

ORIGINAL

JA
B
DWO
SJK

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF HAMILTON SOUTHEASTERN)
UTILITIES, INC. TO: 1) INCREASE ITS SEWER)
RATES AND CHARGES PURSUANT TO THE)
COMMISSION'S MINIMUM STANDARD FILING)
REQUIREMENTS; 2) ADOPT A NEW RATE)
SCHEDULE REFLECTING THE APPROVED)
RATES AND CHARGES; 3) INCREASE ITS)
SYSTEM DEVELOPMENT CHARGES; 4))
IMPLEMENT A FATS, OILS AND GREASE)
CHARGE; AND 5) UPDATE ITS RULES AND)
REGULATIONS)

CAUSE NO. 44683

APPROVED: FEB 20 2019

ORDER OF THE COMMISSION ON REMAND

Presiding Officers:

David E. Ziegner, Commissioner

Carol Sparks Drake, Senior Administrative Law Judge

On September 24, 2015, Hamilton Southeastern Utilities, Inc. ("HSE" or "Petitioner") initiated this proceeding by filing a Verified Petition and Notice of Intent to File in Accordance with Minimum Standard Filing Requirements ("Verified Petition") with the Indiana Utility Regulatory Commission ("Commission"). The relief HSE requested in its Verified Petition included an across-the-board rate increase of 8.42%¹ and an increase in its system development charge in all existing service areas. HSE also requested approval of a fats, oils, and grease ("FOG") program and revisions to its rules and regulations.

The Commission commenced an evidentiary hearing in this Cause on February 24, 2016. On November 9, 2016, the Commission issued an Order ("44683 Order") authorizing a rate increase of 1.17% consistent with the findings in the 44683 Order. The Commission also authorized HSE to increase its system development charges and approved HSE's new FOG management rules, monthly FOG charge, and inspection fee for customers in violation of the approved FOG rules. Rule and billing changes were also approved.

On December 9, 2016, HSE appealed the 44683 Order by filing a Notice of Appeal with the Court of Appeals of Indiana.² HSE initially named the Commission as an appellee-respondent, but later moved to dismiss the Commission. Over the Commission's objection, in rendering its opinion on September 28, 2017, the Court of Appeals granted HSE's motion to dismiss the Commission. *Hamilton Southeastern Utils., Inc. v. Indiana Util. Regulatory Comm'n*, 85 N.E.3d

¹ In its rebuttal testimony, HSE agreed with certain adjustments the Indiana Office of Utility Consumer Counselor ("OUCC") proposed, resulting in HSE's rate increase request being reduced from 8.42% to 6.27% across-the-board.

² Shortly before filing its Notice of Appeal, HSE filed a petition with the Commission on November 29, 2016, asking the Commission to reconsider and revise the 44683 Order. HSE's petition for reconsideration was subsequently deemed denied under 170 IAC 1-1.1-22(e)(5).

612, 619 (Ind. Ct. App. 2017). The Court of Appeals also made the following determinations: (1) the Commission acted arbitrarily in excluding certain SAMCO³-related expenses (the three percent contract increase and a ten percent management fee) when calculating HSE's rate increase; (2) the Commission was within its discretion to exclude the paid-in-arrears SAMCO expenses from HSE's calculation of working capital; (3) the Commission did not err in concluding HSE's system development charge should be based on the evidence presented, and (4) the Commission properly permitted HSE to recover its passed-through income tax liability in its rates. *Hamilton Southeastern Utils., Inc. v. Ind. Util. Regulatory Comm'n*, 101 N.E.3d 229, 230-31 (Ind. 2018). Consistent with the foregoing determinations, the Court of Appeals originally affirmed in part, reversed in part, and remanded this matter to the Commission. *Hamilton Southeastern Util., Inc. v. Ind. Util. Regulatory Comm'n*, 85 N.E.3d 612, 626.

Petitions to transfer were subsequently filed, and the Supreme Court of Indiana on June 27, 2018, granted transfer. Our Supreme Court concluded the Commission was a proper party to the appeal, reversing the Court of Appeals on that issue, and the Supreme Court summarily affirmed the Court of Appeals on the issue of whether the Commission may include in HSE's revenue requirement the state and federal income taxes HSE's individual shareholders paid. The Supreme Court remanded this case to the Court of Appeals with instructions to permit the Commission to brief whether the Commission acted arbitrarily in excluding the disputed SAMCO-related expenses from HSE's rate calculation. *Hamilton Southeastern Utils.*, 101 N.E.3d at 234. On October 11, 2018, the Commission filed an appellee brief upon this issue.

