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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”) ) CAUSE NO. 42351 DSIC 10  
 PURSUANT TO IND. CODE CHAP. 8-1-31; (B) )  
 A NEW RATE SCHEDULE REFLECTING ) APPROVED: MAR 22 2017  
 THE DSIC; AND (C) INCLUSION OF THE )  
 COST OF ELIGIBLE DISTRIBUTION )  
 SYSTEM IMPROVEMENTS IN ITS DSIC )

ORDER OF THE COMMISSION

**Presiding Officers:**

**James F. Huston, Commissioner**

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

On January 17, 2017, 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 IAC 6-1.1. On January 31, 2017, the City of Crown Point, Indiana (“Crown Point”) filed its Petition to Intervene in this Cause, which was granted by the Commission on February 16, 2017. The Indiana Office of Utility Consumer Counselor (“OUCC”) and Crown Point filed their respective cases-in-chief on February 16, 2017. Sullivan Vigo Rural Water Corporation filed its Petition to Intervene on February 20, 2017, which was granted at the evidentiary hearing. Petitioner filed its rebuttal testimony and attachments on February 22, 2017. On February 23, 2017, Crown Point filed a correction to the pre-filed testimony of Mr. Gregory T. Guerrettaz.

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 February 27, 2017 at 10:30 a.m. in Room 222 of the PNC Center, Indianapolis, Indiana. At the evidentiary hearing, 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 applicable law and evidence presented, 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 also provided notice of its filing in this Cause to its wholesale customers pursuant to 170 IAC 6-1.1-4. 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. Under Ind. Code ch. 8-1-31 and 170 IAC 6-1.1, the Commission has jurisdiction over DSIC proceedings. 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 issued in Cause No. 44450 on January 28, 2015 ("2015 Rate Order"). On December 30, 2015, Petitioner filed a Step Two True-Up to update rate base as set forth in the Stipulation and Settlement Agreement approved by the 2015 Rate Order, which took effect January 29, 2016. The rate base as updated by that true-up is referred to herein as the "2015 Rate Order Rate Base." Petitioner's most recent DSIC was approved in Cause No. 42351 DSIC 9 on May 4, 2016 (the "DSIC 9 Order"), approving a DSIC for water customers of 1.95% calculated on a percentage-of-bill basis, calculated to produce a \$3,474,913 net revenue increase. In accordance with the Commission's rules, Petitioner's Reconciliation Report for DSIC 9 is not due for filing until the 30 days beginning May 4, 2017. The DSIC Improvements approved in DSIC 9 consisted of non-revenue producing projects placed in service between December 1, 2014 and November 30, 2015 and not included in Petitioner's 2015 Rate Order Rate Base.

Petitioner proposes to add to the DSIC approved in DSIC 9 non-revenue producing projects placed in service between December 1, 2015 and November 30, 2016 that were not included in the 2015 Rate Order Rate Base or the DSIC Improvements approved in DSIC 9. After giving effect to adjustments made on rebuttal, as described below, Petitioner's proposed DSIC would produce total annual DSIC revenues of \$8,307,026, which when combined with the 1.95% rate directed in the DSIC 9 Order would equate to a percentage rate of 6.61%. The combined DSIC 9 and DSIC 10 revenues represent a 5.44% percentage overall increase above the base revenue level approved in the 2015 Rate Order (as adjusted by the Step Two True Up).

**4. Petitioner's Direct Evidence.** Petitioner presented the direct evidence of Gary M. VerDouw, Director of Rates and Regulatory for Indiana-American, and Stacy S. Hoffman, Director of Engineering for Indiana-American.

**A. Calculation of DSIC 10.** Mr. VerDouw testified regarding the filing requirements and methodology for calculating the DSIC. Mr. VerDouw 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 in the manner set forth in 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, in accordance with 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. VerDouw explained that Petitioner currently has a DSIC surcharge in effect of 1.95%, which was approved by the Commission on May 4, 2016 in Cause No. 42351 DSIC 9. Mr. VerDouw testified that Petitioner proposes to add to the DSIC 9 surcharge an additional surcharge to include only non-revenue producing projects placed in service between December 1, 2015 and November 30, 2016 that were not included in rate base in the 2015 Rate Order Rate Base.

Mr. VerDouw then discussed how Petitioner calculated the Net Investor Supplied DSIC Additions. He stated that Petitioner started with DSIC Improvements of \$68,213,628 which he reduced by the amount of related plant retirements (\$5,338,830), consistent with the DSIC 8 Order. The actual amount of the cost of removal, net of salvage in the amount of \$8,345,399 was then added. Mr. VerDouw stated that there were total reimbursements from the Indiana Department of Transportation ("INDOT") and others in the amount of \$147,491. These reimbursements were removed from the DSIC Improvements, resulting in Net Investor Supplied DSIC Additions of \$71,072,706, as shown on Line 5 of Schedule 1 of Attachment GMV-2.

