff Rate D revenue; amortization of rate case expense; increase in reconnection fee revenue; increase in property and casualty insurance expense; increase for new billing software and maintenance fees; increase for changes in IT contract expense; and increase for changes to the engineering retainer. However, Ms. Ahmed expressed disagreement with several of Petitioner's proposed revenue adjustments. Ms. Ahmed stated that Petitioner used an incorrect time period to calculate the total sales revenue to correct a customer misclassification and proposed an $8,717 decrease to pro forma revenue requirements. She also made several corrections to Petitioner's workpapers that calculated a new NOAA average for the NTA, resulting in a decrease to sales revenue of $77,985. Ms. Ahmed explained her disagreement with Petitioner's test year sales and anticipated natural gas purchases. She recommended a total natural gas purchase adjustment of ($4,970,424).

With respect to operating expenses, Ms. Ahmed made changes to the IURC fee based on her pro forma proposed revenue adjustments. She also disagreed with Petitioner's proposed adjustments to miscellaneous expense, depreciation expense, property tax, utility receipt tax, and federal and state income taxes. Ms. Ahmed agreed with Petitioner's calculation of accumulated depreciation through March 31, 2016, but calculated a total of $291,744 in additional depreciation through June 2016. She also agreed with Petitioner's methodology to calculate working capital, but she updated the amount based on the OUCC's proposed adjustments.

Debra A. Wilcox, a Utility Analyst II with the OUCC, proposed additional pro forma adjustments to Petitioner's operating results, including: payroll expense increase of $26,708; payroll tax increase of $2,043 and employee stock ownership plan expense increase of $18,320 based on the OUCC's payroll expense adjustments; pension expense increase of $41,724; health insurance expense increase of $5,689; bad debt expense increase of $37,510 using a three-year, rather than six-year, historical average; elimination in energy efficiency rebates under the NTA of $46,225; decreases in amortization of litigation costs related to Cause No. 43995 and a necessity certificate filing of $36,170 and $26,866, respectively; elimination of energy efficiency administrative costs of $98,372 authorized in Cause No. 44063; and elimination of scholarship expenses of $16,000. She also proposed maintaining the Energy Efficiency Rider due to ongoing collaboration between the OUCC and Petitioner in winding down that program.

Bradley E. Lorton, a Utility Analyst with the OUCC, recommended a return on Petitioner's common equity of 8.8%. Using the same proxy group as used by Dr. Boquist, Mr. Lorton prepared a DCF and a CAPM analysis. However, Mr. Lorton used different inputs in his analyses, including changing the forward dividend yield and growth rate of his DCF analysis. He also used the mathematical average of the geometric mean and arithmetic mean for future long-term returns in his CAPM analysis. Mr. Lorton testified that his DCF and CAPM analyses resulted in a return of 8.8% and 8.03%, respectively. Mr. Lorton acknowledged that he made no adjustment for Petitioner's size or lack of liquidity, noting that Petitioner, as a regulated entity, has reduced risks as compared to unregulated entities. Mr. Lorton also discussed how the

macroeconomic factors of interest rates, economic growth, and inflation further supported his recommended lower cost of common equity rate of 8.8%.

Brien R. Krieger, a Utility Analyst II with the OUCC, described his review of Petitioner's COSS. Mr. Krieger did not disagree with Petitioner's COSS or the proposed allocation of the revenue requirement to customer classes. However, Mr. Krieger made two recommendations. First, he recommended Petitioner improve its tracking of actual meter and service costs for each rate class. Second, he recommended the Commission deny Petitioner's proposed tariff language change exempting grain dryers with alternate fuel sources from paying the monthly service charge during periods of disconnection until Petitioner investigates the cost and effect of such change on other customers within the commercial service rate class.

C. **Petitioner's Rebuttal Case.** Mr. Osmon addressed several concerns with the OUCC's adjustments. He testified many of the adjustments were due to timing differences and changes that occurred after Petitioner filed its case-in-chief. He noted that the OUCC made adjustments to depreciation through March 31, 2017, but that the utility plant cutoff is June 30, 2016. He also pointed out that the OUCC reduced operating expense based on its depreciation adjustment through March 31, 2017, but did not include the additional $300,000 of utility plant additions through March 31, 2017. Mr. Osmon explained that although Petitioner would not contest the OUCC's adjustment to pro forma payroll expense, he disagreed that the increase was unsubstantiated because he is not an hourly employee.

