STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF INDIANA-AMERICAN WATER COMPANY, INC. FOR APPROVAL OF (A) A NEW DISTRIBUTION SYSTEM IMPROVEMENT CHARGE ("DSIC") PURSUANT TO IND. CODE CHAP. 8-1-31; (B) A NEW RATE SCHEDULE REFLECTING THE DSIC; AND (C) INCLUSION OF THE COST OF ELIGIBLE DISTRIBUTION SYSTEM IMPROVEMENTS IN ITS DSIC

CAUSE NO. 42351 DSIC-10

TESTIMONY OF

CARL N. SEALS – PUBLIC’S EXHIBIT NO. 2

ON BEHALF OF THE

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

FEBRUARY 16, 2017

Respectfully submitted,

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TESTIMONY OF OUCC WITNESS CARL N. SEALS
CAUSE NO. 42351 DSIC-10
INDIANA-AMERICAN WATER COMPANY, INC.

I. INTRODUCTION

Q: Please state your name and business address.
A: My name is Carl N. Seals, and my business address is 115 West Washington Street, Suite 1500 South, Indianapolis, Indiana 46204.

Q: By whom are you employed and in what capacity?
A: I am employed by the Indiana Office of Utility Consumer Counselor (“OUCC”) as a Utility Analyst in the Water/Wastewater Division. My qualifications and experience are set forth in Appendix A.

Q: What is the purpose of your testimony?
A: The purpose of my testimony is to discuss Indiana-American Water Company, Inc.’s (“Indiana-American” or “Petitioner”) request to include the cost of capital improvements in the calculation of its Distribution System Improvement Charge (“DSIC”). I propose the costs of two projects involving the relocation of newer water mains be excluded from the DSIC.

Q: What have you done to prepare your testimony?
A: I reviewed Indiana-American’s petition, its case-in-chief consisting of the testimonies of witnesses Gary M. VerDouw and Stacy S. Hoffman, and Indiana-American’s workpapers. I also reviewed Excel spreadsheets and invoices submitted by the Petitioner in response to OUCC discovery as well as testimony and Orders of the Commission from previous DSIC cases. On February 10, 2017, I met with Indiana-American staff in Terre Haute, Indiana, to observe the retirement of a service line to a former residence that was to be demolished.
by the city. I reviewed pertinent portions of the final orders in Cause No. 42351 DSIC-1 and Cause No. 42351 DSIC-7, copies of which are attached hereto as Attachment CNS-1 and Attachment CNS-2, respectively.

Q: What distribution improvement costs does Petitioner include in its proposed DSIC?
A: Based on my review of invoices Petitioner provided in response to OUCC discovery, DSIC costs consisted primarily of planned water main replacements and other distribution system improvements. The cost of the planned improvements was $56,451,990 or 79% of the total $71,072,707 system improvements Indiana-American has included in this request. Indiana-American refers to planned projects as “non-blanket” projects. The remainder of the costs totaling $14,620,716 are for “blanket” projects including replacement of valves, hydrants, and meters and unscheduled or emergency repairs of water main and service line breaks. Petitioner’s Exhibit SSH-1.

II. WATER MAIN RELOCATIONS

Q: What is the purpose of the Distribution System Improvement Charge?
A: In Cause No. 42351 DSIC-1, the Commission noted in its order that “the purpose of a DSIC proceeding is to encourage, through an expedited and automatic rate increase, repair or replacement of a distribution system’s aging and failing infrastructure.” (Cause No. 42351 DSIC-1, Final Order, page 21.) According to Mr. James L. Cutshaw,1 Indiana-American’s witness in DSIC 1, a DSIC “is an innovative ratemaking mechanism that encourages and assists water utilities to make the investments necessary to replace aging infrastructure.” (Emphasis added.) Direct Testimony of James L. Cutshaw on Proposed Distribution

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1 Senior Financial Analyst for Indiana-American at the time.
System Improvement Charge, p. 4, filed December 19, 2002 in Cause No. 42351 DSIC-1.

Q: Do all of Petitioner’s DSIC projects involve replacing aging or failing infrastructure?
A: No. There are two projects in particular that involve main relocations that do not replace aging infrastructure. Projects R10-01D1.16-P-0048 and R10-01D1.16-P-0045 involve relocating mains that were placed in service less than 15 years ago. The main replaced in Project R10-01D1.16-P-0048 was placed in service in 2005, and the main replaced in R10-01D1.16-P-0045 was placed in service in 2007. These two projects total $125,876.

Q: Why are these two lines being replaced?
A: According to data filed in SSH-2, both mains needed to be moved because the water mains were “in conflict with sewer project[s].”

Q: Are main relocations a necessary cost of doing business?
A: Yes. The cost of main relocation should be an expected cost of operating a water utility. There are situations that may not reasonably be foreseen during the original planning of a utility’s mains that may later require the utility to relocate mains. To the extent the costs of relocation are reasonably incurred by the public water utility, it is appropriate that these costs be included in rate base. However, that does not mean such costs may necessarily be included in a DSIC, particularly where the lines being replaced as a result of the relocation are not in need of replacement due to their age or condition.

Q: Has the Commission ever addressed the age of plant being replaced for purposes of DSIC eligibility?
A: Yes. In Indiana-American’s seventh DSIC (Cause No. 42351 DSIC-7), the Commission declined to include the replacing of meters in service less than ten years as DSIC eligible projects. In the DSIC-7 Order, the Commission found that “recovery of the replacement cost of newer traditional meters with AMR meters does not fit within the context of the DSIC,
in that the Commission stated in DSIC-1 that the purpose of DSIC recovery is to replace aged infrastructure.” Final Order, Cause No. 42351 DSIC-7, p. 13

Q: Where should the costs of these relocation projects be recovered?
A: Indiana-American should seek to include the prudently incurred costs of these two projects in its next base rate case.

III. RECOMMENDATIONS

Q: Please summarize your recommendations:
A: I recommend the Commission exclude from the calculation of the DSIC projects R10-01D1.16-P-0048 and R10-01D1.16-P-0045.

Q: Does this conclude your testimony?
A: Yes.
APPENDIX A

Q: Please describe your educational background and experience.
A: In 1981 I graduated from Purdue University, where I received a Bachelor of Science degree in Industrial Management with a minor in Engineering. I was recruited by the Union Pacific, where I served as mechanical and maintenance supervisor and industrial engineer in both local and corporate settings. I then served as Industrial Engineer for a molded-rubber parts manufacturer before joining the Indiana Utility Regulatory Commission (“IURC”) as Engineer, Supervisor and Analyst for more than ten years. It was during my tenure at the IURC that I received my Master of Health Administration degree from Indiana University. After the IURC, I worked at Indiana-American Water Company, initially in their rates department, then managing their Shelbyville operations for eight years, and later served as Director of Regulatory Compliance and Contract Management for Veolia Water Indianapolis. I joined Citizens Energy Group as Rate & Regulatory Analyst following the October 2011 transfer of the Indianapolis water utility and joined the Office of Utility Consumer Counselor in April of 2016.
On December 19, 2002, pursuant to Indiana Code 8-1-31, Indiana-American Water Company, Inc. ("Petitioner" or "Indiana-American") filed its Petition seeking approval of a Distribution System Improvement Charge ("DSIC") for various improvement projects that were placed in service between August 1, 2001 and November 30, 2002. Given the statutory deadline requiring the Commission to issue an Order not later than sixty (60) days after a petition is filed under Indiana Code 8-1-31, the Presiding Officers, in lieu of convening a Prehearing Conference, issued a Docket Entry on December 27, 2002 establishing a procedural schedule for this Cause and scheduling an Evidentiary Hearing date of January 29, 2003. Petitioner prefiled its direct case-in-chief on December 19, 2002. The Indiana Office of Utility Consumer Counselor ("Public") prefiled its case-in-chief on January 21, 2003. The Petitioner prefiled rebuttal testimony on January 24, 2003.

Accompanying its Petition, on December 19, 2002, Petitioner filed a Verified Motion for Establishment of Procedures to Protect Against Disclosure of Confidential Information ("Motion to Protect Confidential Information"). The Motion to Protect Confidential Information sought confidential treatment of evidence to be introduced at the Evidentiary Hearing concerning Petitioner's security improvements made in response to the terrorist attacks of September 11, 2001. In addition to the claim of trade secrets, Petitioner claimed that detailed disclosure of its security improvements could jeopardize the effectiveness of its security system. In a December 30, 2002 Docket Entry, the Presiding Officers established a procedure that, following the public portion of the evidentiary hearing, an in camera session would be conducted for the purpose of eliciting detailed information about Petitioner's security improvements for which it was requesting approval of a DSIC. Attendance at the in camera session was limited to the Presiding
Officers, other Commissioners, and authorized Commission and Public employees. Based on a preliminary finding that the security improvements constituted trade secrets, the disclosure of which might also jeopardize a security system that is within the state's and national interest to protect, this Docket Entry provided that the record comprising the in camera session of the Evidentiary Hearing would be handled and maintained as confidential information, in accordance with Indiana Code 5-14-3.

Thereafter, and pursuant to notice published as required by law, an Evidentiary Hearing was convened on January 29, 2003 at 10:30 a.m. EST, in Room E-306 of the Indiana Government Center South, Indianapolis, Indiana. Petitioner and the Public attended and participated in the Evidentiary Hearing by presenting evidence into the record of this Cause. On January 29, 2003, at the conclusion of both the public and in camera sessions of the Evidentiary Hearing, this Cause was adjourned. On January 31, 2003, each party filed a Proposed Order that aligned with its testimonial position taken at the January 29, 2003 Evidentiary Hearing.

On January 30, 2003, Petitioner and the Public advised the Presiding Officers via telephone that they had reached a settlement agreement. The Presiding Officers agreed to consider a late-filed settlement agreement. On February 3, 2003, the parties filed their Stipulation and Settlement Agreement and a joint Proposed Order. Also filed on February 3, 2003, was Petitioner’s Notice with Respect to 60-Day Deadline, which stated Petitioner recognized that the Commission’s receipt and consideration of a settlement agreement at this point in the proceedings would require time beyond that allowed by Indiana Code 8-1-31-9(c) for the Commission to issue its Order and Petitioner would have no objection to an Order being issued beyond the 60-day deadline so long as an Order was issued by March 5, 2003. In order to receive the Stipulation and Settlement Agreement into the record of this proceeding, this Cause was public noticed according to law for an Evidentiary Hearing to be conducted on February 14, 2003. With Petitioner and the Public in attendance, this Cause was reopened on February 14, 2003, at 1:30 p.m. EST, in Room E306 of the Indiana Government Center South, Indianapolis, Indiana. The Stipulation and Settlement Agreement was admitted into the record at the Evidentiary Hearing and, with no members of the general public appearing or having expressed a desire to be heard, this Cause was adjourned.

1. **Notice and Jurisdiction.** The Commission published notice of the public Evidentiary Hearings held in this Cause as required by law. Petitioner is a “public utility” within the meaning of Indiana Code 8-1-2-1 and is subject to the jurisdiction of the Commission in the manner and to the extent provided by the laws of the State of Indiana. This Commission has jurisdiction over Petitioner and the subject matter of this proceeding.

2. **Petitioner’s Characteristics.** Petitioner is an Indiana corporation engaged in the business of providing water utility service to approximately 268,000 customers in twenty-one (21) counties in the State of Indiana. Petitioner's corporate office is located in the City of Greenwood, Indiana. Petitioner provides water utility service by means of water utility plant, property, equipment and related facilities owned,
leased, operated, managed and controlled by it, which are used and useful for the convenience of the public in the production, treatment, transmission, distribution and sale of water for residential, commercial, industrial, sale for resale, public authority and public and private fire protection purposes. In addition, Petitioner provides sewer utility service in the City of Somerset, Wabash County, Indiana and in or near the City of Muncie, Delaware County, Indiana.

3. **Indiana Code 8-1-31.** Effective July 1, 2000, the Indiana Legislature enacted Indiana Code 8-1-31 which provides for the Commission to approve distribution system improvement charges in order to allow water utilities to automatically adjust their basic rates and charges to recover a pre-tax return and depreciation expense on Eligible Distribution System Improvements. Eligible Distribution System Improvements are defined as new, used and useful water utility plant projects that:

   (a) do not increase revenues by connecting the distribution system to new customers;
   (b) are in service; and
   (c) were not included in the public utility's rate base in its most recent general rate case. Indiana Code 8-1-31-5.

A petition under Indiana Code 8-1-31 may not be filed more than once every twelve (12) months or in the same calendar year in which the public utility has petitioned the Commission for a general increase in its basic rates and charges. Indiana Code 8-1-31-10. The rate of return allowed on Eligible Distribution System Improvements is equal to the public utility's weighted cost of capital. Unless the Commission finds that such determination is no longer representative of current conditions, the cost of common equity to be used in determining the weighted cost of capital shall be the most recent determination by the Commission in a general rate proceeding of the public utility. Indiana Code 8-1-31-12. The Commission may not approve a DSIC to the extent the proposed DSIC would produce total DSIC revenues exceeding 5% of the public utility's base revenue level approved by the Commission in the most recent general rate proceeding. Indiana Code 8-1-31-13. The DSIC is to be calculated based upon a reasonable estimate of sales in the period in which the charge will be in effect. At the end of each 12 month period with the charges in effect, the difference between the revenues produced through the DSIC ("DSIC revenues") and the depreciation expense and pre-tax return associated with the Eligible Distribution System Improvements ("DSIC costs") shall be reconciled and the difference refunded or recovered as the case may be through adjustment of the DSIC. Indiana Code 8-1-31-14. When a petition to establish a DSIC is filed, the Public may, within thirty (30) days of the petition being filed, confirm that the system improvements are eligible and that the charges were properly calculated, and submit a report to the Commission. The Commission is required to hold a hearing and issue its order not later than 60 days after the petition is filed. Indiana Code 8-1-31-9.

4. **Relief Requested.** Petitioner seeks approval of a DSIC pursuant to Indiana Code 8-1-31, a new rate schedule reflecting the DSIC, and inclusion of the cost
of the Eligible Distribution System Improvements in Petitioner's DSIC. Briefly stated, Petitioner seeks to recover its DSIC costs for Eligible Distribution System Improvements placed in service between August 1, 2001 and November 30, 2002 amounting to $11,959,762. (The total cost of the projects for which Indiana-American claims the ability to recover through a DSIC is $13,270,267, with $11,959,762 representing the investor supplied additions and being the figure used to determine the requested DSIC revenue requirement due to reimbursement from the Indiana Department of Transportation ("INDOT") in the amount $1,310,504.) The depreciation expense of such improvements is $297,503 (calculated by using Petitioner's current Commission-approved depreciation accrual rates), with a return on the improvements using a weighted after-tax cost of capital of 7.83% (10.81% on a pre-tax basis). The rate of return was calculated based on Petitioner's current capital structure and debt cost rate and the cost of common equity determined by the Commission in Petitioner's last rate order. Petitioner's proposed DSIC would produce additional annual revenues of approximately $1,590,353, which would equate to an increase of approximately 1.29% above the rates currently in effect.