Mr. VerDouw also 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 of November 2014. He testified that Petitioner used the average embedded debt cost rate as of November 2014 to determine the long-term debt cost rate. The common equity cost rate of 9.75% is the rate approved by the Commission in the 2015 Rate Order. The weighted cost of capital of 6.60% and pre-tax rate of return of 9.39% were derived as shown on Schedule 4 of Attachment GMV-2. Mr. VerDouw stated the pre-tax rate of return was calculated using a gross revenue conversion factor of 168.5707%, calculated using Utilities Receipts Tax of 1.3207%, State Corporate Adjusted Gross Income Tax of 6.50% and Federal Income Tax of 35%. Mr. VerDouw stated that the resulting pre-tax return is \$6,673,727 when the pre-tax overall rate of return is multiplied by the net investor-supplied original cost of the DSIC Improvements.

Mr. VerDouw stated that Petitioner determined its depreciation expense of \$1,647,513 by using the annual depreciation rates by primary plant account previously approved by the Commission, multiplied by the Improvements, net of related retirements.

Mr. VerDouw explained how the annual revenue requirement of \$8,321,240 for DSIC 10 was calculated. He testified and provided schedules showing that proposed DSIC Revenues of \$11,796,153, resulting from combining DSIC 9 and DSIC 10 totals, do not exceed 10% of Petitioner's base revenue level.

**B. Description of DSIC Improvements.** Petitioner's witness Stacy S. Hoffman sponsored Attachment SSH-1, which provides a summary of costs for non-blanket and blanket project categories, and Attachments SSH-2 and SSH-3, which provide the list of projects included in this DSIC. Attachment SSH-2 lists non-blanket projects individually by project number, with project description, the date placed in service, the project purpose, the resulting

benefits, the applicability of easements, the range of age of plant retired, pipe diameters, pipe length, and the total costs incurred. Attachment SSH-3 lists statewide blanket projects by project number, with project description, the project purpose, the resulting benefits, the range of age of plant retired, and the total costs incurred. That exhibit also lists quantities of blanket project assets replaced. Attachment SSH-4 lists all projects with additions cost detail by utility account. Attachment SSH-5 lists all projects with retirement cost detail by utility account. Attachment SSH-6 lists all projects with cost of removal and salvage detail by utility account. Mr. Hoffman stated that Petitioner has invoices and other cost support for all projects listed in Attachments SSH-2 and SSH-3.

Mr. Hoffman generally described the types of projects included in Attachments SSH-2 and SSH-3. He stated that all of the improvements included in this Cause are replacement infrastructure, reinforcement projects, and distribution system retirements. He explained that replacement infrastructure includes water mains, tanks, tank coating systems, valves, hydrants, service lines, and meters. Some of the projects described by Mr. Hoffman were replacing distribution system facilities that were in poor physical condition or were hydraulically deficient for providing adequate service including public fire protection. Other projects included distribution system infrastructure associated with right-of-way improvement projects wherein the location of Indiana-American's infrastructure directly conflicted with other public infrastructure improvement projects like road and sewer projects. He further explained that reinforcement infrastructure consists of mains, valves, and hydrants with the purpose of improving pressure, fire flow and service reliability of the existing distribution system. He testified that all of the retirements associated with the new infrastructure had been recorded on Indiana American's books and records as of the date of Petitioner's filing. He also testified that no costs of removals were estimated. Mr. Hoffman explained that all of the projects listed individually in Attachments SSH-2 and SSH-3 represented eligible DSIC projects, including the blanket categories. He explained the presentation of the blanket projects, noting that blanket categories are used for common, similar activities like replacement meters, service lines, hydrants, and unscheduled main replacements.

Mr. Hoffman also testified about Petitioner's comprehensive capital improvement planning studies for each of the Indiana-American operations. He explained that the studies include a thorough evaluation of demand projections, regulatory requirements, asset service reliability and quality, replacement of poor condition infrastructure, asset impacts on safety and efficiency, public fire protection, and environmental sustainability. He testified that Petitioner performs an evaluation used for long-term distribution system asset investment planning modeled on a multi-decade forward projection of pipeline asset replacement needs based on distribution pipe materials and the decades of installation of the pipe materials. Another evaluation is used for near term distribution system asset investment planning, which is a detailed modeling of the distribution systems, identifying service risks associated with pipeline failure risks for all pipes in Petitioner's distribution system. Mr. Hoffman described the key inputs to Petitioner's five-year capital investment plan as including a multi-decade forward projection of pipeline asset replacement needs, prioritization modeling of Petitioner's 4,800 miles of distribution pipe, customer rates, and service reliability and impacts. The multi-decade forward projection of pipeline asset replacement needs utilizes the American Water Works Association ("AWWA") software analytics tool, "Buried No Longer Pipe Replacement

Modeling Tool.” Mr. Hoffman stated this modeling projects that pipe replacement needs range from a current projected need of a near 1% annual replacement rate to an annual rate of near 1.5% by the decade of 2030. He testified that the significant gap between the current projected annual pipeline replacement rate need of near 1% and Petitioner’s current actual eight-year annual average pipe replacement rate of only 0.29% without including relocations, and 0.43% including relocations translates to a need to increase Petitioner’s annual pipe replacements. He explained that this gap translates to an unrealistic pipe life expectancy of nearly 250 years, as compared to a more realistic pipe life expectancy of 50 to 100 years. He stated that many pipes in Petitioner’s system that were installed from 50 years ago to over 100 years ago are at or nearing the end of their expected useful life. He indicated Petitioner is planning to increase its replacement rate in the coming years.