Mr. Osmon disagreed with the OUCC's proposed 8.8% return on equity, noting that it is less than the 9.0% the OUCC proposed in Petitioner's last base rate case in 2012. Mr. Osmon testified that since Midwest's last base rate case, the Indiana economy has improved, the risk-reducing decoupling mechanism is no longer in existence, and the prime rate available to Petitioner has increased. He testified that based on these changes, a return above Petitioner's current 10.10% should be authorized.

Mr. Osmon responded to Mr. Krieger's two recommendations. Mr. Osmon stated that Petitioner does maintain a count of every meter size it currently has either in service or in inventory. Each meter also has a meter card that indicates every location that the meter has been placed in service. However, Petitioner does not designate whether the meter is serving a residential or commercial customer because both are in the same customer class. With respect to grain dryers with alternate fuel options, Mr. Osmon pointed out that all but two of these grain dryers share a service line with a residence and/or farm shop building. He also referenced Cause No. 37440 GCA 125, wherein Petitioner's evidence revealed that grain dryer customers are subsidizing residential customers due to the application of demand reservation charges. In response to an April 3, 2017 Docket Entry, Petitioner explained that, despite its current tariff imposing a monthly service charge on grain dryer customers, it has opted not to charge grain dryers the monthly service charge during the months of disconnection out of concern that it may drive these customers off the system and may lead to other meters being disconnected.

Finally, Mr. Osmon addressed Ms. Wilcox's recommended elimination of customer rebates associated with energy efficiency and the scholarship funds available for Midwest employees. With respect to the energy efficiency rebates, Mr. Osmon stated that Midwest has

continued to promote energy efficiency through its rebate program associated with the NTA. In response to a Docket Entry dated April 3, 2017, Petitioner clarified that the energy efficiency rebates are those authorized in Cause No. 43107, which Midwest has been implementing for over nine years through the NTA, and not those authorized in Cause No. 43995, which has been discontinued. Petitioner also explained that it has yet to recover $84,824 of administrative expense associated with the energy efficiency program authorized in Cause No. 43995 and expects to incur more costs in winding down that program. With respect to scholarships, Mr. Osmon stated this offering is an important benefit to employees that allows Midwest to attract and obtain qualified personnel. He also noted that it has been in existence and not questioned in prior base rate case proceedings.

Ms. Mann responded to the OUCC's adjustments by dividing them into three categories. The first category included those with which Petitioner agreed, or the amount was so small that it had no material impact on Petitioner's revenue requirement. These adjustments included the OUCC's recommendations to: remove the GCA revenue; eliminate Tariff Rate D; increase the reconnection fee revenue; decrease the natural gas purchased amount; increase payroll expense, pension expense, property and casualty insurance, employee stock ownership plan expense, billing software and IT contract expense, and engineer retainer; and decrease amortization of the necessity certificate filing. Ms. Mann also agreed with the OUCC's adjustment to miscellaneous expenses, property taxes, payroll taxes, and the methodology to be used for flow through adjustments such as IURC fees, utility receipts taxes, federal taxes, and working capital.

Ms. Mann stated that the second category of adjustments were those to which Midwest would not object. These included: a customer misclassification adjustment; new NOAA data for the NTA; health insurance expense; amortization of expense related to Cause No. 43995; and the new state income tax rate.

With respect to the third category of OUCC adjustments, Ms. Mann stated that Midwest specifically disagreed with: adjustments to bad debt expense; removal of energy efficiency customer rebates; removal of administrative expenses related to winding down the energy efficiency program approved in Cause No. 43995; removal of scholarship expenses; changes to depreciation expense; a change in the utility plant component of rate base; continuation of the Energy Efficiency Rider; and the cost of equity to be used in the capital structure.