5. **Petitioner's Direct Evidence.** Petitioner's direct evidence was presented and supported by two (2) of its officers: Assistant Treasurer and Assistant Secretary James L. Cutshaw, who is a Senior Financial Analyst for Petitioner, and Alan J. DeBoy, Vice President of Engineering.

Mr. Cutshaw provided some general background information about DSICs, testifying that the purpose served by a DSIC is to provide an innovative ratemaking mechanism necessary to replace aging infrastructure, which is an issue of national concern. Mr. Cutshaw testified that DSIC revenues to be derived from approval of the Petition would amount to $1,590,353, which is 1.29% of its current base revenue level of $123,449,194. Mr. Cutshaw provided evidence concerning the calculation of the proposed DSIC and sponsored, as **Petitioner's Exhibit JLC-1**, Petitioner's proposed rate schedules reflecting the DSIC. He explained that the rate of return used in the DSIC revenue requirement calculation is Petitioner's weighted average cost of capital derived from Petitioner's capital structure as of November 30, 2002. The long-term debt cost rate used in the calculation is the average embedded long-term debt cost rate as of that date. A common equity cost rate of 10.5% was used because that rate was determined by the Commission in Petitioner's most recent general rate case in Cause No. 42029. The result is a weighted average cost of capital of 7.83% on an after-tax basis. This rate was converted to a pre-tax rate of 10.81% to include revenues for state and federal income taxes.

Depreciation expense was calculated by applying the applicable Commission-approved depreciation accrual rates to the Eligible Distribution System Improvements, net of related retirements. The proposed DSIC volumetric rate was calculated by dividing the DSIC revenue requirement by Petitioner's projected 2003 water sales. Mr. Cutshaw testified that the DSIC revenues that would be produced by the proposed DSIC will be less than 5% of Petitioner's base revenue level as approved in Petitioner's last base rate order.
Petitioner’s witness Alan J. DeBoy sponsored Petitioner’s Exhibit AJD-1 that gave a brief description of each improvement project, the cost of each project, the date each project was placed in service, the account number assigned to each project based on accounting standards found in the Uniform System of Accounts, and Petitioner’s operation area where each project exists. Mr. DeBoy generally described the projects as being replacement infrastructure, reinforcement infrastructure, or security improvements. Mr. DeBoy defined replacement infrastructure as consisting of mains, valves, hydrants, customer services, a water storage tank, process unit components like filter media, coating systems, and sludge collector drive units. Mr. DeBoy stated that a significant portion of main replacements are associated with right-of-way improvement projects where the location of Petitioner’s mains conflicts with municipal improvement projects. Reinforcement projects, according to Mr. DeBoy, are projects that improve service to large areas of the existing distribution system by increasing flow capacity, and consist of new mains, a water storage tank in Hobart, Indiana, and a pump station located in Petitioner’s Northwest operation referred to as the Taft Street Pump Station. Mr. DeBoy stated that security improvements provide enhancements that deter, delay and detect unauthorized entry to water utility property.

Mr. DeBoy also provided testimony that each improvement listed on Petitioner’s Exhibit AJD-1 was an “Eligible Distribution System Improvement” as defined in Indiana Code 8-1-31-5. As to the eligibility requirement that a project not increase revenues by connecting the distribution system to new customers, Mr. DeBoy testified that he had an understanding and familiarity with all of the projects listed on Petitioner’s Exhibit AJD-1, and none on them increased revenues by connecting the distribution system to new customers. Regarding the second statutory eligibility requirement that all projects are in service, Mr. DeBoy stated that he has personal knowledge of the projects listed on Petitioner’s Exhibit AJD-1. Mr. DeBoy further testified as to his understanding that before an in service date can be designated on Petitioner’s accounting system the person responsible for oversight of the project must conduct a physical inspection to confirm that the project is in service. Mr. DeBoy also reiterated Mr. Cutshaw’s testimony that none of the improvements were included in Petitioner’s rate base in its most recent general rate case. Mr. DeBoy testified that the rate base cutoff date used in Petitioner’s last general rate case was July 31, 2001, and that all projects listed on Petitioner’s Exhibit AJD-1 reflect in service dates subsequent to July 31, 2001.

6. Public’s Case-In-Chief. The Public’s case-in-chief was presented through three (3) of its employees: Edward R. Kaufman, Lead Financial Analyst in the Rates/Water/Sewer Division; Judith I. Gemmecke, Utility Analyst; and Scott A. Bell, Assistant Director of the Sewer/Water Division.

Mr. Kaufman asserted that Petitioner should not be allowed to recover through a DSIC proceeding those improvements to components of its utility that comprise source of supply, water treatment plant, general plant or security. After removing improvements to those utility components that should be disallowed, Mr. Kaufman proposed that completed plant amounting to $7,723,795 could be included in Petitioner’s DSIC.
In his testimony, Public's witness Mr. Kaufman discussed the theory behind DSICs. Mr. Kaufman asserted that the DSIC was created as a special tool to provide utilities with additional resources to accelerate the replacement of aged distribution assets. Mr. Kaufman supported his analysis by quoting several sources including a January 18, 2000 memo from Eric W. Thornburg, former Vice President of Indiana-American, to the Members of the Indiana Senate Committee on Commerce and Consumer Affairs. This memo was included as Attachment No. 1 to Public's Exhibit No. 1. In that memo Mr. Thornburg stated as follows:

This new technique will allow for the replacement of aged infrastructure, primarily pipelines, without the necessity of filing for a rate increase with the added cost to customers and delay of such undertakings. It does not include new main extensions that would produce additional revenues for the utility.

Mr. Kaufman then discussed the factors that differentiated distribution mains and other distribution assets from other investments made by utilities between rate cases. In Public's Exhibit No. 1, pgs. 7 & 8, Mr. Kaufman asserted as follows:

There are several factors which in combination give weight to the need for a DSIC to specifically promote the replacement of old distribution system assets:

1) The scope of replacing these assets is very large.

2) The replacement of distribution system assets is ongoing or continuous in nature.

3) The replacement of distribution assets is a series of many small projects. Thus, a utility is unable to time a rate case around their replacement as it could for a single large project.

Mr. Kaufman added that if one accepts the supposition that the factors described above are so severe that traditional ratemaking is unlikely to adequately facilitate necessary infrastructure improvements on a large scale, then the same rationale needs to be used to determine what plant should be approved in a DSIC case. Mr. Kaufman contended that the purpose of a DSIC is to accelerate the repair and replacement of aging infrastructure that has not or would not occur under traditional ratemaking. He added that the DSIC was created as a special tool to promote the adequate replacement of old and/or dilapidated distribution assets. The DSIC should not be applied to typical investments made by water utilities on a regular basis and investments that can be handled through traditional ratemaking should be handled in that manner.

Mr. Kaufman also noted that Petitioner's proposed DSIC seeks to earn a return on and return of assets that did not rehabilitate its distribution system and that Petitioner was
using the DSIC as a catch-all for virtually all of its rate base additions (other than those that increase revenues by hooking up new customers to the distribution system). Mr. Kaufman then referred to several of Petitioner's responses to data request questions that highlighted Petitioner's assertion that the DSIC was designed to include treatment plant, general plant and source of supply assets as well as distribution assets. Mr. Kaufman added that Indiana-American's response to data request question 36 indicated that Indiana-American has not accelerated the replacement of its mains as a result of the opportunity to collect DSIC revenues.

Mr. Kaufman also asserted that the limited time frame of a DSIC procedure limited the Public's ability to conduct meaningful fact finding and that a DSIC procedure should not include additions that are controversial and/or require a lengthy review. Additionally, Mr. Kaufman stated that the DSICs used in Pennsylvania and Illinois had significant differences than the DSIC proposed by Petitioner. The key differences were that both Illinois' and Pennsylvania's DSICs limited recovery to very specific account categories, included an earnings test and required consumer notification. Finally, Mr. Kaufman proposed that any future DSIC should include a 10-year projection of plans to repair and rehabilitate its distribution. Mr. Kaufman argued that since the rationale of the DSIC is to promote the replacement of aging infrastructure it seems logical that utilities should have a plan on how and when they intends to replace aging infrastructure. Such a plan will help to address the concerns expressed by the parties that led to creation of the DSIC.

Also testifying on behalf of the Public was accountant, Judith I. Gemmecke. Ms. Gemmecke echoed Mr. Kaufman's beliefs about what should be included in a DSIC and discussed specific calculations of the DSIC given certain parameters shown below. In considering Ms. Gemmecke's testimony it is important to note that Petitioner presented its calculation for the DSIC which included a return of 10.81% (before tax) on additions made which Petitioner asserts are subject to the surcharge, less the amounts contributed by INDOT. To that result, Petitioner added depreciation, which it calculated by subtracting retirements from the total additions of assets. Ms. Gemmecke noted that by making no adjustment for those contributed funds, this calculation allows depreciation on Contributions in Aid of Construction ("CIAC").

Ms. Gemmecke, presented her calculation of the DSIC, which also included the 10.81% before tax return, but only on the additions the Public recommends should be allowed in the DSIC as discussed earlier. Her calculation decreases the allowable additions by the amount of related retirements at original cost. To that result, Ms. Gemmecke also added depreciation expense, which she calculated by subtracting retirements from the total additions of allowable assets. By making no adjustment for funds contributed by INDOT, this calculation also allows for depreciation to be collected on CIAC. Ms. Gemmecke points out in her testimony that Indiana is one of a handful of states that allows water utilities to collect depreciation on CIAC. Allowing depreciation on contributed plant accomplishes many of the same goals the DSIC was intended to accomplish -- namely, providing additional funds to replace aging distribution systems.
On page 6 of Public's Exhibit No. 2, Ms. Gemmecke included the following accounts in her calculation of the DSIC:

<table>
<thead>
<tr>
<th>Account</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>331001</td>
<td>TD (Transmission/Distribution) Mains Not Classified by Size (formerly Mains Conversions)</td>
</tr>
<tr>
<td>333000</td>
<td>Services</td>
</tr>
<tr>
<td>334200</td>
<td>Meter Installations</td>
</tr>
<tr>
<td>335000</td>
<td>Hydrants</td>
</tr>
</tbody>
</table>

The Public encouraged the Commission to use these same accounts in determining eligibility for a DSIC, especially in light of the time limitations for conducting discovery, conducting an evidentiary hearing, and issuing a final order.

The Public's engineering witness, Mr. Scott A. Bell, Assistant Director of the Public's Rates/Water/Sewer Division, testified that Petitioner's investments in Source of Supply, Water Treatment Plant and General Plant should not be included in the calculation of the DSIC. He also stated that there are some items Petitioner listed as Transmission and Distribution Plant that should also not be included in the calculation of the DSIC. Mr. Bell pointed out that Petitioner made investments in "Tank Security Improvements" in a number of its operational areas that total approximately $1,977,417. He stated that Petitioner has categorized those investments as "Transmission and Distribution Plant" and assigned to Account No. 330000. While having no independent knowledge of the exact nature of the security improvements other than what was represented by Petitioner in its pre-filed testimony, Mr. Bell testified that these "Tank Security Improvements" should not be considered eligible for inclusion in the calculation of the DSIC because these improvements are not repairs or replacements of aging transmission and distribution infrastructure, but rather are investments in the new security systems as a result of the increased security risks after September 11, 2001. He concluded that while it is important that a utility make prudent investments in security, such improvements should not be considered eligible for inclusion in the calculation of the DSIC. Mr. Bell recommended that Petitioner should recover its security related investments in a more appropriate proceeding.

Mr. Bell also testified about Petitioner's inclusion of the 1.5 MG water storage tank in Hobart, Indiana, which represents an investment of approximately $1,644,841. He testified that the water storage tank and associated facilities should not be eligible for inclusion in the calculation of the DSIC because the investment Petitioner made in the Hobart water storage tank was not only to replace an aging water storage facility, but also to provide additional storage capacity to adequately serve increasing water demands or to meet fire-flow requirements. He stated that, in effect, the Hobart water storage tank would increase Indiana-American's revenue by making it possible to connect the distribution system to new users. He concluded that the investment in the 1.5 MG storage facility should not be considered DSIC eligible.
7. **Petitioner’s Rebuttal.** Mr. Cutshaw responded to the Public’s testimony to exclude improvements that have been recorded as Source of Supply, Water Treatment Plant, General Plant, Distribution Reservoirs and security improvements. Mr. Cutshaw testified that Indiana-American reviewed the language of the statute, as written, to determine what improvements are and are not eligible. Mr. Cutshaw suggests that the Public is attempting to add factors not provided in the statute and is relying on variations of the DSIC implemented in the States of Pennsylvania and Illinois to support its position. Mr. Cutshaw testified that these additional factors are not found in Indiana Code 8-1-31 and stated that Indiana-American’s proposed DSIC is calculated pursuant to the definition the Legislature used.

Mr. Cutshaw stated that it is significant that some of the improvements Indiana-American included as "Eligible Distribution System Improvements" could not be included in a similar rate adjustment in either Illinois or Pennsylvania because it reveals the differences in the Indiana legislation as compared to Pennsylvania and Illinois. He explained that the Pennsylvania variety of the DSIC was first employed before there was a statute specifically authorizing it. The Pennsylvania Public Utility Commission established its DSIC in the order that is included with Mr. Kaufman’s testimony as Attachment No. 4. The only statutory authority for the request was the generic authority to approve automatic tracker mechanisms. The Pennsylvania Commission approved of the concept of a DSIC, and in the process, established all of the procedures and requirements for a DSIC without any guidance from the legislature. In doing so, the Commission defined what is and is not eligible. After the Pennsylvania DSIC was first approved in this fashion, the Pennsylvania legislature confirmed what the Commission had done, and left all decisions regarding the eligibility and implementation to the Pennsylvania Commission. 66 Pa. Cons. Stat. § 1307(g).

Mr. Cutshaw further testified that the Illinois variety of the DSIC is likewise very general. The Illinois legislature left the decision whether to approve a DSIC entirely up to the Commission, indicating that the Commission "may authorize" the mechanism. 220 Ill. Code § 5/9-220.2. Mr. Cutshaw states these differences are significant for purposes of Indiana’s DSIC legislation because this alternative approach was available to the General Assembly when Indiana Code 8-1-31 was enacted. The Legislature could have left to the Commission the decisions whether a DSIC should be approved, what would be eligible and what procedures would govern, as has been done in both Illinois and Pennsylvania. He speculated that the Legislature chose not to do so and instead specifically chose to define what is authorized as a DSIC.