Mr. Hoffman went on to describe the “tidal wave” effect on the future cost to customers caused by deferral of pipe replacements year by year. He explained that to the extent pipe replacement needs are deferred further into the future, service quality will suffer from increasing numbers of pipe breaks, service disruptions, health risks from potential drinking water contamination exposure during pipe breaks, property damages, and related community opportunity costs related to community health and economic development. He referred to recent AWWA and Water Research Foundation reports highlighting the challenge of aging infrastructure for utilities, customers and regulators, as well as a report prepared by the Economic Development Research Group, Inc. for the American Society of Civil Engineers (“ASCE”) that calculated estimates of economic impacts of failing to invest in water infrastructure across the country. Both Mr. Hoffman and Mr. VerDouw referenced the 2016 report published by the Indiana Finance Authority which estimated current utility infrastructure needs to be \$2.3 billion, with an additional projected \$815 million annual spend to maintain the utilities into the future. Mr. Hoffman discussed the various challenges to closing the current gap in main replacement rates, including the challenge of effectively educating all stakeholders about (1) buried pipe infrastructure and its function in providing reliable water service, (2) the cost of replacing poor condition pipes and the link to the cost of providing water service, and (3) the consequences of delaying replacement of poor condition pipes. He also noted the challenge of attracting reasonable cost capital.

Mr. Hoffman testified about Petitioner’s prioritization model for identifying pipeline replacement investment needs. He stated that in July 2015, Indiana-American met with Commission staff as well as representatives of the OUCC, the City of Crown Point, and the Town of Schererville, to review details of Petitioner’s pipeline prioritization model and process. He testified about the long term benefits that can result from using these models to develop a more systematic approach to replacing poor condition pipes. He stated prioritization models are excellent tools for a prudent asset management approach.

Mr. Hoffman testified regarding what types of projects are eligible for inclusion in Petitioner’s DSIC filings. Mr. Hoffman explained that Petitioner has been involved in ten DSIC filings and, over the years, the Commission’s Orders have clarified and provided guidance on the types of projects it considers to satisfy the DSIC statute’s requirements.

Mr. Hoffman testified about the inclusion of tank-related projects in Petitioner’s proposed

DSIC, referring to the Commission's Order dated December 27, 2012 in Cause No. 42351 DSIC 7 (the "DSIC 7 Order") in which the Commission authorized DSIC recovery on tank-related projects consisting of foundation rehabilitations, a paint rehabilitation, a tank roof replacement and some distribution pump work to enable Indiana-American to take the tanks offline. He testified that the tank-related projects included in this DSIC 10 are similar to those included in DSIC 7 insofar as they consist of capital rehabilitation work on existing tanks and not construction of new tanks. He described the tank-related projects in this DSIC 10 as consisting of replacement of tank coating systems, structural steel, and tank appurtenances. He noted the projects are recorded in National Association of Regulatory Association Utility Commissioners ("NARUC") 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 described two categories of meter replacements included in this DSIC 10: meters replaced as part of Petitioner's length of service ("LOS") plan, and meters replaced under Petitioner's accelerated automated meter reading ("AAMR") plan that were or would have been 10 years old or older as of November 30, 2016. He described the LOS plan, which consists of replacing meters at the LOS age approved by the Commission in Petitioner's 30-Day Filing No. 2610 approved on January 20, 2010 and of replacing broken meters regardless of age. He then described the AAMR category of meters, citing the DSIC 7 Order as support for inclusion of meters that were or would have been ten years old or older as of November 30, 2016. He stated additions and cost of removals for the AAMR meters ten years old and older were calculated from the actual material and installation costs for these meters. He stated retirement values for the 10 years old and older meters were calculated at gross original cost and computed using the Handy-Whitman index to trend back current day costs to original costs because Petitioner's financial system for these mass assets does not show original cost for this specific subset of ten years old and older meters.

Mr. Hoffman testified that all Improvements listed in Attachment 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 previously included in rate base; 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. He testified that he verified that none of the project costs identified in this Cause were included in rate base in any prior Causes. Mr. Hoffman also explained that some of the project costs included in this DSIC 10 are for projects that were placed in service prior to December 1, 2015, but were not included in DSIC 9 and were not previously included in rate base in any prior case, because the costs were incurred subsequent to the most recent rate base cutoff or because Petitioner had not completed all accounting for these costs by the most recent rate base cutoff.