Regarding bad debt expense, Ms. Mann explained that the last three years included an unusually low number of write-offs, which is why Petitioner chose to use a six-year average. She indicated that using the OUCC's approach would create too little rate revenue to cover Petitioner's expected bad debt expense.

With respect to the energy efficiency customer rebates, Ms. Mann suggested that the OUCC's adjustment to remove all rebates may be due to Ms. Wilcox's unfamiliarity with Cause No. 43017, which is separate from the energy efficiency program approved under Cause No. 43995 that has expired. Ms. Mann recommended the Commission reject the OUCC's adjustment. While acknowledging the energy efficiency program under Cause No. 43995 had expired, Ms. Mann explained that Midwest has not yet recovered all of the administrative costs associated with the approved energy efficiency programs. Ms. Mann recommended the Commission reject

the OUCC's adjustment, noting that at $14,229 per year, more than five years will be required to recover the administrative costs. Thus, the issue would likely be an issue again in Petitioner's next base rate case.

Ms. Mann explained that Petitioner had two objections to the OUCC's depreciation adjustments. The first objection related to the removal of depreciation expense for a fully depreciated 2008 Ford truck that had already been removed from Petitioner's books and records. The second objection related to the removal of depreciation expense for assets that would be fully depreciated by March 31, 2017. Ms. Mann stated that depreciation expense is tied to rate base. Consequently, simply removing assets because they would be depreciated by March 31, 2017, fails to recognize that assets will be added within that same period. She noted that between June 30, 2016 and January 31, 2017, Petitioner added $280,000 in assets. Ms. Mann also explained that because of the OUCC's errors on depreciation, the OUCC had miscalculated Petitioner's utility plant in service to be included in rate base.

Finally, with regard to scholarship expense, Ms. Mann testified that such employee benefits are necessary to attract and retain employees in Washington, Scottsburg, and Bloomfield, Indiana, where Petitioner maintains its offices. Therefore, Petitioner objected to the removal of this expense, which it views as necessary for the provision of gas service.

Dr. Boquist disagreed with Mr. Lorton's recommended 8.8% cost of common equity. He stated that the OUCC's position is not supported by the proper application of the DCF or CAPM models. In addition, he testified that the approval of such a low cost of common equity would jeopardize Midwest's financial integrity because the resulting level of net operating income would not constitute a fair return on the value of Midwest's property.

Dr. Boquist disagreed that Midwest's risk is significantly lower because it has the NTA. He noted that in its last rate case, Midwest had another tracker in addition to the NTA and Mr. Lorton recommended a return on equity 20 basis points higher than he is recommending in this case. Dr. Boquist also disagreed with Mr. Lorton's reasoning on the effects of inflation.

Regarding Mr. Lorton's use of the DCF and CAPM models, Dr. Boquist testified that in calculating the forward dividend yield in the DCF model, Mr. Lorton only used one-half of the expected growth in dividends. He said this procedure understates the forward dividend yield for the upcoming year and will result in the investor being perpetually short in its expected return. With regard to the CAPM model, Dr. Boquist explained his concern with the OUCC's method of using both the geometric mean and the arithmetic mean and then averaging the results generated. Dr. Boquist stated that the arithmetic average is the correct market risk premium to be used in the model because it identifies that return which should have been expected by investors at the beginning of the investment horizon. He also disagreed with Mr. Lorton's methods of determining the risk free rate, the equity risk premium, and the size premium. Dr. Boquist also disagreed with Mr. Lorton regarding the macroeconomic trends on inflation, bond yields, and the interest rate for long-term debt.

Mr. Heid responded to the OUCC's recommendations on Petitioner's COSS and rate design. He stated that changing Petitioner's tariff language to reflect installed meter sizes is

unnecessary because all customers are assigned for billing purposes to the correct customer class based on their meter size and eligibility criteria. Mr. Heid also disagreed with Mr. Krieger's suggestion to segregate grain dryer customers and perform another COSS. He said performing a COSS is impractical when Midwest is simply trying to keep small farming operations on the system. He suggested the Commission approve Midwest's proposal and require the results be reported in Midwest's next rate case. Finally, Mr. Heid testified that because the energy efficiency program has expired, there is no need to keep Sheet No. 70.