On December 5, 2018, the Court of Appeals reversed the Commission on the SAMCO expenses issue, remanding this matter for the Commission to make additional findings to support its decision on these expenses or to recalculate HSE's rates. Specifically, the Commission's charge on remand is to more specifically explain why the Commission disallowed the three percent SAMCO hourly billing rate increases and ten percent SAMCO management fee in determining Petitioner's level of rate increase. The Court of Appeals cautioned that the Commission's order on remand must contain specific findings on the factual determinations material to the Commission's ultimate conclusions.

Based upon the applicable law and the evidence presented, as discussed fully below, the Commission concludes that SAMCO's three percent across-the-board billing increase and ten percent management fee that HSE proposed to recover in rates were appropriately disallowed, but the Commission takes to heart the judicial directive to more fully expound upon the findings supporting this conclusion; therefore, the Commission finds:

1. Commission Jurisdiction. This Cause is before the Commission pursuant to the opinion of the Court of Appeals of Indiana issued upon remand from the Supreme Court. *Hamilton Southeastern Utils.*, 101 N.E. 3d at 234. HSE is a public utility as that term is defined in Ind. Code § 8-1-2-1(a), and the Commission has authority to approve rates and charges for HSE's utility service under Ind. Code § 8-1-2-42. The opinion of the Court of Appeals reversed the Commission on the SAMCO expenses issue and remanded this matter for the Commission "to make additional findings to support its decision or for a recalculation of HSE's rate." Slip Op.

³ SAMCO is an abbreviation for an affiliate company of HSE, Sanitary Management & Engineering Company, Inc. HSE and SAMCO are governed by the same set of board members and have the same shareholders.

93A02-1612-EX-2742 at p. 6 (“Remand Opinion”). Accordingly, the Commission has jurisdiction over Petitioner and the subject matter of this proceeding.

2. Petitioner’s Characteristics. HSE is a corporation organized under the laws of the State of Indiana and is engaged in providing sewer utility service pursuant to certificates of territorial authority and indeterminate permits the Commission issued in Cause Nos. 38685, 38819, 38897, 39567, 40501, 41528, 41745, 41752, 41798, 43435, 43581, and 43761. Petitioner owns, leases, operates, manages, and controls utility plant, property, equipment, and related facilities that are used and useful for the convenience of the public for the provision of sewer utility service.

3. Issue on Remand. HSE’s requested relief included recovering through its rate increase the following two expenses attributable to its affiliate, SAMCO:

- (a) a three percent increase in all the hourly billing rates SAMCO charges HSE for SAMCO’s employees’ services; and
- (b) a ten percent management fee that SAMCO adds to HSE’s bill when purchasing materials and equipment on HSE’s behalf and when managing projects that other contractors perform.

The OUCC objected to the three percent billing rate increase and the ten percent management fee. In support of its position, the OUCC submitted and the Commission admitted into evidence, without objection by HSE (Tr. A-97), guidelines the National Association of Regulatory Utility Commissioners (“NARUC”) recommends regulators consider when reviewing affiliate pricing. Public’s Ex. 1, Attachment MAS-13. In the Remand Opinion, the Court of Appeals was critical of the Commission’s application of the NARUC guidelines, stating:

In addition, the Commission’s findings shed no light on why it chose to apply the portion of the NARUC guidelines pertaining to fully allocated costs when the NARUC guidelines themselves provide that ‘[u]nder appropriate circumstances, prices could be based on incremental cost, or other pricing mechanisms as determined by the regulator.’

Remand Opinion at p. 5. On remand, the Commission is tasked with better illuminating the factual determinations material to disallowing the two expenses identified above and the interplay between the NARUC guidelines and our findings and conclusions or drafting alternative findings to support a recalculation of HSE’s rate.