Mr. Hoffman also noted that, pursuant to the settlement and Order in Cause No. 44584, Petitioner has not included in this DSIC 10 any DSIC eligible meter or service line replacements completed in Russiaville as a result of transitioning Russiaville customers to Indiana-American immediately following the acquisition of the Russiaville system.

Mr. Hoffman testified regarding the funding of the Improvements. He stated that projects included in this DSIC 10 were funded by Petitioner or were reimbursed by INDOT or others, as noted by Mr. VerDouw.

Mr. Hoffman stated Petitioner has a five-year Strategic Capital Expenditure Plan that provides for budgeted amounts of approximately \$228,600,000 for replacement mains, reinforcement mains, DSIC tank related work, hydrants, services and meters for the period 2017-2021. He testified that included in this amount is approximately \$31,000,000 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 Richard J. Corey and Carl N. Seals. Mr. Corey described his review of Petitioner's application for DSIC and recommended a DSIC rate increase of 6.59% based on (1) Mr. Corey's recommendation that an Indiana State Income Tax rate of 6.0625% and the current IURC fee of 0.1171966% be applied to yield a Pre-Tax Rate of Return of 9.35%, and (2) Mr. Seals' recommendation to exclude amounts for the cost of relocations of water mains less than 15 years old.

Mr. Corey gave an overview of Petitioner's DSIC request and explained how Petitioner presented hundreds of work orders representing thousands of invoices, which the OUCC is not able to verify the prudence of during the shortened DSIC timeframe. Mr. Corey explained a more thorough review of the prudence of the DSIC additions may take place before they are added to rate base during Indiana-American's next rate case.

Mr. Corey testified in support of the OUCC's proposed DSIC calculation based on its proposed Indiana State Income Tax rate of 6.0625% and IURC fee of 0.1171966%. Mr. Corey explained the state income tax rate used by Petitioner was only effective for revenues earned during the period July 1, 2015 through June 30, 2016. Mr. Corey stated the current state income tax rate of 6.25% is effective from July 1, 2016 through June 30, 2017. After that, the income tax rate drops again on July 1, 2017 to 6.00%. Mr. Corey further explained the state income tax rate will continue to decline annually until it reaches 4.9% as of July 1, 2021. To account for the decline in state income tax rate, Mr. Corey testified that the OUCC proposed using a weighted tax rate, calculated by weighting three months of tax at the current rate of 6.25% and nine months of tax at the rate of 6.00%, because the DSIC will likely go into effect in March 2017.

Mr. Corey explained Petitioner used an IURC fee rate of 0.1319% in its calculation of its proposed DSIC. Mr. Corey noted the current IURC fee rate of 0.1171996% went into effect as of July 1, 2016. Mr. Corey used the current IURC fee rate in the calculation of his proposed DSIC.

Mr. Corey used his recommendations on state income tax rate and IURC fee rate to determine the pre-tax rate of return of 9.35% based on a gross up factor of 167.7489%. Mr.

Corey applied this pre-tax rate of return to DSIC additions of \$70,946,830, which includes removal of the \$125,876 recommended by Mr. Seals, for a pre-tax return of \$6,633,529. After inclusion of \$1,645,515 in depreciation expense on DSIC 10 additions Mr. Corey calculated total DSIC 10 revenues of \$8,279,044. Mr. Corey added the DSIC 9 Revenues of \$3,474,913 to the DSIC 10 revenues for total DSIC revenues of \$11,753,957. Mr. Corey then divided the total DSIC revenues by the volumetric and metered revenue from Cause No. 44450 to yield a DSIC of 6.59%.

Mr. Seals noted that 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. He noted 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. Mr. Seals discussed the purpose of the DSIC. He noted that in Cause No. 42351 DSIC 1, the Commission said “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.) He added that, according to one of Indiana-American’s witnesses 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.” Direct Testimony of James L. Cutshaw on Proposed Distribution System Improvement Charge, p.4, filed December 19, 2002 in Cause No. 42351 DSIC 1. Mr. Seals testified not all of Petitioner’s DSIC projects involve replacing aging or failing infrastructure. He noted two projects in particular totaling \$125,876 that involve main relocations that do not replace aging infrastructure. He said 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 (2005 and 2007 respectively). He explained that according to Mr. Hoffman’s Attachment SSH-2, both mains needed to be moved because the water mains were “in conflict with sewer project[s].”

Mr. Seals acknowledged that 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. He added that 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 when the lines being replaced in the relocation are not in need of replacement due to their age or condition.

Mr. Seals referred to Cause No. 42351 DSIC 7, in which the Commission declined to include the replacing of meters in service less than ten years as DSIC eligible projects. He noted that 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. Mr. Seals said Indiana-American should seek to include the prudently incurred costs of these two projects in its next base rate case.