Mr. Cutshaw responds to Mr. Kaufman’s concerns that Indiana-American has not increased its investment in the replacement of mains by noting that Indiana-American makes its investment decisions based upon what will be needed, when it will be needed, and whether and to what extent there is capital available. Indiana-American believes the DSIC should help with its ability to access capital by mitigating some of the effects of regulatory lag. The DSIC should therefore help Petitioner in its ability to make all types of rehabilitations, replacements, and improvements throughout its utility systems. Mr. Cutshaw did not consider it appropriate to eliminate the Hobart storage tank from the
DSIC asserting it was not included in rate base in Cause No. 42029, and that it does not increase revenues by connecting new customers. He also stated that, while not a requirement under Indiana Code 8-1-31, the Hobart storage tank is a replacement of existing tanks as explained by Mr. DeBoy.

In defending the inclusion of security costs, Mr. Cutshaw testified that the security improvements are improvements to existing infrastructure. Mr. Cutshaw suggests that if a 100-foot section of a main is replaced, the overall main will have been improved. In the same manner, if an investment is made to secure one of its facilities against a terrorist attack, the facility will have been improved. He does not believe an improvement to existing infrastructure should be treated any differently from the replacement of existing infrastructure. Mr. Cutshaw further testified that he believed adequate access to information had been provided to the Public related to the security improvements and he finds it significant that a Non-Disclosure Agreement was executed with the Utility Consumer Counselor and the Public’s Water and Sewer/Rates Director. Mr. Cutshaw also disagreed that Indiana-American has provided no more information on the security-related improvements than it provided on security expense in Cause No. 42029. He stated that at issue in Cause No. 42029 were security-related Operation and Maintenance expenses as opposed to the capital items at issue here. He explained that Indiana-American has provided in this proceeding every security task order number, the total amount for each, and the operation for each in Petitioner’s Exhibit AJD-1. Indiana-American also provided information on security capital expenditures through the presentation of its case-in-chief during the in camera portion of the hearing. Finally, Indiana-American’s witnesses have been available to respond to any questions about the security program or task orders that are included in Petitioner’s Exhibit AJD-1.

As to Mr. Kaufman’s concern that the type of review that would be done in a rate case cannot be completed during the abbreviated process for a DSIC, Mr. Cutshaw stated that the DSIC was not intended to be and will not result in a final determination that the DSIC assets are in rate base for purposes of a general rate case. The Public will have the opportunity to conduct a full rate base review in its next general rate case.

Mr. Cutshaw stated that he did not believe limitations on accounts that are eligible for DSIC and an earnings test would be consistent with Indiana Code 8-1-31. However, Mr. Cutshaw believed a requirement for customer notice and a requirement that a utility file a forecast that could be updated in future DSIC proceedings could be consistent with the DSIC statute and could be adopted if the Commission finds appropriate. Mr. Cutshaw stated Indiana-American would be willing to comply with these requirements in future DSIC proceedings if the Commission requests, but suggested a five-year forecast instead of ten years.

Mr. Cutshaw does not agree with the Public’s assertion that retirements should be deducted from additions subject to DSIC in determining the net investor supplied DSIC additions to which the pre-tax return is applied. Mr. Cutshaw explained that under mass asset accounting rules, retirements are treated as fully depreciated with the original cost.
being deducted from both utility plant and accumulated depreciation. Such a retirement results in no change to the net book value of the Company's assets.

Mr. Cutshaw also disagreed with the depreciation rates used by the Public because different depreciation rates apply to Petitioner's Northwest, Mooresville, Warsaw, West Lafayette, and Winchester operations. Mr. Cutshaw provided a table that was later corrected at the hearing which reflects the appropriate depreciation rates. Next, Mr. Cutshaw disagreed with the Public's conversion from MGAL to CCF. Indiana-American determined the conversion to CCF (hundred cubic feet) by dividing the MGAL (thousand gallons) by 0.75. He explained that this is the same relationship that has existed in the Company's tariff sheets for many years.

Finally, Mr. Cutshaw disagreed with the Public's suggestion to separate Water Groups 1, 2, 3 into Water Group 1, Water Group 2, and Water Group 3. Mr. Cutshaw explained that this is inappropriate because the company's rate design has moved toward Single Tariff Pricing ("STP"). Rate base and operating income findings have been proposed and approved for the combined Groups, not for each separate Group mainly because there are different groupings for General Water Service, Sales for Resale, Private Fire Protection, and Public Fire Protection. The Groups shown on Schedule No. 1 of Public's Exhibit No. 2 are the Sales for Resale groupings. For General Water Service there are only two Groups, with Johnson County and Southern Indiana in Group 2. Mr. Cutshaw stated it is consistent with the movement towards STP to continue to make one finding for Water Groups 1, 2, 3 as a whole as proposed on Petitioner's Exhibit JLC-2.

During Indiana-American's rebuttal case, Mr. DeBoy testified that he did not agree with Mr. Bell's opinion that the Hobart water storage tank should not be included in this case. He asserted that the Hobart tank satisfied the conditions for eligible distribution system improvements put forth in Mr. Cutshaw's testimony. Mr. DeBoy testified that he believed that Mr. Bell proposed to exclude the tank because it is new as opposed to replacement infrastructure. Mr. DeBoy noted that there is nothing in the statute that states only replacement infrastructure is eligible. He went on to explain that, in fact, the Hobart water storage tank actually replaced three elevated water storage tanks that were beyond economical repair.

8. Commission Findings and Analysis. We note, first, that the Petitioner and Public have filed a Stipulation and Settlement Agreement. The Commission has a clear standard for its review and consideration of settlement agreements. Settlements presented to the Commission are not ordinary contracts between private parties. United States Gypsum, Inc. v. Indiana Gas Co., 735 N.E.2d 790, 803 (Ind. 2000). When the Commission approves a settlement, that settlement "loses its status as a strictly private contract and takes on a public interest gloss." Id. (quoting Citizens Action Coalition v. IPL Energy, 664 N.E.2d 401, 406 (Ind. Ct. App. 1996)). Thus, the Commission "may not accept a settlement merely because the private parties are satisfied; rather [the Commission] must consider whether the public interest will be served by accepting the settlement." Citizens Action Coalition, 664 N.E.2d at 406.
As will be explained more fully below, we find that the public interest will not be served by approving the parties' settlement.

A determination of whether the Petition filed herein complies with Indiana Code 8-1-31 hinges on the phrase “distribution system.” This phrase is not defined in Indiana Code 8-1-31 or elsewhere in Title 8 of the Indiana Code. In addition, the testimony of the Parties agrees neither on the meaning nor significance of this phrase. Petitioner contends that any improvement to a water utility qualifies for a DSIC so long as the improvement meets the eligibility criteria of (1) not increasing revenues by connecting the distribution system to new customers, (2) being in service, and (3) not being included in the public utility’s rate base in the most recent general rate case. Indiana Code 8-1-31-5. Petitioner encourages the Commission to look to the plain language of the statute and find that any improvement to any component of a water utility qualifies for a DSIC, limited only by the above three (3) eligibility criteria. The Public, on the other hand, supports a more limited meaning of “distribution system,” relying on legislative intent, DSIC legislation in other states, as well as an interpretation of the language of Indiana’s DSIC statute that may tend to argue against the broad view advocated by Petitioner.

A. Meaning of “Distribution System.” Use of the phrase “distribution system” as applied to different types of utilities, and of the phrase “water distribution system” as applied specifically to water utilities, is not foreign or uncommon to the Commission or to those whom it regulates. This Commission has used the phrases “distribution system” or “water distribution system” to identify one component of a water utility that is distinguishable from other water utility components. By way of example, on September 18, 2002, in Cause No. 42226, the Commission issued an Order in a proceeding brought by the same Petitioner in this proceeding, Indiana-American Water Company, Inc., seeking approval to acquire the water distribution system properties of the Town of Dune Acres. The Commission’s Order in that acquisition proceeding restated Indiana-American’s testimony as to the relief it was seeking: “He (Indiana-American witness, Randal D. Edgemon) testified that Indiana-American proposes to acquire only the distribution system assets consisting of the distribution mains, valves, hydrants and other appurtenances necessary to provide water service. This also includes the service lines, meters, and meter installation. Mr. Edgemon testified that Indiana-American is not purchasing the source of supply, storage or booster pumps related to source and treatment from Dune Acres. The remaining facilities not purchased will not be needed to provide service after the system is interconnected to Indiana-American’s Northwest Operation.” Cause No. 42226, September 18, 2002, pg.3.

Other Commission Orders have also distinguished the distribution system from other functional components of a water utility. See, for example, Cause No. 41684, August 4, 2000, pgs. 3 & 4: “The directors of North Dearborn Water Corporation authorized Robert E. Curry & Associates to perform an engineering study of the utility’s source of water supplies, water treatment, water distribution system and elevated water storage for the purpose of determining the adequacy of the existing water works facilities to accommodate present and future water demands to the utility.” In Cause No. 41879, July 3, 2001, pg. 2, it states: “Petitioner’s facilities consist of a water distribution system serving the customers and a water treatment plant rated at 350,000 gal/day that was built
in 1952. Petitioner's facilities also include 2 wells with a pumping capacity of 350 GPM each and a water tower with a capacity of 150,000 gallons. From these examples, the commonly recognized components of a water utility are its source of supply (underground wells or surface water), treatment (water treatment plants), storage (elevated water storage tanks), and distribution (mains/pipes, valves, hydrants and meters needed to deliver water to customers). In short, this Commission and regulated water utilities commonly differentiate among their various utility components, including the segregation of activity into the "distribution system."

This differentiation was established in this proceeding in a response to a discovery request from the Public asking Petitioner to identify the categories of all relevant capital improvements. The discovery response, submitted by the Public into evidence (Public's Exhibit No. 1, Attachment No. 3, pg. 20), is a table containing information that Petitioner prepared using the same accounting format as other water utilities when submitting their Annual Reports to the Commission. More specifically, this table is an account matrix that corresponds to accounting practices originally promulgated by the National Association of Regulatory Utility Commissioners ("NARUC") and then adopted by most state public utility commissions, including Indiana's Commission. Indiana's adoption, by reference, of NARUC's rules governing the classification of accounts for water utilities is found at 170 IAC 6-2-2. A summary of Petitioner's account matrix, categorizing all of its proposed DSIC eligible projects, is illustrated below. The "Subsidiary Accounts" and their corresponding numbers shown on the vertical axis are further segregated by the matrix into classifications by function as shown on the horizontal axis (EG: "Source of Supply," "Water Treatment," and "Transmission and Distribution").
<table>
<thead>
<tr>
<th>Subsidiary Account</th>
<th>Description</th>
<th>Amount</th>
<th>Source of Supply/ Pumping Plant (SS)(PU)</th>
<th>Water Treatment Plant (WT)</th>
<th>Transmission &amp; Distribution Plant (TD)</th>
<th>General Plant</th>
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<tr>
<td>303200</td>
<td>Land SS</td>
<td>143,998.81</td>
<td>143,998.81</td>
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<tr>
<td>304100</td>
<td>Structures SS</td>
<td>74,673.16</td>
<td>74,673.16</td>
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<tr>
<td>304200</td>
<td>Structures PU</td>
<td>545,787.04</td>
<td>545,787.04</td>
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<td></td>
<td></td>
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<tr>
<td>304300</td>
<td>Structures WT</td>
<td>111,572.31</td>
<td>111,572.31</td>
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<td></td>
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<tr>
<td>304302</td>
<td>Tank Ptg WT</td>
<td>49,498.00</td>
<td>49,498.00</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>304800</td>
<td>Structures Misc</td>
<td>51,299.61</td>
<td></td>
<td></td>
<td></td>
<td>51,299.61</td>
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<tr>
<td>307000</td>
<td>Wells &amp; Springs</td>
<td>31,632.50</td>
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<td></td>
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</tr>
<tr>
<td>311200</td>
<td>Pump Eq Elec</td>
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<tr>
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<tr>
<td>320190</td>
<td>Wt Equip Clear</td>
<td>60,529.00</td>
<td></td>
<td>60,529.00</td>
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<tr>
<td>320191</td>
<td>WT Equip Plant</td>
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<td></td>
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<tr>
<td>330000</td>
<td>Dist Reserv</td>
<td>3,622,258.29</td>
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<tr>
<td>331001</td>
<td>Mains</td>
<td>5,020,306.63</td>
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<td>5,020,306.63</td>
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<td></td>
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<tr>
<td>333000</td>
<td>Services</td>
<td>1,279,349.58</td>
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<td>1,279,349.58</td>
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<td>334200</td>
<td>Mtr Installs</td>
<td>1,074,128.33</td>
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<td>335000</td>
<td>Hydrants</td>
<td>350,010.33</td>
<td></td>
<td>350,010.33</td>
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</tr>
<tr>
<td>343000</td>
<td>Tools/Shop</td>
<td>4,339.00</td>
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<tr>
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<td>Comm Equip</td>
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<td></td>
<td>30,085.00</td>
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<tr>
<td>346190</td>
<td>Remote Instrum</td>
<td>10,608.00</td>
<td></td>
<td>10,608.00</td>
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</tr>
<tr>
<td>347000</td>
<td>Misc Equip</td>
<td>58,588.08</td>
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<td></td>
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<td>58,588.08</td>
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<tr>
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<td></td>
<td>13,270,267.31</td>
<td>11,179,541.60</td>
<td>589,752.86</td>
<td>11,346,053.16</td>
<td>154,919.69</td>
</tr>
</tbody>
</table>

The Public’s evidence supports, for DSIC purposes, those project amounts identified in Subsidiary Account Nos. 331001 (Mains), 333000 (Services), 334200 (Meter Installations), and 335000 (Hydrants), totaling $7,723,795, all of which are further categorized functionally on the matrix within “Transmission & Distribution Plant.” The only other Subsidiary Account Petitioner lists within “Transmission and Distribution Plant,” and for which the Public’s evidence supports exclusion from DSIC, is No. 330000 (Distribution Reservoir), amounting to $3,622,258.29, which the evidence shows accounts for all “Tank Security Improvements,” and the installation of a 1.5 million gallon water storage tank in Hobart, Indiana.

This breakdown of a water utility into its various functional components is also used by the American Water Works Association (“AWWA”). In response to a bench question as to his definition of “distribution system,” the Public’s engineering witness, Scott A. Bell, answered by referring to the AWWA’s Manual: *Principles of Water Rates, Fees, and Charges*. Mr. Bell specifically referred to Table 7-1 in the section of the manual regarding “Allocating Costs of Service to Cost Components,” and described how that table separates a water utility’s components into Intangible Plant, Source of Supply Plant, Water Treatment Plant, Transmission and Distribution Plant and General Plant.
We believe that the AWWA manual and NARUC’s accounting system are consistent with the general understanding in the industry of what can and cannot properly be described as distribution system improvements in the context of water utility plant projects. Items that fall within the other functional categories (EG: Source of Supply/Pumping Plant, Water Treatment Plant, and General Plant) should not be considered distribution system for purposes of a DSIC.