5. **Commission Discussion and Findings.** Based on the evidence presented, Petitioner and the OUCC have resolved many of the issues raised in this proceeding by accepting the other party's position or adjustment. We begin by addressing those issues and then address the remaining disputed issues.

A. Pro Forma Operating Adjustments.

1. **Agreed Adjustments.** The evidence demonstrates the parties agreed or did not take issue with the following accounting adjustments reflected in Petitioner's Exhibit 10, Schedule C-1 Rebuttal:

- Elimination of GCA revenue
- Decrease in revenue for customer misclassification
- Decrease in revenue for revised NOAA data for NTA
- Elimination of Tariff D revenue
- Increase in reconnection fee revenue
- Decrease in natural gas purchased
- Increase in payroll expense
- Increase in pension expense
- Increase in health insurance expense
- Decrease in IURC Fee
- Increase in property and casualty insurance
- Increase in employee stock ownership plan expenses
- Increase for new billing software and maintenance fees
- Elimination of amortization from Cause No. 43995
- Decrease in amortization of necessity certificate
- Increase for IT contract expense
- Increase for engineering retainer
- Decrease to miscellaneous expense
- Increase to payroll taxes
- Increase in property taxes
- Decrease in rate case expense[3]

[3] At the evidentiary hearing, the OUCC did not offer the prefiled testimony of Leja D. Courter and no other testimony was offered to dispute Petitioner's proposed rate case expense amount.

Additionally, the evidence indicates that the parties agreed upon the methodology to be used to calculate the utility receipt taxes, income taxes, and the proposed rate increase adjustments. We find that the evidence presented and discussed in Finding Paragraph 4 supports the above adjustments to Petitioner's test year operating revenues and expenses.

2. **Bad Debt Expense.** During the test year, Midwest had bad debt expense of $38,696. Petitioner proposed an increase in bad debt expense of $51,756 based on actual fiscal year write-offs over the past six years. The OUCC proposed using the last three years because the period used by Petitioner included some large write-offs. Ms. Mann, on rebuttal, argued that the last three years included an unusually low number of write-offs and would lead to a higher level of volatility.

The purpose of this adjustment is to include in a utility's revenue requirement a reasonable dollar amount based on actual experience to cover future bad debt. We agree that the use of either the three-year or the six-year average will provide skewed results. It has been five years since Petitioner's last base rate case and, based on history, we expect it will be another five years before Petitioner files another base rate case. Therefore, we find that Midwest's bad debt expense should be adjusted based on a five-year average for an increase of $53,517. We find the five-year period to be more reasonable because it will capture both the unusually high and low write-offs.

3. **Customer Rebates (Energy Efficiency Expenses Associated with the NTA).** Midwest proposed elimination of the energy efficiency rebates to customers under the NTA of $25,000 that was authorized by the Commission in Cause No. 43107. The OUCC recommended eliminating an additional $21,225 from test year expense for rebates provided to customers based on the expiration of the energy efficiency program authorized under Cause No. 43995. On rebuttal, Ms. Mann disagreed, noting that the energy efficiency component of the NTA is a continuing obligation and separate from the energy efficiency program authorized under Cause No. 43995, which has been eliminated.

As an initial matter, we note that the OUCC's position in this Cause is contrary to the position that it recently took in *Community Natural Gas Co., Inc.*, Cause No. 44768 at 21 (IURC March 22, 2017). The OUCC's position fails to recognize that the energy efficiency customer rebates in question were established in Cause No. 43107 wherein we approved the use of an NTA as an Alternative Regulatory Plan ("ARP") under Ind. Code ch. 8-1-2.5. The OUCC did not propose to terminate the ARP, but instead agreed with the continued use of the NTA. In addition, the energy efficiency program approved under Cause No. 43995 did not replace the energy efficiency efforts authorized for Midwest in Cause No. 43107. Therefore, we reject the OUCC's recommendation to further reduce the expense associated with customer rebates provided under the NTA and agree that Petitioner's proposed adjustment to the test year expense as set forth in Petitioner's Exhibit 10, Schedule C-1 Rebuttal, is reasonable.