Mr. Seals stated that Commission’s order in Cause No. 42351 DSIC 1 noted 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." He further stated that, according to Mr. James L. Cutshaw, 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."

**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 pointed out that Indiana-American's rate increases since the April 15, 2009 DSIC 5 Order total over \$67,000,000, a 42.79% increase. He said that the impact of these rate increases on Crown Point is approximately \$1,237,800, a 64.22% increase. He noted that in that same eight-year period, Indiana-American's parent company, American Water Works, experienced an approximate 320% increase in its stock price from \$17.60 per share to about \$74.00 per share.

Mr. Guerrettaz noted that as a wholesale municipal water customer, Crown Point is served water by Indiana-American at a single connection point in Crown Point's service area. He expressed concern, that through the DSIC, Crown Point is assigned costs for the infrastructure improvements made in Indiana-American's various district systems. Many of those district systems were formerly municipal- or investor-owned utilities that received purchase price payments from Indiana-American. Yet Crown Point and other wholesale water customers are asked to pay for the capital replacement needs of those other purchased systems. He testified that is unfair. Crown Point has its own municipal water utility infrastructure capital investment and improvements to make, in addition to other municipal infrastructure capital needs. He asked the Commission to exercise its regulatory expertise and discretion to minimize Indiana-American's continuing rate increases. He did not request in this DSIC a change to the DSIC allocation method approved in the Settlement of Cause No. 44450.

Mr. Guerrettaz also testified that Petitioner's proposed relocation projects that do not replace aged or poor condition infrastructure should be excluded from this DSIC. Otherwise, it would stretch beyond the DSIC purpose of replacing aged deteriorating plant. Noting that some responses to Crown Point's data requests were not received at the time his testimony was filed, Mr. Guerrettaz also expressed concern with Petitioner's plant removals, stating "there should not be a cost for removal in instances where the old line is not removed," and recommending that contractor invoices document instances where old line is physically removed from the ground and the charges for such removal.

**7. Petitioner's Rebuttal.**

**A. Water Main Relocations.** Mr. Hoffman offered testimony to respond to Mr. Guerrettaz's recommendation that Petitioner's relocation projects that did not replace aged infrastructure should be excluded from the DSIC and Mr. Seals' recommendation to disallow two water main relocation projects, totaling \$125,876, because such projects relocated water mains placed in service less than 15 years ago. Mr. Hoffman testified that he did not agree with these recommendations because the Commission already ruled on this issue in DSIC 9. The Commission's DSIC 9 Order states as follows:

Crown Point also recommended that we impose a new restriction on relocation projects to be included in a DSIC, requiring that those relocation projects be shown to replace aged or poor condition infrastructure. Relocation projects have been considered eligible DSIC projects in every one of Indiana-American's prior DSIC cases. These projects replace distribution system infrastructure that has reached the end of its useful life due to road construction or other projects. The DSIC rules set out in 170 IAC 6-1.1 contemplate that these types of projects are eligible for DSIC recovery considering that project costs for which recovery is sought must exclude transportation department reimbursements. Accordingly, we find it unnecessary to impose additional limitations beyond what is required by statute on eligibility of relocation projects for DSIC recovery.

Mr. Hoffman noted that the Commission's DSIC 9 Order is clear and unambiguous, and applies precisely to the issues raised by Messrs. Guerrettaz and Seals. Mr. VerDouw agreed with Mr. Hoffman's testimony on the issue, and testified that he did not agree with Mr. Corey's proposed adjustment to remove \$125,876 for additions related to relocation of mains less than 15 years old.

**B. Costs of Removals.** In rebuttal, Mr. Hoffman also addressed Mr. Guerrettaz's suggestion that "there should not be a cost of removal in instances where the old line is not removed, but rather left buried next to the replacement line." Int. Ex. 1 (Guerrettaz), at 5, lines 3-5. Mr. Hoffman addressed what he believes is a misunderstanding by Mr. Guerrettaz regarding the meaning of "removal" in cost of removals. Mr. Hoffman referenced Petitioner's Response to Crown Point Data Request 2-10 in order to explain the misunderstanding. The response stated:

The question implies a misunderstanding of what "removal" is in the cost of removal. Removal is the cost of removing the asset from service. Much of the pipe being retired in each replacement project is left in place where feasible, however pieces of existing pipes are physically taken from the ground where new replacement pipe is connected to the existing pipe that is to remain in-service and where the existing pipe is retired. Other portions of pipe being retired may also be taken from the ground by [Petitioner] where [Petitioner] is relocating a short length of pipe and where the existing pipe conflicts with a City project. Old hydrants and valve boxes are also physically taken from the site. All of this work also requires excavation, removal of surface material and subgrade soil, backfill with natural soil or compacted crushed stone or flowable concrete fill, and surface restoration. The contractor must be paid for the work described, some of which includes installing the new asset, and some of which includes removing the old asset from service. The 1996 National Association of Regulatory Association

Utility Commissioners (NARUC) Uniform System of Accounts for Class A Water Utilities defines cost of removal as, "... the cost of demolishing, dismantling, tearing down or otherwise removing utility plant, including the cost of transportation and handling incidental thereto." The work [Petitioner] described is cost of removal as defined by the NARUC definition. If these costs were not charged to cost of removals, and instead were charged to additions, the DSIC revenue requirement would be higher due to additional associated depreciation cost. Further, if [Petitioner] took all assets from the ground in their entirety upon retiring them, [Petitioner] estimates the cost of replacement projects could be at least double the cost of the replacement projects in [Company]'s current approach.