B. DSIC Laws in Other States. We also note, as referenced in the Public’s testimony, the comparison of Indiana’s DSIC statute with the DSIC statutes enacted in other states, specifically Pennsylvania and Illinois. The DSIC statutes in these states contain many obvious similarities to Indiana’s statute. In its Exhibit No. 1, Attachment No. 4, the Public produced in evidence an Order from the Pennsylvania Public Utility Commission (“PPUC”) that discusses that state’s DSIC statute. One issue before the PPUC in that proceeding, and an issue presented by the Public in this proceeding, was a concern that the DSIC statute would be in conflict with the traditional ratemaking process. In Public’s Exhibit No. 1, Attachment No. 4, pgs. 11 & 12 the PPUC states: “Recovery of this narrow set of (DSIC) costs is clearly permitted under Section 1307 (a)…and Pennsylvania case law; and, in the Commission’s judgment, this proposal (“to file and implement an automatic adjustment clause to recover its distribution system improvement costs”) is in no way a mechanism to “disassemble” the traditional ratemaking process for several reasons: first, the DSIC is designed to identify and recover the distribution system improvements costs incurred between rate cases; second, the costs to be recovered represent a narrow subset of the company’s total cost of service; and third, the DSIC will be capped at a relatively low level to prevent any long-term evasion of a base rate review of these plant costs.”

In this same Pennsylvania proceeding, the PPUC spoke generally about the purpose of a DSIC: “We agree with the company that the establishment of a DSIC would enable the company to address, in an orderly and comprehensive manner, the problems presented by its aging water distribution system, and would have a direct and positive effect upon water quality, water pressure and service reliability.” Public’s Exhibit No. 1, Attachment 4, pg. 8. This Commission agrees with and endorses such a purpose for a DSIC.

The evidence shows that in Illinois the only projects eligible for DSIC consideration are those that fall within the account numbers noted above: 331 (Transmission and Distribution Mains), 333 (services), 334 (Meters and Meter Installations) and 335 (Hydrants). Public’s Exhibit No. 1, Attachment 5, page 4. These are the same accounts to which the Public proposes to limit DISC eligibility and, as shown in the above matrix, accounts to which Petitioner has assigned some of the projects for which it seeks approval of a DSIC. While not using the exact same account numbers, it appears from the evidence that Pennsylvania likewise generally limits DSIC-eligible property to services, meters, hydrants and mains. Public’s Exhibit No. 1, Attachment 4, page 18.

C. A DSIC Proceeding is an Expedited Proceeding. In contrast to traditional rate case proceedings, Indiana Code 8-1-31 obviously intends for a
determination on a DSIC automatic rate adjustment to be made in an abbreviated and accelerated fashion. First, public notice that a DSIC petition has been filed is not required. Indiana Code 8-1-31-8(c). In addition, the Public is under a statutory deadline to issue a report to the Commission, if it chooses to do so, no later than thirty (30) days after the petition is filed. And the Commission is required to conduct a public evidentiary hearing and issue an order within sixty (60) days of the DSIC petition being filed. Indiana Code 8-1-31-9. These short time frames are not indicative of a proceeding that would require any extensive discovery on the part of the Public or review on the part of the Commission of complex projects that are often, and appropriately, the subject of traditional rate case proceedings.

These short time frames are, however, consistent with purposes set forth in Eric W. Thornburg's memo to the Indiana Senate, urging passage of the DSIC legislation. As noted above, Eric Thornburg was Vice President of Indiana-American. Mr. Thornburg stated as follows:

Regardless of their size and complexity, a common challenge is the age of underground infrastructure, the water mains that convey the product to the customer's tap. The principal focus of regulatory and financial resources has been on improving the quality of our drinking water primarily through promulgating water treatment standards. However, once the water leaves our plants, it travels through piping systems that can be 125 years old.

With so much of the capital available going towards improving water treatment systems, little has been available for replacing pipelines. Compounding the situation is the cost differential. New water lines vary in cost depending on their size, but typical installations average $20 - 100 per foot. We are often retiring pipe that cost less than $1 per foot when it was installed and rate shock can result.

This new technique will allow for the replacement of aged infrastructure, primarily pipelines, without the necessity of filing for increases with the added cost to customers and delay of such undertakings. It does not include new main extensions that would produce additional revenue for the utility.

Petitioner's Exhibit No. 1, Attachment No. 1.
(Emphasis added.)

If Indiana-American's request in this proceeding were consistent with its former Vice President's description of the DSIC legislation, it would not have included improvements to utility components such as water treatment or source of supply, or security improvements, but would have concentrated primarily on the replacement of pipelines, meters and hydrants within the distribution system. In this proceeding, however, Petitioner contends that the lack of qualifying language in Indiana Code 8-1-31-5 to specifically limit "water utility plant projects" to projects within the "distribution system" results in DSIC eligibility for any utility plant project that is in service, was not included in the utility's last rate case, and was not a project to hook-up new customers.
D. Legislative Intent. To the extent Petitioner’s reading of this statute has merit we rely on what the courts have said regarding the discernment of legislative intent. “The intention of the legislature, as ascertained from a consideration of the act as a whole, will prevail over the literal meaning of any of the terms used therein.” Brown v. Grzeskowiak, 230 Ind. 110, 101 N.E. 2d 639 (1951). In City of Indianapolis v. Evans, 216 Ind. 555, 24 N.E.2d 776, (1940), the court said: “The legislative intent, however, is to be ascertained by an examination of the whole, as well as the separate parts of the act, and when so ascertained, the intention will control the strict letter of the statute or the literal import of particular terms of phrases, where to adhere to the strict letter or literal import of terms would lead to injustice, absurdity, or contradict the evident intention of the legislature.” And in Rexing v. Princeton Window Glass Co., 51 Ind. App. 124, 94 N.E. 1031 (1912), we look to the language: “The purpose and scope of an act of the legislature must be determined from its title,” and then to the title of Indiana Code 8-1-31, which is: “Distribution System Improvement Charges.” When read as a whole, particularly with the intended and repeated reference to “distribution system,” we find the most reasonable intent of Indiana Code 8-1-31 is to limit water utility plant projects to projects that are within the utility’s distribution system.

E. The Language of Indiana Code 8-1-31. In addition, we also find the actual language of Indiana Code 8-1-31 to be consistent with our finding as to legislative intent. We, therefore, do not accept Petitioner’s assertion that a plain language examination of Indiana Code 8-1-31 necessarily results in the conclusion that eligible improvements under this statute include any utility improvements that do not increase revenue by connecting the distribution system to new customers; are in service; and were not included in the utility’s last general rate case. Indiana Code 8-1-31-5 states:

As used in this chapter, “eligible distribution system improvements” means new used and useful water utility plant projects that:

1. do not increase revenues by connecting the distribution system to new customers;
2. are in service; and
3. were not included in the public utility’s rate base in its most recent general rate case.

This statute specifically disallows DSIC eligibility for “water utility plant projects” that would increase revenues by connecting the “distribution system” to new customers. This is one place in the statute where the phrase “water utility plant projects” is juxtaposed against the phrase “distribution system,” thereby imparting a meaning to “distribution system” that is narrower than that of “water utility plant projects.” If the broad meaning of “water utility plant projects” was intended to carry through all of Section 5, why qualify Section 5(1) with the phrase “distribution system?” We find it a reasonable interpretation that the statute as written is stating what was obviously intended, which is that the type of water utility plant projects contemplated are necessarily within the water utility’s distribution system.
In addition, this juxtaposition of the phrase “water utility plant projects” with the phrase “distribution system” results only in a limitation that excludes from DSIC eligibility a particular category of utility plant project within the distribution system (connecting to new customers). Connecting to new customers describes a classic type of distribution system activity within the common meaning of “distribution system” as discussed above. We do not find it logical that this “Distribution System Improvement Charge” statute, with this single, exclusionary reference to a specific type of “distribution system” project, intended thereby to open the door of DSIC eligibility to any other “water utility plant project.” Rather, we find that this one exclusion of a type of project within the distribution system is meant to thereby imply the inclusion, or DSIC eligibility, of all other types of distribution system improvements. We find the language and intent of this statute to include the requirement that a water utility plant project, in order to be eligible for DSIC consideration, must be a project within the “distribution system,” limited, as to type of project, only by the ineligibility of projects that connect to new customers.

Accordingly we find, as applied to water utilities, that a common and consistent meaning of the phrase “distribution system” is found: in our previous Orders, in other states’ DSIC laws, and in the water utility industry in general. We find that meaning identifies one component of a water utility that is distinguishable in plant and function from other components such as source of supply, water treatment and, in some instances, water storage. We also find that the evident legislative intent of Indiana Code 8-1-31, as well as the express language of that statute, conveys that same meaning. We cannot conclude that the Indiana General Assembly chose to adopt and repeatedly refer to “distribution system” in Indiana Code 8-1-31 as a way to generally identify, as Petitioner contends, the whole of a water utility. As to what water utility projects fall within the distribution system for DSIC eligibility, we find it within the purpose and meaning of Indiana Code 8-1-31 to look to the categories or accounts that the water utility industry uses, and specifically NARUC’s system of accounts, to identify projects that are within a utility’s distribution system.

F. Projects and Amounts to Be Included and Excluded as Distribution System Improvement Charges. Of the $13,270,267 Petitioner has requested for DSIC eligibility, the Public sought to allow $7,723,795. All of this $7,723,795 is categorized on Petitioner’s matrix within the following Subsidiary Accounts: “Mains” (331001), Services (333000), Meter Installations (334200), and Hydrants (335000). And all of these Subsidiary Accounts are contained within the functional category: “Transmission and Distribution.” Based on our discussion above, since these improvements are categorized as being within Petitioner’s distribution systems, we find that they should be approved for DSIC recovery.

The Public sought to disallow $5,546,472, which includes $2,402,473 for security improvements and $3,143,999 for non-security improvements that the Public claims are either not distribution system improvements or are otherwise not eligible. Of the total amount the Public seeks to disallow, $1,499,158 relates to costs for non-security projects, and $425,057 is for security-related projects, that Petitioner has categorized on its matrix within the functional categories of “Source of Supply/Pumping,” “Water Treatment,” and
“General Plant.” Petitioner has categorized the remaining $3,622,258 within the matrix category of “Transmission and Distribution.” Of that Transmission and Distribution amount, $1,644,841 accounts for the cost of a project to erect a tank in Hobart, Indiana, and $1,977,417 relates to various projects to improve tank security.

Based on our analysis above of the DSIC statute, we find that all non-security projects that fall outside of improvements to the utility’s distribution system; that consist of improvements to Source of Supply/Pumping, Water Treatment and General Plant, should be excluded from recovery of a DSIC charge. In this proceeding, therefore, $1,499,158 should be excluded.

We turn our attention next to the $1,644,841 attributed to placing a new water tower in service in Hobart, Indiana. We agree that the Hobart Water Tower was properly categorized by Petitioner on the account matrix discussed above as being functionally within “Transmission and Distribution Plant”, in Subsidiary Account No. 330000 (“Distribution Reservoir”). Based on our discussion above, that fact argues for inclusion of the water tower as a DSIC. However, we also note that both Pennsylvania and Illinois do not include “Distribution Reservoir” in their definition of DSIC eligible, distribution system projects. That fact suggests, as we believe, that water storage may go beyond the distribution system improvements contemplated by this statute. We are not convinced that the replacement of three (3) water towers with one tower that is three (3) times the capacity of the three (3) replaced towers combined, at a cost of $1.5M dollars, could be adequately reviewed by the Public and determined by this Commission within the time prescribed for the issuance of a DSIC Order.

The construction of new or replacement water storage tanks is accomplished at a considerable expense for water utilities. That expense is ultimately borne by water utility customers, who are the ratepayers. In this proceeding, the Hobart Water Tower is the most expensive single project that Petitioner has presented to this Commission for DSIC approval. As already noted, the DSIC statute does not require public notice that a DSIC petition has been filed. It is difficult to reconcile the inclusion of projects of this magnitude with the procedural constraints imposed by the DSIC statute. Consideration of the water tank in this proceeding is complicated even more by the fact that this tank project has resulted in an infrastructure very different from the infrastructure it has replaced. All of these considerations serve to emphasize the limitations built into the DSIC statute that are not found in a traditional rate case, such as a longer review period and more public notice, all of which are very important for projects of this size and scope. Referring to a Pennsylvania court decision, the PPUC stated: “...the purpose of (Pennsylvania’s automatic rate adjustment law) is to permit reflection in customer charges of changes in one component of a utility’s cost of providing public service without the necessity of the broad, costly and time-consuming inquiry required in a...base rate case.” Public’s Exhibit No. 1, Attachment 4, pg. 10.

It is also arguable that the costs of the Hobart Water Tower project are subject to allocation, with some costs being DSIC eligible and some not being DSIC eligible. But there is not sufficient evidence in this proceeding to support a cost allocation. Even if
such evidence did exist, timely review would be hindered by the complexity of allocation techniques and by the statutory deadlines inherent to DSIC proceedings that have already been discussed.

Mr. DeBoy testified that the Hobart Water Tower project was in the planning stage prior to Petitioner’s acquisition of the Northwest Indiana Water Company, though not placed in service until after its last rate case was filed on June 29, 2001 in Cause No. 42029. This Commission approved Indiana American’s acquisition of the Northwest Indiana Water Company on December 15, 1999. We note, however, our rate Order in Cause No. 42029 gave consideration to certain of Petitioner’s projects (Tunnel Project, Newburgh Project, and Wabash Valley Project) that included estimated costs and estimated in-service dates for completion. Thus, the Commission has allowed for projects that are not yet in service and outside the test year to be included in rates during traditional rate case proceedings. Petitioner could have effectively included the Hobart Water Tower in this most recent traditional rate case, which allowed for a two-step increase to be phased in upon completion of the Tunnel Project.

We also note that the Hobart Water Tower was constructed, at least in part, with additional customer revenue in mind. Mr. DeBoy testified that it would have been shortsighted for Petitioner not to consider future needs in determining the capacity of the Hobart Water Tower and that additional customers were, in fact, a consideration in determining the size tank to build. Notwithstanding, therefore, the argument that the Hobart Water Tower can be described as a distribution system improvement, there is also evidence that a substantial portion of the much larger water tower will increase revenues by permitting connection of the distribution system to new customers, thereby making it ineligible for DSIC recovery. Of course we realize, first, that no water utility customer is directly connected to a water storage tank and, second, that some aging distribution system infrastructure, such as mains, could, for example, be replaced with larger diameter mains in response to or anticipation of new customers, yet still be DSIC eligible. A new or replacement water tower, however, can play a significant role in connecting new customers. It is clearly the intent of the DSIC statute to exclude distribution system projects that connect to new customers, and we find this water tower, with its ability to generate new revenue, fits within the purpose of that exclusion.