4. Affiliate Contract Expenses. The parties’ respective testimony and other evidence upon the affiliate contract expenses issues is set forth in the 44683 Order on pages 18 through 22; therefore, in compliance with the Remand Order, in this Order we limit the evidence included in our discussion to the evidence material to our findings, discussion, and conclusions upon remand, along with the applicable law.

A. Commission Discussion and Findings upon Three Percent Across-the-Board SAMCO Increase. At the time of the hearing in February 2016, HSE had been in operation approximately 25 years, Tr. A-87; Public’s Ex. 2 at 4, having been founded in 1989. Pet.

Ex. 1 (KWC) at 4. HSE has experienced substantial growth, Pet. Ex. 1 (KWC) at 4, and is the largest investor-owned sewer utility in the State of Indiana, Public's Ex. 2 at 4, with CTAs to provide wastewater service to the Fishers, Noblesville, and Zionsville areas. Pet. Ex. 1 (KWC) at 2. HSE's gross plant in service equals about \$98.5 million. Tr. B-25. Petitioner has annual operating revenues exceeding \$10 million and provides wastewater service to more than 20,000 customers. Pet. Ex. 1 (KWC) at 4; Public's Ex. 2 at 4. According to HSE's President, Kendall Cochran, HSE's business model over the last 30 years has been to contract with SAMCO for its operations and engineering services, obtain consulting services from SAMCO, and obtain treatment services from Fishers and Noblesville. Tr. A-144. HSE has seven employees who perform no operation, maintenance, or engineering tasks. Public's Ex. 2 at 3. Essentially, HSE relies on SAMCO to operate its utility. Public's Ex. 1 at 2. OUCC witness James Parks testified that most utilities have an in-house staff, with it being unusual to have everything subcontracted out to another firm. Tr. A-142, 150.

SAMCO is an affiliate of HSE. HSE's Officers and Directors all own shares of SAMCO, Public's Ex. 2 at 3, including Mr. Cochran. Tr. B-69. HSE estimated that 20% of Mr. Cochran's time is expended on SAMCO matters, an estimate the OUCC suggests is low. In addition to sharing Mr. Cochran's services, Mr. Parks testified that SAMCO uses offices owned by HSE. Tr. A-143. Mr. Cochran testified that SAMCO has about 40 employees who engage primarily in HSE work and about 35 employees who perform locates. Tr. B-106. He acknowledged, in responding to questions from the Presiding Administrative Law Judge, that a majority of SAMCO's employees utilize 100 percent of their time on HSE work. Tr. B-105.

SAMCO is a significant operation and maintenance expense for HSE, representing approximately 50 percent of HSE's operating expenses. Tr. A-81; Public's Ex. 1 at 4. For 2014, SAMCO's charges to HSE included in the test year operating expenses totaled \$5,339,669, Public's Ex. 1 at 39, as compared to the total contract charge of \$3,280,990 for the test year in HSE's last rate case, Cause No. 43761, for which the Commission issued an Order on August 18, 2010 ("43761 Order"). 43761 Order at 20. The SAMCO hourly rates in effect during the 2014 test year did not include the three percent increase HSE and SAMCO negotiated in 2015. Mr. Cochran confirmed that HSE has not performed a cost/benefit analysis or other study to determine whether HSE could perform the services SAMCO provides in-house at less expense than it pays SAMCO. Tr. B-48. He testified, "We have, as I said earlier in my testimony, spent the last 25 years trying to make sure SAMCO's rates are at or below the market." Tr. B-48, lines 8-10. Mr. Cochran testified that HSE does not owe it to ratepayers to determine whether HSE can provide the services SAMCO provides at costs below what SAMCO is charging. Tr. B-48. He stated it is enough to prove that SAMCO's rates are at or below the market and if so, SAMCO's rates are reasonable. Tr. B-48. Mr. Parks, however, opined that HSE could secure the same quality and quantity of work SAMCO performs "at a much lower cost" by performing these tasks in-house with HSE staff. Public's Ex. 2 at 5, line 9.

According to Mr. Cochran, most of what SAMCO does for HSE is routine maintenance items, and these services are charged on an hourly basis. Tr. A-88. When asked whether SAMCO uses the same rates for every entity for which it provides services as it charges HSE, Mr. Cochran stated, "Some of our [SAMCO's] clients would be charged different rates if they're bigger or smaller, but they're pretty darn close to these rates." Tr. B-104, lines 17-20.