4. **Energy Efficiency Administrative Costs.** Petitioner proposed to continue to collect $14,229 to recover its costs associated with the energy efficiency program approved in Cause No. 43995. The OUCC recommended eliminating that funding because the energy efficiency program has ended. Both Petitioner and the OUCC indicated that additional

collaboration between the parties is necessary to wind down the program. Petitioner's witness Ms. Mann explained that the costs associated with the program have not yet been fully recovered. In addition, based on the total amount still to be recovered, it will take more than five years to recover the known costs at the rate of $14,229 per year. In light of the OUCC's acknowledgement that additional collaboration is required, Petitioner's lack of recovery of the expenses incurred through March 31, 2017, and the expectation of future costs to be incurred, we agree with Petitioner that $14,229 should continue to be included in Petitioner's annual revenue requirement as reflected in Petitioner's Exhibit 10, Schedule C-1 Rebuttal.

5. Depreciation Expense. The evidence indicates that Midwest and the OUCC were generally in agreement on depreciation expense, except with respect to two adjustments proposed by the OUCC. The first disagreement related to the removal of a fully depreciated Ford truck from Petitioner's utility plant and the corresponding reduction of depreciation expense associated with that truck. On rebuttal, Ms. Mann pointed out that Petitioner had already removed the Ford truck from its utility plant and the associated depreciation expense was removed from its books and records. Therefore, there was no need to remove the asset or the depreciation again. In advance of the hearing, the OUCC filed a second revision to Ms. Ahmed's testimony and schedules indicating agreement that no additional depreciation adjustment was required for this truck, which was subsequently admitted into evidence at the hearing as OUCC's Exhibit 1.

The second depreciation issue related to the OUCC's proposal to reduce depreciation by considering what additional assets would be fully depreciated by March 31, 2017 and removing those assets from depreciation expense. Initially, we note that although Petitioner's rebuttal schedules on Exhibit 10 reflect agreement with the OUCC's proposal, both Ms. Mann's rebuttal testimony and her testimony at the hearing reflect Petitioner's disagreement with the OUCC's proposed adjustment. As Ms. Mann noted, the rate base cutoff date for the plant in this Cause is June 30, 2016. Depreciation expense is tied to rate base. She explained that the reason Petitioner and the OUCC both included assets that were added between the end of the test year, i.e., March 31, 2016, and June 30, 2016, is that depreciation and rate base are part of the same overall utility plant calculation. Simply removing some assets because they would be depreciated by March 31, 2017, fails to recognize that some assets also will be added during this time. Therefore, we decline to accept the OUCC's adjustment to further reduce Petitioner's depreciation expense.

Accordingly, we find Petitioner's depreciation expense should be increased by $18,161, for a total of $1,214,545.

6. Scholarships. The OUCC proposed an adjustment to remove expenses related to scholarships available for the dependents of Petitioner's employees. Petitioner's witnesses Mr. Osmon and Ms. Mann explained that this expense is an integral part of its employee benefits because it allows Petitioner to attract and retain qualified employees at its offices in small, rural Indiana communities. We recognize that finding and retaining qualified employees can be more difficult in small, rural locations as opposed to larger urban areas that typically offer more diverse community activities and amenities. It is also a benefit that Petitioner has been offering, with apparent success, for several years. Accordingly, based on the evidence presented, we find that Petitioner's inclusion of $16,000 in scholarship expense is

reasonable to assist with the attraction and retention of qualified employees, which are necessary and essential to Petitioner's provision of safe and reliable service.

B. Rate Base. Based on our findings above regarding depreciation expense and the undisputed evidence of Petitioner on all other elements of utility plant as of June 30, 2016, we find that Petitioner's rate base, used and useful for delivery of natural gas service to its customers, and based on original cost, is $16,498,104.