This Cause is the first DSIC proceeding brought before this Commission, and our findings and conclusions will impact future DSIC petitions. It is a primary charge of this Commission to ensure just and reasonable utility rates. The traditional ratemaking process contains the safeguards needed for comprehensive review, particularly of complex and expensive projects, by the Public, the Commission, and the public in general. We find the DSIC statute is similar in purpose to other “tracker” statutes that allow utilities expedited adjustment to rates in matters that fall outside the need for the comprehensive review allowed in a traditional rate case.

We are, however, not prepared to find in this proceeding, as has been determined in Pennsylvania and Illinois, that any project categorized within “Distribution Reservoir” is not DSIC eligible. Distribution Reservoir projects presented to the Commission for
DSIC recovery will be considered on a case-by-case basis. We find only, for all of the above reasons specific to this particular project, that the Hobart Water Tower project is not DSIC eligible.

Finally, we address the $2,402,473 in security costs that Petitioner has proposed for DSIC recovery. An amount of $425,057 for security improvements is DSIC excludable for the same reason as the non-security improvements above that did not take place within the distribution system. And even though Petitioner has categorized a portion ($1,977,417) of its security costs as being projects within the distribution system, we find that those security costs should also be excluded from DSIC recovery. We agree with the Public's testimony that the purpose of a DSIC proceeding is to encourage, through an expedited and automatic rate increase, repair or replacement of a distribution system's aging and failing infrastructure. Security improvements, while providing overall improvement to a utility, are not the type of infrastructure improvements contemplated by DSIC statutes.

In addition, given the highly sensitive nature of all security system information, more time than the DSIC statute allows is needed to permit the Public as well as the Commission to fulfill its statutory duties. Indiana Code 8-1-31-9(b) states that the Public may issue a report on a DSIC request within thirty (30) days of the petition being filed. The Public testified, through Mr. Kaufman, that any discovery about improvements that are claimed to be sensitive is difficult and arguments about the recovery of those improvements are awkward, thereby suggesting a lengthier process to ensure adequate review. Given the time needed for the Public and Petitioner to enter into a standard confidentiality agreement, plus the time needed for possible discovery on these sensitive issues, would almost certainly require more than thirty (30) days for the Public to conduct a meaningful review. In addition, given the sixty (60) day time limit for the Commission to issue an order, the meaningfulness of our review is hampered by additional procedures that must be considered and invoked in order to ensure proper confidential handling of sensitive information. Again, the point simply being that the additional complexities of considering security improvements are better suited for a traditional rate case proceeding.

In response to Mr. Kaufman's concern that the review performed in a traditional rate case cannot be completed during the abbreviated process for a DSIC, Mr. Cutshaw stated that the DSIC process was not intended to and will not result in a final determination that the DSIC assets are in rate base for purposes of a general rate case and that the Public will have the opportunity to conduct a full rate base review in the utility's next general rate case. We note, however, that Petitioner's assertion that an imprudent investment can be subsequently removed from rate base does not justify its inclusion in a DSIC. If an investment is, in fact, subsequently excluded from rate base in a future rate case, then ratepayers will have paid both a return on and of an asset that was determined to be ineligible. It is unfair for ratepayers to have incurred such a cost. Moreover, if an asset does not belong in rate base then ratepayers should not have to pay a return on and of that asset. Given the limited time frame, DSIC eligible assets should only include assets that require a minimal review and whose inclusion in rate base is assumed to be reasonable.
For the foregoing reasons and without need to refer to specific categories or
describe even in general terms Petitioner’s security improvements and without need to
make any determination as to the relative prudence of those improvements, we deny
recovery of the security improvements in this DSIC proceeding. We find that, without
regard to what component of a system they are designed to make secure, security
improvements do not properly fall within the descriptor “distribution system
improvement” and were not intended to be recovered in a DSIC proceeding regardless of
their desirability. In so concluding, we also agree with the Public’s testimony that a
utility’s undertaking of prudent security measures should not be dissuaded. With a
heightened concern about terrorist attacks, we encourage utilities to take prudent
measures to ensure that their facilities and employees are protected, and to ensure that a
safe product can be delivered to consumers. Given, however, the need expressed by
Petitioner to be sensitive to the need to maintain secrecy where appropriate, a DSIC case
simply does not allow sufficient time to afford due process to the parties and adequate
time for the Commission to balance the need for secrecy with the expedited review
required by statute. Petitioner may seek to recover these expenditures in a subsequent
general rate case.

In addition to the foregoing reasons to exclude security improvements as well as
the other excluded items we believe our position here is reasonable given our practice of
allowing utilities to recover depreciation of contributed property. In Cause No. 39595,
the Commission stated on page 23, “The Commission’s current policy of allowing the
recovery of depreciation on the contributed property provides to the Company additional
internally generated funds to cover at least part of the replacement cost.” Indeed,
Petitioner’s last rate case, Cause No. 42029, had $60 million in CIAC on which
depreciation was calculated and included in rates.

Also, We agree with the Public’s recommendation that future DSIC proceedings
should include a projection of plans to repair and rehabilitate the distribution system, but
find Petitioner’s suggestion that such a projection be limited to a 5-year forecast, as
opposed to 10 years, to be more reasonable.

G. Calculation of Distribution System Improvement Charges. As to
calculation of a DSIC, both Petitioner and the Public agree the before tax rate of return
should be 10.81% on certain additions less the amounts contributed by INDOT. The
Public further reduces the amount on which the return applies by the original cost of
those assets that are now no longer in service as they have been replaced by the assets
eligible for the DSIC. Petitioner has acknowledged Indiana allows a return on the Fair
Value of assets. Petitioner also acknowledges that if such asset values were not
eliminated in the DSIC calculation, Petitioner would earn a return on assets no longer in
service as well as earning a return on the replacement of those assets. On cross-
examination by the Public, Petitioner’s witness Mr. Cutshaw indicated, under Petitioner’s
method of calculation, it will be earning a return on the fair value of the assets which
have been retired as well as earning a return on these new assets, some of which were
replacements for those assets retired. In its proposed order, the Public notes that Mr.
Cutshaw asserted in his rebuttal testimony that retirements should not be deducted from rate base additions in a DSIC because, under mass accounting rules, when a utility retires an asset it has no impact on the utilities net book value. We observe that such a rationale may be technically correct, but it is also irrelevant since such a factor would only apply in original cost ratemaking. Petitioner’s rate base is based on the fair value of its assets. When any asset with a positive fair value is retired that will reduce the utility’s fair value rate base. Thus, if retirements are ignored and a utility is allowed to earn a return on new plant through a DSIC, they will collect a return on both the new plant through its DSIC and on the retired asset through its return on the fair value rate base determination from the utility’s last rate case. (We asked Mr. DeBoy if it could be determined when individual assets that have been retired were purchased. He indicated that it would be possible by pulling fixed asset records. We note that this information appears to be found in the response to data request question 33 included in Attachment No. 3 to Mr. Kaufman’s testimony.)

Petitioner did not provide the fair value determination from their last rate case for the items retired. We agree with the Public as to the net amount eligible to receive a return on. We therefore find Petitioner may receive a 10.81% before tax return on $5,859,778 of net additional plant.

In Cause No. 42029, the Commission determined that the fair value of Indiana American’s rate base was $562,680,669. The Commission also determined that Indiana American’s original cost rate base was $403,085,800. Mass accounting rules do not apply to the Commission’s determination of a utility’s fair value and any retirement of plant will impact the fair value rate base. In Cause No. 42029, Mr. DeBoy used a replacement cost new less depreciation study to estimate Indiana American’s fair value. His methodologies for the study are described on page 26 of our final order in that Cause. While aged plant that is retired may have a negligible original cost, the fair value of such retired assets may not be negligible and not so easily determined.

Both Petitioner and Public agree on the method of calculating depreciation. Each took what they considered DSIC eligible assets, deducted retirements, and applied the appropriate depreciation rates. The disagreement is in what constitutes DSIC eligible assets. Applying our previous decision as to what assets are DSIC eligible, we therefore find Petitioner may earn depreciation in the amount of $163,849.

As to Petitioner’s objection to Ms. Gemmecke’s unbundling of the Water Groups, the Commission notes that Ms. Gemmecke provided not only each water group on its own, but also as a total of all water groups. The Commission does not have a blanket stance on single-tariff pricing, but considers each case on its own merits. Ms. Gemmecke’s schedules were helpful in determining if we should take the same stance in this case as we took in Cause 42029 regarding the movement toward single-tariff pricing for Indiana-American. This abbreviated proceeding does not allow us to re-visit that issue; therefore we have determined to apply the increase to the Groups as an average. We therefore find the calculations of eligible DSIC assets should be calculated and applied according to the schedule below:

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## DSIC Calculation and Rate Schedule

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Water Groups</th>
<th>Wabash</th>
<th>Northwest</th>
<th>Mooresville</th>
<th>Warsaw</th>
<th>West Lafayette</th>
<th>Winchester</th>
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<tbody>
<tr>
<td>Additions subject to DSIC</td>
<td>$7,723,795</td>
<td>$5,942,722</td>
<td>$169,439</td>
<td>$969,547</td>
<td>$78,349</td>
<td>$73,118</td>
<td>$144,716</td>
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<td>Less Reimbursement by INDOT</td>
<td>1,310,504</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Less Retirements</td>
<td>553,513</td>
<td>406,378</td>
<td>23,638</td>
<td>83,146</td>
<td>6,974</td>
<td>3,566</td>
<td>16,027</td>
<td>13,784</td>
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<tr>
<td>Net Investor supplied DSIC Additions</td>
<td>5,859,778</td>
<td>4,225,840</td>
<td>145,801</td>
<td>886,401</td>
<td>71,375</td>
<td>69,552</td>
<td>128,689</td>
<td>332,121</td>
</tr>
<tr>
<td>Pre-tax Rate of Return</td>
<td>10.81%</td>
<td>10.81%</td>
<td>10.81%</td>
<td>10.81%</td>
<td>10.81%</td>
<td>10.81%</td>
<td>10.81%</td>
<td>10.81%</td>
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<tr>
<td>Pre-Tax Return on Net DSIC Additions</td>
<td>633,442</td>
<td>456,813</td>
<td>15,761</td>
<td>95,820</td>
<td>7,716</td>
<td>7,519</td>
<td>13,911</td>
<td>35,902</td>
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<tr>
<td>Depreciation on DSIC Additions</td>
<td>163,849</td>
<td>132,872</td>
<td>3,660</td>
<td>14,073</td>
<td>2,354</td>
<td>1,520</td>
<td>3,859</td>
<td>5,511</td>
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<tr>
<td>Total DSIC Revenues</td>
<td>797,291</td>
<td>589,685</td>
<td>19,421</td>
<td>109,893</td>
<td>10,070</td>
<td>9,039</td>
<td>17,770</td>
<td>41,413</td>
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<tr>
<td>DSIC Rate per MGAL</td>
<td>$0.0219</td>
<td>$0.0267</td>
<td>$0.0256</td>
<td>$0.0101</td>
<td>$0.0288</td>
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<td>DSIC Rate per CCF</td>
<td>$0.0164</td>
<td>$0.0200</td>
<td>$0.0192</td>
<td>$0.0076</td>
<td>$0.0216</td>
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<td>$0.0107</td>
<td>$0.1521</td>
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</tbody>
</table>

### H. Confidential Information.
The December 30, 2002 Docket Entry issued in this Cause made a preliminary determination that security-related evidence received during the in camera portion of the Evidentiary Hearing would be handled and maintained as confidential pursuant to Indiana Code 5-14-3. This preliminary determination was based on the trade secret exception to disclosure found in Indiana Code 5-14-3-4, as well as the need to protect security-related information that, if disclosed to the public, would jeopardize a security system that is within the state’s and national interest to protect. The Commission hereby makes a permanent determination that the record of the in camera portion of the Evidentiary Hearing conducted in this Cause on January 29, 2003, shall be handled and maintained as confidential in accordance with Indiana Code 5-14-3.

### I. Settlement Agreement.
The parties’ Stipulation and Settlement Agreement filed in this proceeding proposes several significant findings that differ from the findings we have made herein. First, the Stipulation and Settlement Agreement proposes a finding that the Hobart Water Tower is an eligible DSIC project. Second, the Settlement Agreement proposes to include as DSIC eligible a pump station project (“Taft Street Pump Station”) that is excluded from eligibility herein because it was not categorized by Petitioner as being within the distribution system, except for an individual pump station project that was categorized on Petitioner’s matrix as being a “Main” project within “Transmission and Distribution.” The remainder of the Taft Street Pump
Station projects were categorized as being within "Source of Supply/Pumping," and, therefore, excluded. Mr. DeBoy testified that the Taft Street Pump Station improves service to the distribution system. The Public, in its testimonial Proposed Order, states that the Taft Street Pump Station should be considered as being within the distribution system, though still DSIC ineligible because of testimony that it would increase the ability to connect to new customers. We are not convinced, however, that the best evidence shows anything other than a majority of the Taft Street Pump Station projects were correctly categorized as being outside of the distribution system. The third difference between the Stipulation and Settlement Agreement and our findings herein is the proposal that all security improvements, including tank security improvements, be excluded from DSIC recovery, but that the portion attributable to "tank security improvements" ($1,977,417) be allowed to accrue "post-in-service" allowance for funds used during construction ("AFUDC") and deferred depreciation.

AFUDC is a recognized accounting mechanism that allows a utility to accrue the cost of debt related to major construction projects during the construction period. Once an in-service project is approved in a general rate proceeding for inclusion in rate base, the utility can begin earning a return on the value of the project. However, economic erosion to the utility can occur if there is a significant lag between the time the project is placed in service and the time of the utility's next general rate proceeding. This is because once the project is placed in service, but before it is approved for inclusion in rate base as an asset of the utility, not only does AFUDC cease as an available accounting tool, but also depreciation commences which is ultimately subtracted from the net original cost of the project to determine its value in rate base. In order to avoid the economic erosion that would otherwise result to the utility, the Commission can authorize, during this lag period, the continued, or "post in-service," accrual of AFUDC as well as deferring depreciation.

Most cases brought before this Commission seeking post in-service AFUDC and deferred depreciation ("AFUDC Remedy") contemplate that remedy from the outset. The AFUDC Remedy in this proceeding, however, was apparently not contemplated, and obviously not sought, until the submission of the late-filed settlement agreement. In determining the appropriateness of the AFUDC Remedy, we have previously said: "The precedents are clear that the requested treatment (the AFUDC Remedy) is appropriate in the case of major projects being placed in service and when the denial of the requested relief would have severe financial ramifications." Cause No. 39150, June 19, 1991. Evidence of these criteria was not produced in this proceeding. While evidence of the value of the security improvements was produced, we do not have evidence to support whether or not these security improvements are "major" in the context of the AFUDC Remedy, or whether our denial of the AFUDC Remedy would have severe financial ramifications on Petitioner. The AFUDC Remedy is a different form of relief from the DSIC remedy sought in this proceeding.