In addition to routine maintenance, SAMCO's responsibilities include managing projects for HSE. Mr. Cochran confirmed that HSE does not get bids for this work from other entities that manage projects. Tr. A-90.

SAMCO is also performing increased services for HSE as a result of an Agreed Order that HSE and the Indiana Department of Environmental Management ("IDEM") entered into in July 2013 requiring HSE to develop and implement a Maintenance Program, an Operations and Capacity Management Program, an Information Management Program, a Training and Review Program, and a Monitoring and Modification Program. Petitioner's Ex. 1 (KWC) at 5-7; Public's Ex. 1 at 4-5. OUCC witness Margaret Stull testified that the requirements of that Agreed Order will significantly increase HSE's operating costs. Public's Ex. 1 at 4. Mr. Cochran testified that the age of HSE's equipment caught up with HSE sooner than anticipated, and some of the operational issues resulted in spills and overflow. These operational issues caused IDEM to issue a Notice of Violation in March 2013. Pet. Ex. 1 (KWC) at 6. SAMCO was operating HSE's system when the IDEM issued this Notice, and it is SAMCO who drafted and is carrying out the agreed actions for HSE to prevent future overflows and prospectively ensure the collection system is in good working order. Mr. Cochran testified that implementation of these preventive maintenance programs has caused HSE to spend significant amounts. He stated that the operational costs associated with the Compliance, Maintenance, and Operation Plan are not "one time" costs, but rather, costs that HSE will incur on a regular basis to ensure a safe and reliable system. Pet. Ex. 1 (KWC) at 7. Ms. Stull opined that HSE's increased operating costs to implement the Agreed Order are greater than they otherwise would be if HSE performed the compliance-related work because SAMCO's fees include a profit component and are, therefore, higher than the costs HSE would reasonably incur using its own employees. Public's Ex. 1 at 5.

Since the 43761 Order, HSE and SAMCO negotiated new rates that increase all the hourly rates SAMCO charges HSE for its employees' services by three percent. Bob Butler, who reports to Mr. Cochran and HSE's Board, represented HSE in these negotiations. Tom Kallio, who reports to the SAMCO Board, represented SAMCO. HSE and SAMCO have the same Board members. Tr. A-82.

OUCC witness Stull testified that the OUCC posed data requests to HSE in this proceeding asking whether profit is included in the rates SAMCO charges HSE. HSE responded that it has no knowledge how SAMCO determines the rates to be billed to HSE. Public's Ex. 1 at 38-39. Ms. Stull testified that many investor-owned and some municipal utilities in Indiana use affiliates to provide services, but in these situations, the affiliate charges only its fully allocated cost, and there is no mark-up or profit included in the amounts the utility is billed. Public's Ex. 1 at 39. Mr. Parks testified, by way of example, that a project engineer making approximately \$26 per hour at SAMCO is billed to HSE at \$126 per hour. Tr. A-145. On rebuttal, Mr. Cochran acknowledged that SAMCO billed HSE \$70,000 for four months of engineering services by a SAMCO engineer whose annual salary, Mr. Cochran expects, is about \$50,000 or somewhat lower. Annualized, HSE will be billed over \$200,000 for this employee's services since most of his time is spent performing work for HSE. Tr. B-58-59. Mr. Cochran testified that a majority of SAMCO's employees' time is now exclusively utilized for HSE. Tr. B-105.

In this proceeding, HSE proposed that the three percent increase negotiated in SAMCO's charges be included in its rates based on the 2015 Schedule of Rates for Engineering and

Contractual Services per the Utility Services Agreement (affiliate contract) between HSE and SAMCO, as amended. Specifically, HSE proposed increasing SAMCO's test year engineering fees of \$1,824,252 by \$54,728, yielding *pro forma* engineering fees of \$1,878,980. HSE also proposed increasing the test year other contractual services of \$2,025,674 by \$60,770, yielding *pro forma* other contractual services of \$2,086,444. Public's Ex. 1 at 41-42. HSE's witnesses did not elaborate on what costs or other factors justified the agreed increase of all SAMCO's hourly rates other than to state this is what SAMCO and HSE negotiated. Pet. Ex. 2 at 7; Pet. MSFR #32 at 3. Ms. Stull, however, testified that HSE's affiliate should be subject to the same practices that apply to Indiana's other investor-owned and municipal utilities by only being allowed to include SAMCO's fully allocated cost of providing services in HSE's rates. Public's Ex. 1 at 14. As support for this position, she cited the NARUC guidelines as industry guidelines regarding affiliated contracts. Public's Ex. 1 at 34.