Thus, Mr. Hoffman testified that costs of removals are incurred in Indiana-American's replacement projects, and these costs are appropriately accounted for and charged to these projects. He noted that Mr. Guerrettaz has presented no evidence to the contrary.

Mr. Hoffman also addressed Mr. Guerrettaz's recommendation that "it should be documented on contractor invoices when and if the old line was removed and the cost of such removal." Int. Ex. 11 (Guerrettaz), at 5, lines 5-6. Mr. Hoffman explained Indiana-American's approach for documenting and accounting for costs of removal and noted that this is the same approach used in past DSIC cases. He testified that the Commission clearly approved such approach when Crown Point and the OUCC questioned Indiana-American's cost of removal accounting in DSIC 9, and ordered that there was no basis to disallow the costs of removals.

**C. State Income Tax Rate and IURC Fee.** In rebuttal, Mr. VerDouw responded to the OUCC's proposed adjustments to the State Income Tax rate and IURC fee used by Indiana-American in its case-in-chief. Mr. VerDouw agreed with Mr. Corey's recommendation that the state income tax rate should be adjusted from 6.5% to the current state income tax rate of 6.25%, in order to remain consistent with the methodology used in DSIC 9. Mr. VerDouw disagreed, however, with Mr. Corey's recommendation that the state income tax rate reflect a forward-looking blended rate of 6.0625%. Mr. VerDouw testified that using a blended rate would deviate from the methodology applied in DSIC 9 and improperly apply a future adjustment in a case that does not use a forward-looking timeframe in the DSIC calculation. He presented revised schedules showing that using the current state income tax rate of 6.25% would change the DSIC percentage from 6.62% to 6.61%.

Mr. VerDouw also testified regarding Mr. Corey's recommendation to adjust the IURC fee from the rate Petitioner used of 0.1319% to the current rate of 0.1171996%. Mr. VerDouw testified that he agreed with the adjustment, in theory, but noted that the change was immaterial and had no effect on the DSIC rate or final revenue requirement. Mr. VerDouw further testified that if the IURC fee is adjusted down in this DSIC to reflect current rates, the adjustment should work both ways and be applied in future DSICs where the IURC fee has increased.

**D. Rate Design Applied to Crown Point.** In his rebuttal testimony, Mr.

VerDouw addressed Mr. Guerrettaz's suggestion that Crown Point should not be assigned the same cost for infrastructure improvements as other customers, because Crown Point is a wholesale customer served at a single connection point. Mr. VerDouw explained that in Petitioner's 2007 Rate Case, docketed as Cause No. 43187, the Commission directed Indiana-American to include in its next DSIC filing calculations for both the then-current method of recovery via a volumetric charge as well as the calculation of a percentage to be applied over both the volumetric and customer charge, which had been recommended by the Industrial Group Intervenor in the 2007 Rate Case. The Commission, in its DSIC 4 Order issued on April 2, 2008, ordered Indiana-American to calculate the recovery of DSIC 4 and future DSIC's via a percentage that is applied equally to volumetric and customer charge revenue; this methodology is still in place with DSIC 10. Mr. VerDouw noted that the parties in Indiana-American's most recent rate case (Cause No. 44450) agreed that such methodology would remain in place, but further changes could be proposed in connection with Indiana-American's next general rate case proceeding. He stated that the appropriate venue for any DSIC rate calculation methodology changes would be as a part of Indiana-American's next general rate case proceeding, but that Indiana-American would be happy to meet with the City of Crown Point prior to the next rate case filing to discuss DSIC rate design options to consider as part of its next rate case proceeding.

## **8. Commission Discussion and Findings.**

**A. DSIC Requirements.** Indiana Code ch. 8-1-31 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 Ind. 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.

## **B. Approval of Proposed DSIC.**

i. Water Main Relocations. The OUCC and Crown Point sought to disallow \$125,876 for additions related to Petitioner's relocation of mains less than 15 years old. As noted in the Commission's DSIC 9 Order:

Crown Point also recommended that we impose a new restriction on relocation projects to be included in a DSIC, requiring that those relocation projects be shown to replace aged or poor condition infrastructure. Relocation projects have been considered eligible DSIC projects in every one of Indiana-American's prior DSIC cases. These projects replace distribution system infrastructure that has reached the end of its useful life due to road construction or other projects. . . . [I]t is unnecessary to impose additional limitations beyond what is required by statute on eligibility of relocation projects for DSIC recovery.