The Parties' joint settlement agreement asserts that Petitioner's recovery under the settlement agreement will be less than what it sought under the DSIC remedy and, therefore, falls within Petitioner's original request as lesser included relief. As stated
above, and regardless of the amount to be recovered by Petitioner under either remedy, we consider the AFUDC Remedy to be distinct from the DSIC remedy, each requiring proof of different elements. Therefore, given our finding that the evidence does not support approval of either a DSIC or AFUDC for security improvements, we conclude that neither remedy is appropriate in this proceeding.

We do not find it in the public interest that an automatic rate increase be imposed on ratepayers for improvements that we do not find, based on the evidence, to be within the utility's distribution system, or that Petitioner be allowed to continue to accrue AFUDC and defer depreciation when eligibility for those remedies has been neither sought nor proven. Accordingly, we reject the Stipulation and Settlement Agreement.

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

1. Indiana-American Water Company, Inc. is approved a Distribution System Improvement Charge that generates $797,291 in additional annual revenue.

2. We find that for purposes of determining the DSIC revenue, a before tax return of 10.81% should be applied to the net investor supplied DSIC eligible assets of $5,859,778. Such a figure includes distribution assets added since Petitioner's last rate case less reimbursements by Indiana Department of Transportation for line relocations, less the distribution assets retired and replaced since the last rate case.

3. Recovery of DSIC revenues through an adjustment of rates shall be in accordance with the DSIC Calculation and Rate Schedule found herein in Finding Paragraph No. 8G. Petitioner shall file with the Gas/Water/Sewer Division of the Commission, prior to placing into effect the DSIC rates herein approved, separate amendments to its rate schedule with reasonable reference therein reflecting that such charges are applicable to the rate schedules reflected on the amendment.

4. In accordance with Indiana Code 8-1-31-15, Petitioner shall file a revised rate schedule resetting the DSIC when the Commission issues an Order authorizing a general increase in rates and charges that includes the eligible distribution system in the utility's rate base.

5. In its next DSIC case, Indiana-American should file a five-year forecast of its distribution system replacement program.

6. This Order shall become effective upon and after the date of its approval.
MCCARTY, LANDIS, RIPLEY AND ZIEGNER CONCUR; HADLEY ABSENT;
APPROVED:

FEB 27 2003

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

Nancy E. Manley
Secretary to the Commission
STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF INDIANA-AMERICAN WATER COMPANY, INC. FOR APPROVAL OF (A) A NEW DISTRIBUTION SYSTEM IMPROVEMENT CHARGE ("DSIC") PURSUANT TO IND. CODE CHAP. 8-1-31; (B) A NEW RATE SCHEDULE REFLECTING THE DSIC; AND (C) INCLUSION OF THE COST OF ELIGIBLE DISTRIBUTION SYSTEM IMPROVEMENTS IN ITS DSIC ORDER OF THE COMMISSION

Presiding Officers:
Carolene Mays, Commissioner
Aaron A. Schmoll, Senior Administrative Law Judge

On October 1, 2012, Indiana-American Water Company, Inc. ("Indiana-American" or "Petitioner") filed with the Commission its Petition and Submission of Case-in-Chief for approval of a new distribution system improvement charge ("DSIC") pursuant to Indiana Code ch. 8-1-31 and 170 I.A.C. 6-1.1. On October 16, 2012, Petitioner filed an updated version of Petitioner’s Exhibits GPR-3 and SSH-1 to correct for an error in the classification of a project booked to the wrong account. The update did not affect Petitioner’s requested DSIC percentage rate. On October 19, 2012, the City of Crown Point, Indiana ("Crown Point") filed its Petition to Intervene in this Cause, which was granted by the Commission’s Docket Entry dated November 5, 2012. The Indiana Office of Utility Consumer Counselor ("OUCC") and Crown Point filed their respective cases-in-chief on October 31, 2012. Petitioner filed its rebuttal testimony and exhibits on November 7, 2012.

Pursuant to notice given as provided by law, proof of which was incorporated into the record by reference and placed in the official files of the Commission, a public evidentiary hearing was convened in this Cause on November 15, 2012 at 1:30 p.m. in Room 222 of the PNC Center, Indianapolis, Indiana. The hearing was continued to and concluded on November 20, 2012. At the evidentiary hearings, the prefiled evidence of Petitioner, Crown Point and the OUCC was offered and admitted into the record of the proceedings of this Cause. No members of the general public appeared or participated at the evidentiary hearing.

Having considered the evidence and being duly advised, the Commission now finds:

1. **Notice and Jurisdiction.** Due, legal and timely notice of the public hearing in this Cause was given and published as required by law. Petitioner is a "public utility" within the meaning of that term in Indiana Code § 8-1-2-1 and is subject to the jurisdiction of the Commission in the manner and to the extent provided by the laws of the State of Indiana. The Commission has jurisdiction over Petitioner and the subject matter of this proceeding.
2. **Petitioner’s Characteristics.** Petitioner is an Indiana corporation engaged in the business of rendering water utility service to customers in numerous municipalities and counties throughout the State of Indiana for residential, commercial, industrial, public authority, sale for resale and public and private fire protection purposes. Petitioner also provides sewer utility service in Wabash and Delaware Counties.

3. **Relief Requested.** Petitioner seeks approval of a DSIC pursuant to Indiana Code ch. 8-1-31, a new rate schedule reflecting the DSIC, and approval of the costs of the eligible Distribution System Improvements (“Improvements”) in Petitioner’s DSIC. Petitioner’s most recent rate order was approved in Cause No. 44022 on June 6, 2012 (the “2012 Rate Order”). Petitioner’s most recent DSIC was approved in Cause No. 42351 DSIC 6 on October 20, 2010 (the “DSIC-6 Order”), but the DSIC was reset to zero as a result of the 2012 Rate Order. In accordance with the Commission’s rules, Petitioner submitted a Reconciliation Report on November 21, 2011, which included the twelve month reconciliation of DSIC-6 (October 20, 2010 through October 19, 2011). Petitioner’s Case-in-Chief included an updated Reconciliation Report which includes the reconciliation for the period of October 20, 2011 through June 14, 2012, which was the final DSIC billing period before the DSIC surcharge was re-set to zero due to the implementation of new rates pursuant to the 2012 Rate Order. This final reconciliation showed an over-recovery, which Petitioner showed as an offset to its proposed DSIC revenues.

The rate base cutoff in Cause No. 44022 consisted of property in service as of June 30, 2011. Therefore, Petitioner proposes to implement a DSIC to include non-revenue producing projects placed in service between July 1, 2011 and August 31, 2012 that were not included in Petitioner’s rate base in the 2012 Rate Order. Petitioner’s proposed DSIC would produce total annual DSIC revenues of $6,194,699, which would equate to an increase of approximately 3.19% above the base revenue level approved in Petitioner’s 2012 Rate Order.


   A. **Calculation of DSIC 7.** Mr. Roach testified regarding the filing requirements and methodology for calculating the DSIC. Mr. Roach provided evidence concerning the calculation of the proposed DSIC and sponsored Petitioner’s proposed rate schedules reflecting the DSIC in the same format as the existing tariff on file with the Commission. He explained that Petitioner is proposing to treat the DSIC as per the Commission’s April 2, 2008 Order in Cause No. 42351 DSIC 4, in that the rate would be a percentage that would be applied to both the consumer’s volumetric and metered service charge revenues. He further explained that, as per the Commission’s April 30, 2010 Order in Cause No. 43680, Petitioner calculated the DSIC as a single percentage of bills that will be the same for all rate groups.

   Mr. Roach testified that Petitioner proposes to include only non-revenue producing projects placed in service between July 1, 2011 and August 31, 2012 that were not included in rate base in the 2012 Rate Order. He added that all DSIC projects included in Petitioner’s request are new used and useful water utility plant projects that: (1) do not increase revenues by connecting the distribution system to new customers; (2) are in service; and (3) were not
included in Petitioner’s rate base in the 2012 Rate Order.

Mr. Roach testified that Petitioner’s proposed DSIC would apply to public and private fire protection in a manner consistent with Petitioner’s tariff that is presently on file with the Commission. Petitioner’s tariff as filed in Cause No. 44022 makes the DSIC applicable to public and private fire protection. Mr. Roach explained that Petitioner made this modification to its tariff in Cause No. 44022. He testified that the change eliminates the temporary subsidy of public and private fire service customers by non-fire service customers that occurs when the Commission approves a DSIC for Petitioner that was applied to all charges except those on public and private fire service. Mr. Roach stated with public and private fire service tariff charges available for inclusion in the DSIC, the result is lower increase in rates for all customers than what would occur if public and private fire service tariff charges were excluded from the DSIC. He testified that the Commission Staff has indicated they were uncertain the Commission had meant to approve this modification to Petitioner’s tariff and that Petitioner had agreed with Staff to raise the question for the Commission in this DSIC proceeding. He testified if the Commission finds the DSIC should not apply to public and private fire protection, the resulting DSIC would increase to 3.58%.

Mr. Roach then discussed how Petitioner calculated the Net Investor Supplied DSIC Additions. He stated that Petitioner reduced the DSIC Improvements of $51,119,265 by the amount of the related plant retirements associated with the DSIC Improvements, consistent with the DSIC-6 Order. Mr. Roach stated that the amount of retirements made from July 2011 through August 2012 was $4,014,075. Mr. Roach explained that he further adjusted the retirement amount for the actual amount of the cost of removal, net of salvage in the amount of $4,442,365. Mr. Roach stated that there were total reimbursements from the Indiana Department of Transportation (“INDOT”) and others, in the amount of $95,277. These reimbursements were removed from the DSIC Improvements, resulting in Net Investor Supplied DSIC Additions of $51,452,278, as shown on Line 5 of Petitioner’s Exhibit GPR-3-U.

Mr. Roach also sponsored Petitioner’s Exhibit GPR-4, Petitioner’s rate of return summary. Mr. Roach explained that the rate of return used in this proceeding is Petitioner’s weighted average cost of capital computed from Petitioner’s capital structure as approved by the Commission in the 2012 Rate Order. He testified that Petitioner used the embedded debt cost rate as of June 2011 to determine the long-term debt cost rate. The common equity cost rate of 9.70% was determined in the 2012 Rate Order, and the weighted cost of capital is 6.95% and a pre-tax rate of return of 9.79%. Mr. Roach stated the pre-tax rate of return was calculated using a gross revenue conversion factor of 1.6934, calculated using Utilities Receipts Tax of 1.4%, State Corporate Adjusted Gross Income Tax of 7.75% and Federal Income Tax of 35%. He explained that the State Income Tax was calculated using an average of the effective tax rate for the period July 1, 2012 to June 30, 2013 by averaging the rates of 8% (2012) with the rate of 7.5% (2013). Mr. Roach stated that the resulting pre-tax return is $5,037,176 when the pre-tax overall rate of return is multiplied by the net investor-supplied original cost of the Improvements.

Mr. Roach stated that Petitioner determined its depreciation expense of $1,536,531 by using the annual depreciation rates by primary plant account previously approved by the Commission, multiplied by the Improvements, net of related retirements.
Mr. Roach testified and provided exhibits showing that the proposed DSIC Revenues are within the 5% range of Petitioner’s base revenues as approved by the Commission in the 2012 Rate Order.

Petitioner’s witness Stacy S. Hoffman sponsored Petitioner’s Exhibit SSH-1 (as updated, Petitioner’s Exhibit SSH-I-U), which provides a brief description of each Improvement project, the costs of each project, the date each project was placed in service, the account number assigned to each project based on accounting standards found in the National Association of Regulatory Utility Commissioners (“NARUC”) Uniform System of Accounts for Class A Water Utilities (“USoA”) and Petitioner’s Operation area where each project exists.

Mr. Hoffman provided greater detail regarding the individual Improvements exceeding $100,000 in total costs. For each of these Improvements, he explained why the improvement was needed, the resulting benefits to Petitioner and its customers and whether the plant had been retired. This is consistent with Petitioner’s presentation in its past DSIC cases. Mr. Hoffman stated that Petitioner has invoices and other cost support for all projects listed in Petitioner’s Exhibit SSH-1.

Mr. Hoffman generally described the Improvements as either replacement or reinforcement infrastructure. He explained that replacement infrastructure includes mains, tanks, tank coating systems, valves, hydrants, service lines and meters, while reinforcement infrastructure consists of mains, valves and hydrants with the purpose of improving pressure and flow of the existing distribution system. Mr. Hoffman testified about the inclusion of tank-related projects in Petitioner’s proposed DSIC, referring to the Commission’s February 27, 2003 Order in Cause No. 42351 DSIC-1 in which the Commission stated it would consider future requests to include “Distribution Reservoir” (i.e., water storage tank) projects for DSIC recovery on a case by case basis. He stated the tank-related projects included in this proceeding consist of certain foundation rehabilitations, a paint rehabilitation, a tank roof replacement and some distribution pump work to enable Indiana American to take the tanks offline. He said the projects are recorded in Uniform System of Accounts distribution Accounts, do not increase water storage capacity, and otherwise meet the statutory criteria to qualify as eligible distribution system improvements.

Mr. Hoffman testified that all of the retirements associated with the new infrastructure have been completed, but some cost of removals were estimated because, although the work was complete, the cost of removals were not yet paid. The estimates for these removals were included in Mr. Hoffman’s work papers submitted in support of Petitioner’s case in chief. Mr. Hoffman proposes to reconcile any variance between the estimated and actual removal costs in Petitioner’s reconciliation report.

Mr. Hoffman testified that all Improvements listed in Petitioner’s Exhibit SSH-1 meet the DSIC statutory requirements. He testified the following about the projects included for recovery in this Cause: none of the projects increase revenues by connecting the distribution system to new customers, all of the projects are in service, none of the projects were included in rate base in the last general rate proceeding, all necessary local, state and federal permits, approvals and authorizations have been obtained, and there was no affiliate involvement in any of the transactions. Mr. Hoffman explained that as Director of Engineering he has familiarity with
these projects through regular communication with Indiana-American Engineering staff during the planning, design and construction phases of these projects. Indiana-American project managers also confirm projects are in service through a physical inspection and then enter in-service dates for completed projects in the Indiana-American accounting software system.

Mr. Hoffman testified regarding the funding of the Improvements. He stated that projects included in this DSIC 7 were funded by Petitioner or were reimbursed by INDOT or others, as noted by Mr. Roach.

Mr. Hoffman stated Petitioner has a five-year Strategic Capital Expenditure Plan that provides for budgeted amounts of approximately $171,500,000 for replacement mains, reinforcement mains, DSIC tank related work, hydrants, services and meters for the period 2013-2017. He testified that included in this amount is approximately $32,000,000 budgeted over the same period for water main replacements required by state and local governments as a result of road improvements and other projects.