Ms. Stull defined affiliate transactions as business relations with related parties or parties that have affiliated interests. Public's Ex. 1 at 34. She testified that SAMCO's charges to HSE appear to be at a rate that is higher than SAMCO's cost of providing the service, Public's Ex. 1 at 36, i.e., at a higher rate than SAMCO's fully allocated costs. Ms. Stull noted that the NARUC guidelines caution:

The prevailing premise of these Guidelines is that allocation methods should not result in subsidization of non-regulated services or products by regulated entities unless authorized by the jurisdiction regulatory authority.

Public's Ex. 1 at 34 and Attachment MAS-13 at 3. Under the NARUC guidelines, affiliate transaction pricing is based on two assumptions:

First, affiliate transactions raise the concern of self-dealing where market forces do not necessarily drive prices. Second, utilities have a natural business incentive to shift costs from non-regulated competitive operations to regulated monopoly operations since recovery is more certain with captive ratepayers. Too much flexibility will lead to subsidization. However, if the affiliate transaction pricing guidelines are too rigid, economic transaction may be discouraged.

Public's Ex. 1 at 34; Public's Ex. 1, Attachment MAS-13 at 6. As discussed below, we find inclusion of the three percent across-the-board increase is not supported by the evidence or the NARUC guidelines. While, as the Court of Appeals observed, the NARUC guidelines themselves provide that under appropriate circumstances, prices could be based on "incremental cost, or other pricing mechanism as determined by the regulator," Remand Order at 5, we find that HSE has not presented us with testimony demonstrating this is such a circumstance. Indeed, we are persuaded that the evidence HSE presented demonstrates an increase was negotiated but not that SAMCO's costs or the market support this change.

The onus is upon HSE to present proper documentation showing the Commission that its affiliate contract, in this case the 2015 Schedule of Rates for Engineering and Contractual Services, is in the public interest. *City of Fort Wayne v. Utility Ctr., Inc.*, 840 N.E.2d 836, 842 (Ind. Ct. App. 2006). HSE bears the burden of justifying the inclusion of affiliate-based costs in its rate base. *Petition of L.M.H. Utils. Corp.*, Cause No. 43022 (IURC March 22, 2007). In this

proceeding, HSE presented no evidence upon SAMCO's fully allocated cost, responding to an OUCC data request that it has no idea how SAMCO determines the rates it bills HSE. Public's Ex. 1 at 39; Attachment MAS-19 at 1-2. HSE also refused to provide the OUCC access to information regarding SAMCO's books and records, including its cost of providing services to HSE. Public's Ex. 1 at 36. HSE opted, instead, to rely upon Mr. Cochran's testimony that SAMCO's 2015 rates, incorporating the three percent increase, are at or below the market. Pet. Ex. 8 at 4. In support of this position, Mr. Cochran on rebuttal presented what he characterized as a market study as Attachment KWC- R-3, but was simply a compilation of rates and contract information HSE found on-line for various engineering firms or obtained by personal contact with the organizations shown. Tr. B-76. The Commission finds it telling that Mr. Cochran testified that SAMCO's clients will be charged different rates if they are bigger or smaller. Tr. B-104, lines 17-20. Accepting that premise, the Commission rejects the proposition that the rates on the internet equate to the rates any of the sample engineering firms identified in the 'market study' will charge a client like HSE if offered over \$5 million in services annually, particularly if a majority of their staff can expend 100% of their time providing these services. As Mr. Parks explained, the billing rates for consulting firms typically include a major allowance for unbilled hours, marketing, idle time between projects, and overruns that cannot be billed, but for SAMCO, the majority of such unbilled hours that are typical for other consulting firms do not exist. Public's Ex. 2 at 6.