Based on our findings above and recognizing that both Petitioner and the OUCC have calculated rate base using the same method, we find that Petitioner's fair value rate base should be calculated as follows:

Utility Plant in Service	$36,100,951
Accumulated Depreciation	($21,977,457)
Additions to Utility Plant-June 30, 2016	$1,277,386
Additional Depreciation Expense – June 30, 2016	($303,636)
Net Utility Plant in Service	$15,097,244
Plus:	
Working Capital	$574,069
Materials and supplies – 13 month average	$826,792
Total Original Cost Rate Base	$16,498,104

C. Cost of Capital. The only issue between the parties on the cost of capital is the fair and reasonable return on equity capital to be used in the capital structure. The parties appear to agree that this equity return must: (1) be sufficient to attract capital to Midwest on reasonable terms; (2) allow Midwest to maintain its financial integrity to render continuous and reliable service; and (3) be commensurate with that available on investments with corresponding risks.

Midwest requests a return on equity of 11.00%, (based on its analysis and results ranging from 10.57% to 13.94%), and the OUCC recommends a return on equity of 8.8% (based on its analysis and results ranging from 8.03% to 8.8%). As we consider the evidence before us, we are cognizant of the wide range of results produced by the various analyses of the parties, spanning from 8.03% to 13.94%, a 5.91% range. Petitioner was authorized in its last base rate case, Cause No. 44063, a return on equity of 10.1%.

Dr. Boquist explained that investors in equity securities face a number of risks for which they expect to be compensated. Separate risks that investors consider when deciding the return required to induce an investment in an equity security include interest rate risk, inflation risk, financial risk, liquidity risk, business risk, and regulatory risk. Dr. Boquist pointed to specific business risks incurred by gas utilities in particular, which include business cycles, weather conditions, conservation, and alternative sources of energy supply. He also indicated that due to gas utilities' need for capital, they are exposed to substantial interest rate risk, inflation risk, financial risk, and regulatory risk. He explained that Midwest faces all of these risks.

Having considered the proxy group selected by the parties, we find the utilities represented in the group are less than representative of Petitioner's operations. All have financial operating characteristics exceeding Midwest's size and scope, and all are publicly traded. As previously found appropriate in such circumstances, we find an additional risk premium is warranted in this case to account for the small size of Midwest, its lack of publicly traded stock, and the difference in load served. *E.g. Midwest Natural Gas Corp.*, Cause No. 44063 at 22 (IURC Nov. 7, 2012); *Lawrenceburg Gas Co.*, Cause No. 43090 at 9 (IURC June 20, 2007).

We also recognize that since the Petitioner's last rate case, it has removed the sales reconciliation component tracker, which we have recognized as increasing risk to Petitioner's shareholders. However, counteracting this additional risk is Petitioner's retention of the NTA.

In discussing the need to attract capital, Mr. Osmon stated that Midwest has significant plant expansions planned using debt and retained earnings, but that it is also considering issuing additional common equity shares from either treasury stock or newly authorized stock. He states that in the case of additional debt or new equity capital, the authorized return on equity will impact the cost of the former and the ability to attract the latter. In Cause No. 44809, Petitioner sought and was granted authority to issue long-term debt in an amount up to $2,500,000, for a period of five years, at an annual interest rate of up to 3.75%. Mr. Osmon noted in his rebuttal testimony that Petitioner witnessed the interest rate increase by 99 basis points from July through December 2016. As a result, Petitioner was unable to obtain financing in accordance with the parameters set out in the Commission's Order. Consequently, Petitioner had to seek modification of its financing authority to reflect the rising interest rate environment and allow for a higher ceiling on long-term debt.

We also note that Petitioner has also reported actual net operating incomes below its authorized net operating income in GCA tracker proceedings since December 2015, which has continually eroded its financial integrity. Additionally, we must account for returns being earned by similar businesses in this part of the country with similar corresponding risks and uncertainties. The Commission notes that since 2013, it has authorized returns on equity for natural gas utilities in the range of 9.9% to 10.2%.

In determining what constitutes a fair rate of return for a utility, the Commission generally calculates a composite cost of capital by adding together weighted costs of various components of a utility's capital structure and comparing the resulting figure, expressed as percentage of a utility's combined debt and equity accounts, to the utility's existing rate of return; this serves as initial point of reference in establishing a fair rate of return for utility operations. *Gary-Hobart Water Corp. v. Ind. Util. Regulatory Comm'n*, 591 N.E.2d 649, *reh'g denied,* (Ind. Ct. App. 1992). Additionally, a utility's rates and charges are to recover its operating expenses plus a reasonable return for investors for a foreseeable time after they are set.