5. **OUCC’s Case-in-Chief.** The OUCC presented testimony of Harold H. Riceman, Edward R. Kaufman and Margaret A. Stull. Mr. Riceman described his review of Petitioner’s application for DSIC and concluded that, based on Mr. Kaufman’s testimony, the OUCC proposes excluding the entire meter category of expenditures totaling $18,005,555 and that Petitioner’s proposal to apply the DSIC to public and private fire protection revenues be rejected. Mr. Riceman stated the OUCC recommends a DSIC of 2.12%. He also recommended in future DSIC filings Petitioner provide Petitioner’s Exhibit SSH-1 sorted by account number and then by district.

Mr. Kaufman testified in support of the OUCC’s proposal to exclude meter expenditures from the DSIC. Mr. Kaufman clarified that to the extent Petitioner has replaced meters at the end of their life of service, the OUCC does not object to including those meters in a DSIC, but that the OUCC objected to recovery of the cost of meter registers or any automated meter reading ("AMR") equipment through a DSIC. He also advocated for exclusion of the cost to replace any meters that were less than ten (10) years old. Mr. Kaufman contended that including these expenditures in the DSIC calculation stretches the definition of distribution system beyond that contemplated in the Commission’s rules. He argued replacing properly functioning meters with AMR meters to implement a change in Petitioner’s operations is not necessary to transport treated water. He further argued that replacing meter registers does not aid in the transportation of water. Mr. Kaufman noted that the meter replacement program was not discussed in Petitioner’s direct testimony in this Cause, although “Accelerated AMR” appears numerous times in Petitioner’s Exhibit SSH-1. He relied on a capital improvement plan submitted in Petitioner’s last rate case (Cause No. 44022) as forecasting approximately $7,549,723 in meter replacement expenditures for the period covered by this DSIC (July 2011 through August 2012) in contrast to the $18,005,555 proposed to be included in this case. He asserted that such a large scale in meter replacement program is inconsistent with the purpose of a DSIC because it is not equivalent to replacing aged infrastructure. He suggested that the funds Petitioner spent to install registers and replace meters less than ten (10) years old might have been better devoted to the replacement of aged pipe infrastructure. Mr. Kaufman concluded that the OUCC does not object to including the costs to replace meters older than ten (10) years in this DSIC, but that Petitioner has not provided sufficient evidence to determine such costs and therefore the OUCC’s proposed
DSIC calculation excludes the entire meter category.

Ms. Stull testified in support of the OUCC’s recommendation to deny Petitioner’s request to modify the DSIC calculation to include fire protection revenues. She concluded the modification to the DSIC calculation to include fire protection revenues should be addressed in a proceeding other than an expedited DSIC proceeding where the OUCC and other parties can fully review, understand and consider the effects of the proposed change.

Eliminating all meter expenditures and related depreciation expense and excluding any public or private fire protection revenues, Ms. Stull calculated the OUCC’s recommended DSIC percentage to be 2.12%.

6. **Crown Point’s Case-in-Chief.** Gregory T. Guerrettaz, President of Financial Solutions Group, Inc., offered testimony on behalf of Crown Point. Mr. Guerrettaz recommended Petitioner provide additional information in future DSIC filings that would increase transparency, simplify review, and facilitate the expedited DSIC process schedule. He pointed out that while the OUCC has only 30 days to file its report and the Commission has only 60 days to issue its order, Petitioner has on average filed its DSIC’s about every 18 months. This gives Petitioner much more time to reasonably prepare the DSIC than other DSIC stakeholders have to investigate its content and respond. He asserted Petitioner has the opportunity to prepare testimony and exhibits in a manner that provides transparency, reasonable explanations of important matters, and minimizes the need for costly, time-consuming discovery, in all facilitating the expedited DSIC review and order process. He explained that without this reasonable level of upfront disclosure, the other DSIC stakeholders and the Commission are left to pursue explanations and details that should reasonably be part of Petitioner’s case-in-chief presentation.

Mr. Guerrettaz first pointed out that Petitioner’s Exhibit SSH-1 is formatted across the 8 ½ inch axis of the page rather than formatted in landscape along the 11 inch axis. He pointed out that the Commission’s GAO 2005-4 set forth the required DSIC forms with the SSH-1 form printed in landscape while all other forms are printed across the 8 ½ inch axis. He testified that, as printed from the Commission’s website, by not using the landscape format, Petitioner’s SSH-1 has very fine print and is difficult to read and use.

Second, he suggested that the brief two or three sentence description of all projects exceeding $100,000 in cost presented in Exhibit SSH should provide more information. This additional information would facilitate a more user friendly and efficient, timely review in the expedited DSIC procedural schedule and also would result in a more transparent, complete Petitioner’s case-in-chief presentation. For example, rather than requiring DSIC stakeholders to dig through the fine print of SSH-1, Petitioner should simply state the cost of each project in its brief, written description. Similarly, when Petitioner describes main replacements or installation of a second main, Petitioner should state the size of the original main and the size of the replacement or supplemental main. He suggested one additional line per project description would accomplish this, e.g.: “Total cost of $360,000, main sizes, original two inch, replacement ten inch.” He explained that under the accelerated DSIC schedule, participants are pressed for time and want to quickly and efficiently focus on the largest projects. Stating a total cost for each project in the short Exhibit SSH project description would facilitate that effort and would
relieve the reviewer of the time consuming burden of having to dig around in SSH-I for each summarized project’s total cost and then correlate that cost to each written project description. He also explained that stating the size of the original main and the replacement main would allow the reviewer to focus during the first read through of Petitioner’s Exhibit SSH testimony on those instances where the main size has substantially increased, thereby eliminating the need to hunt and peck through SSH-I for core pieces of information on projects that otherwise the reviewer just finished reading about in Petitioner’s Exhibit SSH. He testified in the current two or three sentence SSH description format of main replacement projects, a small main which is replaced or supplemented by a much larger main to accommodate service to new area or a current area of expected customer growth, can in essence be hidden and treated like any DSIC recovery of cost for deteriorated main replacement.

Third, Mr. Guerrettaz recommended when Petitioner proposes to include in DSIC recovery a new cost description not previously included in prior DSIC Exhibits SSH-I, or proposes to include electronic technology or computer related costs, it should say so in its testimony. He pointed out that Petitioner includes substantial “AMR” and accelerated AMR Program costs in Exhibit SSH-I but never listed any “AMR” or accelerated AMR Program costs in any prior DSIC Exhibits SSH-I. This lack of information creates an invitation for problems, delay, and inefficiency.

Fourth, Mr. Guerrettaz pointed out that 25 of the 43 listed main replacements in SSH are described as the original main being “undersized”, but nowhere in Petitioner’s testimony did it define what undersized means. He referred to the Response to Crown Point’s Data Request 1-5 where Petitioner stated, “When Mr. Hoffman was referring to mains being undersized, he was referring to being undersized for purposes of fire protection. As a result, none of the replacement mains which are replacing mains that were “undersized” will increase revenues by allowing the connection of new customers that could not previously be connected.” Thus, Mr. Guerrettaz recommended that if it is Petitioner’s position that undersized mains are only “undersized” for purposes of fire protection and were not replaced or augmented by a second main to facilitate new connections or new sales revenue, it should state the main was only undersized for fire protection in the short Exhibit SSH project descriptions. Mr. Guerrettaz testified it is axiomatic that larger size mains have the ability to move more water and thereby the potential to serve additional customers. Yet, he pointed out that the $1.3 million installation in Noblesville of 16 inch and 12-inch water mains and an $844,000 Northwest reinforcement project to “improve marginal system pressures” only received a one sentence description in Petitioner’s Exhibit SSH. Mr. Guerrettaz stated that “it seems reasonable that for the installation of large, new costly mains, if Petitioner wants DSIC expedited recovery, it would offer more than just a one sentence description regarding the nature of the project and would briefly explain why such large, new mains will not support connection of new customers. To offer only a one sentence explanation is to invite time consuming and costly discovery. The approach of providing bare bones and having the other DSIC participants divide the details is not conducive to an expedited schedule.” It is also a disservice to the transparency of public rate increase documents, and is not conducive to an expedited schedule.

Mr. Guerrettaz also testified regarding water tank related projects included in this DSIC. He pointed out that in DSIC 1, the Commission rejected inclusion of the Hobart Water tank and
explained the rationale therefore. He testified the Commission was on the right path in DSIC 1 when it rejected water tank DSIC recovery. He testified that water tanks are very different from distribution system mains and should properly be excluded from DSIC recovery. He explained unlike hundreds or thousands of miles of aging, deteriorated, below ground distribution mains, above ground water tanks are easily susceptible to periodic inspection at distinct locations. He testified water towers may be water utility plant but they are not “distribution system.” He recommended Petitioner’s request for DSIC inclusion of water tower costs be denied.

Mr. Guerrettaz also addressed AMR. He testified that while Exhibit SSH-1 lists many millions of dollars of “accelerated AMR program,” nowhere in its testimony or in its Petition, does Petitioner describe what those costs are, or justify their inclusion in this DSIC 7. He pointed out that none of the previous DSIC-1 through 6 Exhibits SSH-1 listed costs as “AMR” or “accelerated AMR program.” Mr. Guerrettaz recommended rejection of the accelerated AMR program costs in this DSIC-7 pointing out that Petitioner did not present a single sentence in its testimony to even acknowledge their existence, no less justify AMR inclusion within the limits of DSIC recovery. In his view, automated meter reading equipment is distinguishable from the need to replace aged or deteriorating distribution mains in aged appurtenances so as to not be considered recoverable in the DSIC. Electronic meter reading equipment and related items should not be considered part of the “distribution system” for DSIC inclusion. He testified to the extent Petitioner is replacing existing functional meters with new, electronic data sending meters, that is not improving the mains and piping through which water flows and should not be DSIC recoverable. Finally, to the extent that meter reading expense and related operating expenses are reduced by AMR, a proper match of that new technology’s cost with the intended technology savings should be considered in the context of a base rate case where the offsetting savings may be included, rather than within the confines of the expedited DSIC process.

7. Petitioner’s Rebuttal.

A. AMR. Alan J. DeBoy, President of Indiana American, offered testimony to respond to Mr. Kaufman’s and Mr. Guerrettaz’s suggestion that Petitioner’s AMR program be excluded from DSIC recovery. Mr. DeBoy first apologized that the AMR program acceleration had not been raised in Petitioner’s case-in-chief testimony. He stated Petitioner simply had not anticipated that the AMR program acceleration would raise any concerns. Mr. DeBoy explained the AMR program represents a significant investment by Petitioner. He testified the program fits plainly within what the Commission has indicated in prior DSIC cases and in the Commission’s rules is eligible for recovery in a DSIC. He stated AMR meters have been included in past DSIC and general rate cases without question. He explained the OUCC’s and Crown Point’s proposal to change to a more restrictive interpretation of eligible distribution system improvements would have a significant impact on Indiana American and its earnings and would expedite the filing of Indiana American’s next general rate case. He calculated the OUCC’s and Crown Point’s interpretation would deprive Indiana American of approximately $1.5 Million in annual net income and would produce a reduction in return on equity of almost 50 basis points. In contrast, Mr. DeBoy testified the difference in interpretations between the OUCC’s and Petitioner’s position produces about a 1% difference in overall rates or approximately 50¢ per month for the average residential customer. Mr. DeBoy explained that the differences between the parties on the inclusion of AMR relate to whether Indiana American’s speed of implementation is appropriate or whether the implementation should be spread over a couple of years more. He
cited to the Commission’s Order in Indiana American’s first DSIC proceeding in which the Commission found the only limitation on DSIC eligibility once an improvement is found to be distribution system is whether it results in connection of the distribution system to new customers. He testified the OUCC’s and Crown Point’s interpretation and proposed exclusion of AMR would be a dramatic shift away from the Commission’s prior DSIC Orders.

Mr. Hoffman also testified in support of Petitioner’s inclusion of AMR in this DSIC. He too opined that Mr. Kaufinan’s opposition to including AMR appears based on the timing of implementation of the program. He testified that extending the time to convert to AMR technology would delay realization of the benefits of the technology and, in the interim, create systems with multiple generations of equipment, resulting in inefficiencies of operating and maintaining the equipment. In contrast, Mr. Hoffman testified, a shorter technology conversion time reduces conversion costs. He presented evidence that Indiana American had realized a savings of greater than 25% in material costs based on the quantities and conversion time for Petitioner’s AMR conversion. He referred to other water utilities who have converted to AMR technology over relatively short periods. He explained that extending the conversion time for AMR conversion would be contrary to recognized best practices and that prudent conversion time to AMR technology must include replacement of meters and meter registers less than ten (10) years old with AMR technology. Mr. Hoffman testified that AMR costs have been included in Indiana American’s DSIC filings since 2007. In addition, he stated Indiana American had met with representatives of the OUCC and the Commission in July 2010 to discuss the benefits of AMR technology. Mr. Hoffman testified he does not believe the timing of implementation came up during that or any other meeting.

Mr. Hoffman responded to Mr. Kaufinan’s suggestion that Indiana American’s meter replacement program takes funds away from replacing aged infrastructure, explaining that not only is AMR technology very important but appropriate types of distribution system investments vary over time. Mr. Hoffman presented evidence that showed Petitioner has increased investments in main replacements to a yearly average of $18.7 Million per year over the last five years.

Mr. Hoffman then offered detailed testimony on the benefits of AMR technology, including benefits to meter reading, employee safety, enhanced customer services, billing benefits, distribution system water quality and backflow detection benefits and related potential for capital expenditures deferrals, in addition to cost savings benefits. According to Mr. Hoffman, all of these benefits cannot be fully realized until conversion to AMR technology is complete. He also explained that Mr. Kaufinan’s suggestion that replacing registers on meters does not aid in the transportation of water does not take into consideration that meter registers are integral components of the entire meter assembly.

Finally, Mr. Hoffman testified that AMR technology is critical to Indiana American’s performance of its capacity factor study as ordered by the Commission in Cause No. 44022. He explained that AMR technology installed on a sufficient number of meters across all customer classes is required to conduct the new capacity factor study because it provides a record of dynamic water use profiles of actual customers in all customer classes through time. He stated this requirement and desire to complete the modern capacity factor study meant more AMR conversions were necessary even sooner than Indiana American had previously planned. In
addressing Mr. Kaufman’s reliance on the capital plan submitted in Cause No. 44022, Mr. Hoffman noted that the capital plan submitted in that Cause was developed over 2 ½ years ago and has undergone re-evaluations and updates since that time. As a result, he stated that the capital plan has little relevance regarding the AMR technology conversion issue in this case.

B. **Tank-Related Projects.** In rebuttal, Mr. Hoffman addressed Mr. Guerrettaz’s testimony that tank-related projects should not be included in this DSIC. Mr. Hoffman distinguished the tank-related projects included in this DSIC filing and the Hobart water tank disallowed in the first DSIC case. He stated all of the work on the tank-related projects is capital rehabilitation work on existing tanks and not construction of new tanks. He explained the projects do not increase storage capacity and none of the work was for the purpose of adding new customers.