In addition, Mr. Parks testified that a \$126 per hour rate, as shown in SAMCO's rate schedule before the three percent increase (Public's Ex. 2, Attachment JTP-1 at 2), appears typical of consulting engineering firm charges for project engineers and covers the direct salary cost, benefits, pension, bonus, profit sharing, and overhead costs. Public's Ex. 2 at 6. This rate is also within—or greater than—some of the engineering rates shown in HSE's market study. Pet. Ex. 8, Exhibit KWC-R-1 re Clark Dietz, Inc. and HWC Engineering. Based on the OUCC's evidence, the Commission finds the requested three percent increase was not shown to be necessary from a competitive market perspective and that HSE has failed to persuade us this increase is in the public interest. We are, instead, dubious that the rates SAMCO charged before the negotiated increase are today reasonable, but only the three percent increase is before the Commission on remand. Having increased exponentially the services SAMCO is providing since our 43761 Order such that HSE paid SAMCO in excess of \$5 million in the test year, it is questionable whether profit is inappropriately being paid to SAMCO's shareholders at the expense of HSE's ratepayers. While it is HSE's decision whether to provide more services in-house, especially for routine maintenance and similar functions as the OUCC urged, in the future HSE is directed to offer evidence supporting SAMCO's fully allocated cost so the Commission may determine the appropriate level of SAMCO expenses to include in HSE's rates and to offer evidence demonstrating that continued utilization of SAMCO, instead of an in-house staff, is financially beneficial to ratepayers. The amount HSE pays SAMCO annually, we find, has become too large to permit on-line market rates for consulting firms, which include a profit, to justify rates to HSE that are other than SAMCO's fully allocated cost.

In the absence of underlying cost data, with evidence demonstrating SAMCO's rates without the 2015 agreed increase are market rates and include a profit, and with the IDEM violations prompting increased SAMCO services in perpetuity, we find this is not an appropriate circumstance, under the evidence or the NARUC guidelines, for SAMCO's rates to be increased across-the-board. Under such circumstances, the NARUC guidelines encourage affiliate pricing to be at the lower of the fully allocated cost or prevailing market prices. Since HSE failed to produce

evidence upon SAMCO's fully allocated cost, the Commission is unable to determine that a three percent increase represents SAMCO's fully allocated cost. And, based on Mr. Parks' testimony and Petitioner's market study, we find SAMCO's charges were at market prices without the agreed increase. Given HSE's burden, the Commission concludes that HSE failed to demonstrate the agreed increase is reasonable, merited, or in the public interest. We do so in light of the evidence presented and caution HSE to prospectively demonstrate that profit is not being made by an affiliate interest upon the transactions.

B. Commission Discussion and Findings upon the Ten Percent Added Management Fee. Contrary to HSE's assertion, the evidence HSE presented is conflicting upon whether a ten percent management fee is customary. It also conflicts with Mr. Parks' testimony affirming his experience is otherwise. Tr. A-153.

Mr. Cochran testified on redirect that if a SAMCO employee spends an hour ordering materials for HSE, HSE will pay SAMCO for that hour of time, plus the value of the materials ordered times ten percent. Tr. B-65. The management fee is over and above reimbursement of SAMCO's costs. While Mr. Cochran testified that only a small fraction of the SAMCO invoices contain a ten percent mark-up, according to Ms. Stull, \$685,650 of SAMCO's test year charges were pass-through billings that included a management fee. Public's Ex. 1 at 46. This may be a relatively small fraction of SAMCO's invoices, but we find this dollar amount is significant. Mr. Cochran also testified that ten percent is only added to material costs and subcontractor work, but the Minimum Standard Filing Requirements ("MSFR") included an invoice from Pillar Group Risk Management, Inc. (MSRF # 10 at 19) for the annual premium for professional liability insurance. This invoice in the amount of \$18,687.80 was originally billed to SAMCO, and SAMCO then billed HSE \$9,343.90 for half the insurance premium, plus an additional \$934.39 for the ten percent management fee (MSFR # 10 at 18) for a total of \$10,278.29. HSE paid this invoice within a week of its receipt (MSFR # 10 at 18).