We decline to accept the proposed disallowance in this Cause.

ii. Costs of Removals. Mr. Guerrettaz recommended that we disallow recovery of Petitioner's costs of removals "in instances where the old line is not removed, but rather left buried next to the replacement line." The 1996 NARUC Uniform System of Accounts for Class A Water Utilities defines cost of removal as, "... the cost of demolishing, dismantling, tearing down or otherwise removing utility plant, including the cost of transportation and handling incidental thereto." Thus, the "removal" work described by Petitioner in its evidence constitutes cost of removal as defined by the NARUC definition. Petitioner incurs costs of removal when it removes assets from service, i.e. dismantlement, regardless of whether the old line is physically removed or not, and, based on Petitioner's testimony, these costs are appropriately accounted for and charged to removal projects. Therefore, we find no basis in the record for disallowing these costs.

iii. WLF Davis Ferry Clearwell Tank. Petitioner included in its DSIC \$120,259 for the "WLF Davis Ferry Clearwell Tank" consisting of additions at \$99,499, cost of removal at \$48,187, and, as an offset, cost of retirement at \$27,427. The plant being retired was placed in service in 2009. See Pet. Ex. 2, Attachment SSH-2, page 24 of 24, line 398. Mr. Hoffman gave no other explanation for this particular project in his testimony.<sup>1</sup> During cross-examination by the OUCC, Mr. Hoffman explained that the 2009 coating system on the tank had failed, necessitating the project. Hr. Tr. A-45, A-46. Mr. Hoffman noted that a coating should have an expected life of 10 – 20 years. Hr. Tr. A-46.

With respect to the WLF Davis Ferry Clearwell Tank project, the OUCC disagreed through its proposed order that those costs are DSIC eligible. Because of facts adduced at the hearing, the OUCC maintained that "WLF Davis Ferry Clearwell Tank" should not be included in Petitioner's DSIC 10 as it does not qualify as distribution system. Rather, the OUCC maintains that the tank that received the coating system is treatment plant and the coating should not be considered a distribution system project.

Initially, we note that this project was not included in the OUCC's report. Accordingly, given that Petitioner has established its prima-facie case for including the project in the DSIC,

<sup>1</sup> In his testimony, Mr. Hoffman discussed tank projects generally and asserted that the tank related projects in this DSIC are recorded in the USOA distribution accounts, do not increase storage capacity, and otherwise meet the statutory criteria to qualify as eligible distribution system improvements. Pet. Ex. 2, p. 31.

we find that the evidence the OUCC adduced at the hearing did not overcome the initial presumption, and we decline the OUCC's proposed disallowance.

iv. Meter MoveOuts. In this DSIC, Indiana-American included \$853,244 for 541 "Meter MoveOuts," the purpose of which was described on Pet. Ex. 2, Attachment SSH-3 as "Replacement of meter by moving it from inside structure to meter pit outside structure." Pet. Ex. 2, Attachment SSH-3, Parts 1 and 2. The vintage of the plant retired was 1924 to 2016 and the resulting benefit was "Service reliability." Pet. Ex. 2, Attachment SSH-3, Part 1. During the evidentiary hearing, Mr. Hoffman explained that the move outs were typically done in conjunction with length of service work, meaning that the meter is at its 15-year interval for replacement. Hr. Tr. A-50. Further, Mr. Hoffman opined that newer meters were replaced and moved because they were broken.

The OUCC questioned this project through cross-examination at the hearing, and in its proposed order it asserted the project cost should not be included in DSIC 10. In particular, the OUCC maintained that the project, which includes a wide range of vintages of replaced plant, was done for the purpose of improving its operations and was not shown to be for the purpose of replacing aged infrastructure. The OUCC asserted that, while moving a meter from the basement to the front yard may make good sense from an operational standpoint, it does not improve the distribution system for purposes of a DSIC or necessarily replace aged or failing infrastructure. The OUCC asserted Indiana-American's Meter MoveOuts should be addressed similarly to the Commission's treatment of accelerated AMR meters in DSIC 7.

In DSIC 7, Indiana-American sought 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 replacing meters and meter registers without regard to their condition. Indiana-American had replaced meters with five to ten years of expected remaining useful life as well as meter registers on meters in service less than five years. The OUCC characterized such projects as replacing plant that did not otherwise need to be replaced merely to institute automatic meter reading, and asserted it did not qualify as "eligible distribution system improvements." Final Order, Cause No. 42351 DSIC 7, p. 12. The OUCC argued, in its proposed order, that "the intended benefit was not the replacement of aged or failing infrastructure."