C. **Fire Protection.** Mr. DeBoy testified that the lack of testimony in Petitioner’s last rate case concerning the change to the tariff to include fire protection revenues in the DSIC was pure oversight. He testified that Petitioner did not realize the oversight until the issue was raised after the current tariff had already been approved by the Commission. He explained that Petitioner was uncertain how the tariff could be changed back to the prior methodology without an Order from the Commission to do so in a docketed proceeding and that is why it was proposed in this DSIC proceeding. Mr. DeBoy conceded that the Commission may prefer to delay a decision on this issue until the next general rate case.

D. **Filing Requirements.** Mr. Roach responded to Mr. Guerrettaz’s recommendations. He disagreed with Mr. Guerrettaz’s contention that the proper orientation of Petitioner’s Exhibit SSH-1 has been ordered by the Commission and pointed out that, upon request, Petitioner had provided Crown Point with an electronic copy of the exhibit so that Mr. Guerrettaz could print the exhibit in whatever size and format he desired. He further testified that the additional information recommended by Mr. Guerrettaz to be included in Petitioner’s exhibits is not required by the Commission’s rules and is unnecessary. Mr. Roach testified that Mr. Guerrettaz’s recommendation regarding additional information to be included regarding undersized mains is likewise not required by the Commission’s rules and would impose a test for DSIC eligibility not heretofore espoused by the Commission.

Mr. Hoffman also responded to Mr. Guerrettaz’s suggestion that Indiana American did not provide sufficient evidence to support the main replacement projects included in Petitioner’s case-in-chief. Mr. Hoffman noted that in the Commission’s Order in Indiana American’s first DSIC proceeding, the Commission recognized that mains may be replaced with mains of a larger size and remain eligible for DSIC recovery. In response to Mr. Guerrettaz’s concern over the “Reinforcement Projects” described in Petitioner’s case-in-chief, Mr. Hoffman explained that providing reliable service was the sole purpose of the construction of the reinforcement projects.

Mr. Hoffman also responded to Mr. Riceman’s suggestion of sorting the data in Petitioner’s Exhibit SSH-1 by account number first and then by district, stating that would be acceptable to Indiana American.

A. DSIC Requirements. Indiana Code ch. 8-1-31-1 requires the Commission to approve a DSIC in order to allow a water utility to adjust its basic rates and charges to recover a pre-tax return and depreciation expense on eligible distribution system improvements. Indiana Code § 8-1-31-5 defines eligible distribution system improvements as new, used and useful water utility plant projects that:

(a) do not increase revenues by connecting the distribution system to new customers;
(b) are in service; and
(c) were not included in the public utility’s rate base in its most recent general rate case.

Under Indiana Code § 8-1-31-6, the rate of return allowed on eligible distribution system improvements is equal to the public utility’s weighted cost of capital. Unless the Commission finds that such determination is no longer representative of current conditions, Indiana Code § 8-1-31-12 provides that the cost of common equity to be used in determining the weighted cost of capital shall be the most recent determination by the Commission in a general rate proceeding of the public utility.

Indiana Code ch. 8-1-31 establishes the process for the Commission to follow and authorized the Commission to adopt rules to establish procedures not inconsistent with Chapter 8-1-31 or 170 IAC 6-1.1.

B. Discussion of Proposed DSIC. In our first DSIC order in Cause No. 42351 DSIC-1, issued on February 23, 2003, we addressed the fact that the statutory definition of “eligible distribution system improvements” does not explicitly include any requirement that the new, used and useful plant projects be improvements to the utility’s distribution system. We addressed that omission in our order in DSIC 1, recognizing the importance of interpreting the law with respect to DSIC’s in Indiana by looking at the legislation as a whole. We noted that in Brown v. Grzeskowiak, 230 Ind. 110, 101 N.E. 2d 639 (1951), “The intention of the legislature, as ascertained from a consideration of the act as a whole, will prevail over the literal meaning of any of the terms used therein.” We also relied on the holding in City of Indianapolis v. Evans, 216 Ind. 555, 24 N.E. 2d 776 (1940), noting the court said “The legislative intent, however, is to be ascertained by an examination of the whole, as well as the separate parts of the act, and when so ascertained, the intention will control the strict letter of the statute or the literal import of particular terms or phrases, where to adhere to the strict letter or literal meaning would lead to injustice, absurdity, or contradict the evident intention of the legislature.”

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1 Both Indiana Code § 8-1-31-5 and 170 IAC 6-1.1-1(g) define “eligible distribution system improvements” as new, used and useful water utility plant projects that:
(a) do not increase revenues by connecting the distribution system to new customers;
(b) are in service; and
(c) were not included in the public utility’s rate base in its most recent general rate case.
In DSIC 1, Indiana-American had included in its DSIC application improvements to source of supply, water treatment plant, general plant and security, which the OUCC said should not be included in a DSIC despite the lack of specific exclusion in the definition of “eligible distribution system improvements.” Determining the intent of the legislature and looking at the act as a whole, including the title to establish the purpose and scope of the act, we agree with the OUCC that a DSIC should only include distribution system improvements.

Just as it did in DSIC 1, Petitioner again relies on an overly inclusive interpretation of “eligible distribution system improvements” that does not recognize the Commission’s understanding, as set forth in DSIC 1, of DSICs in Indiana. In that order, we specifically referenced the statements of Indiana American’s former Vice-President, who spoke in favor of the passage of DSIC legislation in order to “allow for the replacement of aged infrastructure.” DSIC 1 Order at 16. In fact, the Commission specifically stated that “We agree with the Public’s testimony that the purpose of a DSIC proceeding is to encourage, through an expedited and automatic rate increase, repair or replacement of a distribution system’s aging and failing infrastructure.” Id. at 21 (emphasis added).

In its application in this case, Petitioner seeks recovery of more than $18 million for numerous meter related projects later identified as an “accelerated AMR program.” Indiana-American included in its DSIC the cost of approximately 90,000 meters to put into place AMR technology by replacing meters without regard to their condition. Petitioner replaced meters with no less than five to ten years of expected remaining useful life. Petitioner replaced meter registers on meters placed in service less than five years ago. In addition to new AMR meters and meter registers, the proposed $18 million DSIC costs include AMR meter reading equipment and meters not yet placed in service. (Response to OUCC DR 3-1, attached to SSH-R1, and OUCC CX-5). The OUCC questioned whether a project that involved replacing plant that did not otherwise need to be replaced merely to institute automatic meter reading qualified as “eligible distribution system improvements.” The OUCC asserted that the definition of “distribution system” in our rule, which we must consider to be within the definition of “eligible distribution system improvements,” indicates that to be included in a DSIC, a project must be necessary for the transportation of water. The OUCC based its position in part on the fact that the definition of “distribution system” includes the provision that the addition must be “necessary to transport treated water... to the customer.” The OUCC maintained that institution of an AMR program, while it could be prudent and includable in rate base, does not qualify for special ratemaking treatment through a DSIC since retiring equipment early to improve billing and other operational functions does not promote the transportation of water. Ultimately, the OUCC considers such projects not to be within the evident intent of DSICs in Indiana. We agree.

In its proposed order, Petitioner asserted there are three basic problems with excluding AMR meters from the DSIC. First, the AMR meters are booked within Account Number 334 of the NARUC Uniform System of Accounts. Second, Petitioner had disclosed in Cause No. 44022 that it was planning to spend approximately $7,549,723 on meters and meter replacements over the period covered by this DSIC and neither the OUCC nor Crown Point raised any objection at that time. Third, Petitioner disclosed in that Cause that it needed to expedite its meter replacement program to comply with our requirement to conduct a new and more detailed
capacity factor study before Petitioner’s next rate case.

Petitioner asserted that since NARUC System of Accounts indicates meters do not need to be installed before they are so booked, that meters not yet in use should be included as a cost in a DSIC. Although uninstalled meters may be considered “in service” for accounting purposes, we do not find such meters to be “in service” for ratemaking purposes, and specifically, for inclusion in a DSIC. As Petitioner notes in its Reply Brief, any DSIC-eligible plant must be used and useful, i.e., actually devoted to providing utility service and reasonably necessary for the provision of that service. Meters on shelves do not provide utility service, even if they are “in service” for accounting purposes. Accordingly, uninstalled meters may not be included in a DSIC.

Further, recovery of the replacement cost of newer traditional meters with AMR meters does not fit within the context of the DSIC, in that the Commission stated in DSIC 1 that the purpose of DSIC recovery is to replace aged infrastructure. We agree with Mr. Kaufman’s assessment that the replacement of meters older than 10 years could be recoverable in a DSIC. However, despite having the opportunity to respond to Mr. Kaufman, Petitioner did not include in the record the necessary information for the Commission to determine what the DSIC factor would be if only 10 year and older meters were considered. While Petitioner’s Exhibit SSH-R1 indicates the number of meters replaced older than 10 years, it is unclear whether that discovery response is solely for the DSIC 7 period. Further, we do not have the retirement costs of the 10 year and older meters that were replaced, nor do we have the cost of meters and associated installation costs related to the AMR meters used to replace 10-year or older meters.

We next address Petitioner’s argument that it had disclosed in the last rate case that it was planning to spend approximately $7,549,723 on meters and meter replacements over the period covered by this DSIC, and neither the OUCC nor Crown Point raised any objection at that time. We note that while Petitioner provided its plan in Cause No. 44022, it made no mention of any intention to include accelerated AMR replacements in a DSIC. Contrary to Mr. DeBoy’s statement of what he interpreted as frustration by the Commission over the frequency of rate cases, the Commission seeks to address issues in each given proceeding fairly and completely. While we do not find that Petitioner’s accelerated AMR meter replacement, as proposed, should be approved under a DSIC proceeding, the Commission has addressed plant replacement programs in the confines of a rate case. Here, we simply do not find that the expedited DSIC process is an appropriate avenue for cost recovery.

Finally, Petitioner’s represented need to replace functional non-AMR meters with AMR meters to perform its capacity factor study does not make plant that would otherwise not qualify for recovery in a DSIC, as defined by the Commission’s rules, eligible for inclusion in a DSIC.

Based on the foregoing, we deny Petitioner’s request to include $18 million of costs associated with its accelerated AMR meter replacement program in this DSIC.

i. Tank Rehabilitation Projects. Crown Point’s witness Guerrettaz recommended we disallow recovery for Petitioner’s investments in tank rehabilitation projects based on our decision to disallow the Hobart Water tank in DSIC 1. The evidence demonstrates that there are meaningful distinctions between the tank rehabilitation projects Petitioner seeks to
include in this DSIC and the Hobart water tank project from DSIC 1. Most notably, the tank projects in this proceeding were necessary rehabilitations of existing distribution infrastructure and were not construction of new tanks. Petitioner’s evidence shows the projects did not increase storage capacity and none of the work was for the purpose of adding new customers. Accordingly, we decline to exclude the tank rehabilitation projects from DSIC recovery.

ii. Fire Protection. A question has arisen in this proceeding whether changes made to Petitioner’s tariff in its last rate case to include in DSIC public and private fire protection revenues should be applicable in this DSIC. The evidence in this case shows that this change went largely overlooked in Cause No. 44022. Petitioner’s evidence in Cause No. 44022 did not discuss the change and no party to that proceeding addressed it. Nevertheless, the tariff filed by Petitioner and approved by the Commission contained the change. As such, we agree with Petitioner’s witness DeBoy that the tariff could not be further revised outside of a docketed proceeding.

However, we do not agree that this modification to the DSIC calculation is appropriately considered within the expedited timeframe of a DSIC proceeding. We are not convinced that the change to Petitioner’s tariff to include public and private fire protection revenues in the DSIC calculation has been presented to date in a manner that will allow all interested parties to fully review this proposed change or to state their position with respect to the change. Accordingly, we defer consideration of the proposed modification to Petitioner’s next general rate case.

iii. Filing Requirements. Mr. Guerrettaz has made a number of suggested additional requirements for the evidence to be filed in support of DSIC requests. We have noted above the applicable statute and rules governing DSIC filings. Mr. Guerrettaz’s suggestions go beyond what is required by statute and under our rules. We decline to adopt his suggested changes. In addition, we note that we have previously acknowledged that, with respect to main replacements, a utility may replace mains “with larger diameter mains in response to or anticipation of new customers, yet still be DSIC eligible.” DSIC 1 Order at 20.

We accept the OUCC’s proposed change to the organization of Petitioner’s Exhibit SSH-1 and direct Petitioner, in future DSIC filings, to sort the exhibit first by account number and then by district.

iv. Projects and Amounts to be Included as Distribution System Improvement Charges. The OUCC’s direct evidence provides a detailed explanation of the methodology used to calculate the proposed DSIC revenue requirements of $3,666,274. The total cost for the net investor supplied DSIC Additions is $34,629,904, and the evidence shows the pre-tax return associated with those additions, as calculated in accordance with Indiana Code ch. 8-1-31 is $3,390,268. The revenue requirement for depreciation on the Improvements is $648,100. Finally, total DSIC revenues of $4,038,368 are reduced by $372,094 to reflect the reconciliation (over-recovery) of revenues under DSIC-6. We find that Petitioner is therefore authorized to collect from its water customers a DSIC of 2.12% calculated on a percentage of bill basis.

C. Reconciliation of Petitioner’s DSIC. Petitioner should be prepared to reconcile the DSIC approved by this Order in the manner prescribed by Indiana Code § 8-1-31-14 and 170 I.A.C. 6-1.1-8. Under Indiana Code § 8-1-31-14, at the end of each 12-month period
a DSIC is in effect the difference between the revenues produced by the DSIC and the expenses and the pre-tax reflected in it should be reconciled and the difference refunded or recovered as the case may be through adjustment of the DSIC.

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

1. A Distribution System Improvement Charge calculated on a percentage of bill basis and designed to generate $3,666,274 in additional annual revenues shall be and hereby is approved for Petitioner Indiana-American Water Company, Inc.

2. Prior to placing into effect the above-authorized DSIC, Petitioner shall file with the Water/Sewer Division of the Commission an appendix to its schedule of rates and charges for water service.

3. The above-authorized DSIC shall be subject to reconciliation as described in Finding No. 8(C) above.

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

ATTERHOLT, BENNETT, LANDIS, MAYS AND ZIEGNER CONCUR:

APPROVED: DEC 27 2012

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

Brenda A. Howe
Secretary to the Commission
AFFIRMATION

I affirm, under the penalties for perjury, that the foregoing representations are true.

Carl N. Seals  
Indiana Office of Utility Consumer Counselor  

February 16, 2017  
Date  

Cause No. 42351 DSIC-10  
Indiana-American Water Company, Inc.
CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing *OUCC Testimony of Carl N. Seals: Public’s Exhibit No. 2* has been served upon the following counsel of record in the captioned proceeding by electronic service on February 16, 2017.

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