Ms. Stull testified the ten percent management fee is a mark-up SAMCO tacks on to pass-through billings from third-party vendors, but HSE is capable of paying the costs of operating its utility without SAMCO's assistance. She testified there is minimal time between when HSE receives and pays SAMCO's bills. Mr. Cochran, however, stated it continues today to be standard industry practice to mark-up material costs and subcontractor work, introducing on rebuttal copies of engineering firm rate schedules that he believed demonstrate similar companies charge a management fee. Pet. Ex. 8, KWC-1. In the 44683 Order it was assumed the management fee may be customary in the industry, but upon remand, we find the evidence in this record persuades us otherwise. Mr. Cochran acknowledged on cross-examination that not all the engineering contract examples he sponsored actually include a ten percent mark-up. Tr. B-70. Importantly, the following exchange also occurred on cross-examination of Mr. Cochran:

Q Well, would you agree with me that a utility with enough customers and enough opportunities to bill would be able to negotiate not having that term [management fee]?

A Might be able to.

Tr. B-74.

Ms. Stull testified that affiliates of other Indiana utilities bill their actual costs plus applicable overheads. They do not mark-up or add a profit component to the costs allocated or directly charged. Public's Ex. 1 at 47-48. Mr. Parks similarly testified that when he provided consulting engineer services, the Indianapolis Department of Public Works did not allow a mark-up. Given this testimony and Mr. Cochran's recognition that the ten percent management fee is a negotiable expense, we find it neither prudent nor reasonable to recover these dollars from ratepayers. HSE provided no evidence demonstrating SAMCO's mark-up on pass-through billings is cost based or justified. We find the evidence persuasive that it is also not market driven or required, that it is more probable that an engineering firm with an opportunity to provide over \$5 million annually in services will negotiate this fee. Mr. Cochran acknowledged that SAMCO itself charges different rates, depending on the size of the entity. Tr. B-104.

As implemented by SAMCO, HSE makes SAMCO whole for SAMCO's employees' time spent ordering materials or managing subcontractors and is then being asked to pay SAMCO ten percent more as a management fee that HSE failed to demonstrate is related to any benefit flowing to HSE and its ratepayers. Our findings and conclusion to disallow recovery of this mark-up from ratepayers is based upon the evidence presented, but we find it is also consistent with the NARUC guidelines recommendation that billings by non-regulated entities should be the lower of the fully allocated cost or prevailing market prices. To help avert subsidization and self-dealing, these guidelines recommend:

Generally, the price for services, products and the use of assets provided by a non-regulated affiliate to a regulated affiliate should be at the lower of fully allocated cost or prevailing market prices. Under appropriate circumstances, prices could be based on incremental cost, or other pricing mechanisms as determined by the regulator.

Public's Ex. 1, Attachment MAS-13 at 6. While these guidelines are not binding upon the Commission, they are consistent with prior Commission orders indicating that services and materials affiliates provide to utilities are to be at cost, with no profit to be made by the affiliated interest from the transaction. *Petition of L.M.H. Utils. Corp.*, Cause No. 43022 (IURC March 22, 2007). Although the NARUC guidelines and the Remand Order both recognize that "[u]nder appropriate circumstances, prices could be based on incremental cost, or other pricing mechanisms," Remand Order at 5, we find no such circumstances were established in this proceeding warranting recovery of a ten percent adder. Based on the evidence, we find this fee is negotiable, and with the operating dollars paid to SAMCO escalating, HSE should be incented to negotiate its cessation or demonstrate its cost justification. We further find that recovery of this fee, given the record, would afford an unwarranted premium to HSE's affiliate.

Based on the findings and discussion above, the Commission continues to find that SAMCO's *pro forma* Contract Services-Other expenses are \$2,003,649 and its *pro forma* Contract Services-Engineering expenses are \$1,822,762, consistent with the 44683 Order.

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

1. Petitioner remains authorized to increase its rates and charges for sewer utility service by 1.17%, or \$139,305, in accordance with the findings entered and the Order approved in this Cause on November 9, 2016, and the additional findings set forth above.
2. HSE is directed to offer evidence in its next rate case demonstrating the fully allocated cost of billings to HSE by an affiliate that HSE seeks to recover in its rates.
3. This Order shall be effective on and after the date of its approval.

HUSTON, FREEMAN, KREVDA, OBER, AND ZIEGNER CONCUR:

APPROVED: FEB 20 2019

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



Mary M. Becerra
Secretary of the Commission