As an initial point of reference, we utilized the comparison noted above to determine whether an adjustment to Petitioner's existing rate of return was warranted. Additionally, we are cognizant of the rising interest rate environment of today's capital markets. As such, having weighed the evidence in its entirety, we find that no reduction is required to Petitioner's current

return on equity. Accordingly, we find that a return on equity of 10.1% is appropriate for Petitioner's capital structure to produce a fair rate of return of 6.99%. This is within the range of reasonableness, comparable to the returns on equity authorized for similarly situated utilities, and allows the utility the opportunity to adequately compensate investors, attract capital, maintain its credit ratings, and operate a financially sound utility.

Based on our findings above, the following table reflects our findings with respect to Petitioner's capital structure and the cost of each element of its capital structure:

Description	Amount	Percent of Total	Cost	Weighted Cost
Common Equity	$10,428,183	57.07%	10.10%	5.76%
Long Term Debt - Existing	$2,028,492	11.10%	4.32%	0.48%
Long Term Debt – New	$2,500,000	13.68%	4.52%	0.62%
Customer Deposits	$397,695	2.18%	6.00%	0.13%
Deferred Taxes	$2,918,457	15.97%	0.00%	0.00%
Total	$18,272,827	100%		6.99%

D. Pro Forma Revenue Requirement. Having considered the evidence of record, we find that Petitioner's current rates and charges are insufficient to allow Petitioner appropriate funds for the safe and reliable operation of the utility and earn a reasonable return on its investment in utility rate base. A summary of the above findings, including other revenue requirements not in dispute in this Cause, are illustrated in the following table:

Revenue Requirement	
Net Original Cost Rate Base	$ 16,498,104
Rate of Return	6.99%
Authorized Net Operating Income	$1,153,217
Pro Forma Net Operating Income	$626,965
Increase in Net Operating Income	$526,252
Revenue Conversion Factor	1.6598568
Required Revenue Increase	$873,503
Percentage Increase	12.13%[4]

E. Cost of Service. Mr. Heid sponsored Petitioner's COSS. Based on that COSS, Mr. Heid allocated the revenue requirement to Petitioner's customer classes, reducing subsidies where appropriate. Mr. Heid indicated that the rate design process was guided by Petitioner's objectives to maintain reasonable relationships between rate blocks and rate schedules as well as mitigating rate shock within a customer class. With these objectives in mind, Petitioner proposed to keep the current monthly service charge for Rate A – General

[4] This percentage does not include GCA revenues.

Service in place, but increase the volumetric rates. Petitioner proposed to increase the monthly service charge to Rate B – Commercial Service from $24 to $26 per month and increase the volumetric rates. For Rate C – Industrial Service, Petitioner proposed to increase the monthly service charge from $142 to $165 and increase the volumetric rates. Petitioner proposed to eliminate Rate D due to the migration of customers to Rate C. For Rate E – Transportation Service, Petitioner proposed to increase the monthly service charge from $380 per month to $460 per month, add a second volumetric block, and increase the volumetric rates. And finally, for Rate STS – School Transportation Service, Petitioner proposed to continue to charge the monthly service charges and volumetric rates corresponding to the meter size that any such school uses and the corresponding meter sizes used in Rate A or Rate B.

Although the OUCC accepted the COSS and proposed allocation of the revenue requirement, Mr. Krieger identified inconsistencies between the manner in which Petitioner's meter study allocated the cost of meters by size to each rate class and the language defining the size of meters included in each of Petitioner's rate classes. The OUCC recommended Midwest improve the allocation accuracy of meters and services in its next COSS by modifying its tariff language to match installed meter sizes with the appropriate tariff as well as its recordkeeping of meters and services to include rate class codes for the installed meter and service. On rebuttal, Mr. Osmon explained how Midwest maintains its records relative to the meters used by customers and suggested that such tariff changes are unnecessary. He also indicated that the issue giving rise to the OUCC's recommendation is not the result of a problem with tariff language but an inherent issue with the process of allocating costs to customer classes.