Again, we note that this project was not included in the OUCC's report. Petitioner established its prima-facie case by stating that the meters were aged or broken and that the project was done for service reliability. Nothing in the Petitioner's case or evidence adduced at the hearing overcame the presumption of eligibility, and we decline the OUCC's proposed disallowance.

v. Indiana State Income Tax Rate and IURC Fee. In its case-in-chief Petitioner proposed using a state income tax rate of 6.5%. OUCC witness, Mr. Corey noted the current state income tax rate is only 6.25% and it would be lowered to 6.0% beginning July 2017. Accordingly, Mr. Corey proposed a blended rate of 6.0625% reflecting a rate of 6.25% for the three months of April through June 2017, and a rate of 6.0% for the months of July 2017 through March 2018. In his rebuttal testimony, Mr. VerDouw agreed 6.5% should not be used



but rejected Mr. Corey's proposal to use a blended rate. Rather, he proposed using the current state income tax rate of 6.25%. Mr. VerDouw asserted Mr. Corey's use of the blended rate was incorrect because the DSIC does not use a forward-looking time frame in its calculation.

As Mr. VerDouw testified, the DSIC is based on a reasonable estimate of sales for the period in which the DSIC will be in effect. As such, it is appropriate to match the reasonable estimate of the tax applicable to Petitioner during the period the revenues will be billed into the calculation of a DSIC. Thus, we agree with the OUCC that a blended state income tax rate is appropriate and we find a state income tax rate of 6.0625% should be included in the calculation of Indiana-American's DSIC 10.

Mr. VerDouw noted that the change from the IURC fee he proposed of 0.1319% to the current IURC fee of 0.1171996% would be immaterial so he declined to use the correct IURC fee. Mr. Corey proposed to use the correct IURC fee in his calculation of the DSIC. While we agree the change in IURC fee is immaterial to the calculation of a DSIC, we also see no reason not to use the correct IURC fee for DSIC billings. As such, we find the current IURC fee rate of 0.1171996% should be used.

vi. Rate Design Applied to Crown Point. The appropriate venue for any DSIC rate calculation methodology changes is in a general rate case proceeding. While we are mindful of Mr. Guerrettaz's concerns, we agree with Petitioner that a change in the DSIC rate calculation methodology is not properly addressed in the abbreviated timeline of a DSIC proceeding. In Cause No. 42416 DSIC 3, we noted that "a DSIC proceeding is intended to be a summary proceeding in terms of the issues presented." Allowing parties to debate the DSIC calculation methodology in a DSIC proceeding would be inconsistent with the "summary nature" of the proceeding. Further, as noted in Mr. VerDouw's testimony, in the Commission's DSIC 4 Order issued on April 2, 2008, we ordered Indiana-American to calculate the recovery of DSIC 4 and future DSICs via a percentage that is applied equally to volumetric and customer charge revenue. This methodology is in place today, and the parties agreed in Indiana-American's most recent rate case (Cause No. 44450) that such methodology would remain in place until Indiana-American's next rate case.

vii. Projects and Amounts to Be Included as Distribution System Improvement Charges. Petitioner's direct evidence provides a detailed explanation of the methodology used to calculate the proposed DSIC revenue requirements, which, after giving effect to the blended Indiana state income tax rate of 6.0625% and the current IURC fee is \$8,292,811. The state income tax rate adjustment changed the DSIC Percentage to Apply to Bill to 6.60%. The total cost for the net investor supplied DSIC Additions is \$71,072,706, and the evidence shows the pre-tax return associated with those additions, as calculated in accordance with Indiana Code ch. 8-1-31, is \$6,645,298. The revenue requirement for depreciation on the Improvements is \$1,647,513. The total revenue requirement associated with the DSIC 10 Improvements is 5.44% of the revenues authorized in Petitioner's last rate case and thus is not subject to reduction under Indiana Code § 8-1-31-13.

Furthermore, the evidence shows that all of the projects reflected in the proposed DSIC are in service, do not result in the addition of new customers to Petitioner's system, and fall into

NARUC Uniform System of Accounts for Water Utilities Accounts 330, 331, 333, 334, or 335. As such, they are eligible for inclusion in a DSIC.

Based on the evidence presented, the Commission finds that Petitioner's request for a DSIC complies with the requirements of Indiana Code § 8-1-31-1 and 170 IAC 6-1.1. Further, Petitioner's proposed DSIC is non-discriminatory, reasonable, and just. We find that Petitioner is therefore authorized to collect from its water customers a DSIC of 6.60% 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 IAC 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 \$8,292,811 in additional annual revenues, is approved.
2. Prior to placing into effect the above-authorized DSIC, Petitioner shall file with the Water/Wastewater Division of the Commission, under this Cause, 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. 9(C) above.
4. This Order shall be effective on and after the date of its approval.

**ATTERHOLT, FREEMAN, HUSTON, AND ZIEGNER CONCUR; WEBER ABSENT:**

**APPROVED:** MAR 22 2017

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

  
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**Mary M. Becerra**  
**Secretary of the Commission**