Based on the evidence presented, we find Petitioner's COSS is reasonably designed and appropriate for establishing rates in this Cause. Midwest is authorized to use this COSS, and the approach to rate design described above, when it makes its compliance filings in this Cause. However, we agree with the OUCC's broader recommendation that Petitioner should improve the allocation accuracy of meters and services in its next COSS, and order Petitioner do so. Petitioner is encouraged to explore all cost-effective means to make such improvements, including those related to its recordkeeping processes and tariff language as the OUCC recommended.

F. <u>Tariff Changes</u>. Petitioner proposed a number of language changes to its existing tariff language. Petitioner also proposed two increases related to its reconnection charge: an increase from $25 to $30 where service has been disconnected due to a violation of the utility's rules and an increase from $30 to $45 for reconnection after hours. The rationale and support for these proposed changes were provided by Petitioner's witnesses Osmon and Heid.

The OUCC addressed five of the proposed changes. Ms. Ahmed agreed with the elimination of Rate D, the increase to reconnection charges, and the use of new NOAA data for application to the ongoing NTA. Ms. Wilcox disagreed with the elimination of the Energy Efficiency Rider established under Cause No. 43995 because the parties were still collaborating on the wind down of the underlying energy efficiency program. Lastly, Mr. Krieger suggested that the language change related to grain dryers be delayed until Petitioner completed additional analysis or a COSS segregating grain dryer costs.

With respect to eliminating the Energy Efficiency Rider, both parties agree that further collaboration is required to wind down this program. Therefore, we find that the Rider should remain part of Petitioner's tariff.

Regarding the proposed tariff revision related to grain dryers, Midwest requested approval to modify its tariff language to reflect its current practice of not charging these customers the monthly service charge during the months that they are disconnected from the system. As an initial matter, we note that because the Commission has jurisdiction over Midwest's rates and charges, Midwest should have first sought Commission approval before it discontinued charging these grain dryer customers the monthly service charge.[5] In the future, Midwest shall seek and obtain Commission approval before making any adjustments to its rates and charges.

In support of its requested change, Midwest explained that it was proposing to eliminate the monthly service charge to grain dryer customers that had alternative fuel sources available to them, such as propane, in an effort to keep these customers on Petitioner's system. Midwest indicated that these customers had expressed an unwillingness to reconnect to Petitioner's system if the monthly service charges were collected. Ms. Osmon also noted that the majority of these grain dryers, which disconnect after the drying season has ended, share a service line with other meters on the property. Thus, at least in these instances, fixed costs through the monthly service charges are already being recovered.

Based on the evidence presented, we find that Midwest has reasonably explained why its proposed changes are needed to retain these grain dryer customers that have alternative fuel sources available. The retention of these customers should ultimately benefit Petitioner's other customers by providing a larger customer base on which to spread fixed costs. Although the majority of the grain dryer customers with alternative fuels sources that regularly disconnect share a service line with property that remains connected during the year, we share the OUCC's concern with wanting to avoid the potential for intraclass or interclass subsidies. Accordingly, we find that Midwest shall further investigate the cost to serve grain dryers and consider alternative rate designs, including entering into special contracts, for purposes of addressing this issue in a COSS to be filed with its next rate case.

Based on the evidence presented, we find that all of the other proposed tariff changes are reasonable and should be approved. Therefore, with the exception of the Energy Efficiency Rider, which should remain part of Petitioner's tariff, Petitioner's proposed tariff changes are approved.

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

1. Petitioner is authorized to increase its rates and charges to produce an additional $873,503 annually beyond that provided by its current rates.

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[5] Ind. Code § 8-1-2-109 makes violations of the Public Service Commission Act a Class B infraction.

2. Petitioner is authorized to implement its rate design in accordance with our findings above.

3. Petitioner is authorized to implement tariff changes in accordance with our findings above.

4. Petitioner shall file a new tariff under this Cause prior to placing into effect the rates, charges, rules, and regulations approved by this Order. Such new tariff, when filed and approved by the Commission's Energy Division, shall cancel all present tariffs.

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

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

APPROVED: AUG 16 2017

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

Mary M. Becerra
Secretary of the Commission