

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

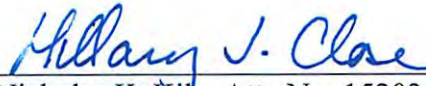
PETITION OF INDIANA-AMERICAN)
WATER COMPANY, INC. FOR)
APPROVAL OF (A) A NEW)
DISTRIBUTION SYSTEM IMPROVEMENT)
CHARGE ("DSIC") PURSUANT TO IND.)
CODE CHAP. 8-1-31; (B) A NEW RATE)
SCHEDULE REFLECTING THE DSIC;)
AND (C) INCLUSION OF THE COST OF)
ELIGIBLE DISTRIBUTION SYSTEM)
IMPROVEMENTS IN ITS DSIC)

CAUSE NO. 42351 DSIC-10

SUBMISSION OF PROPOSED ORDER

Petitioner, Indiana-American Water Company, Inc. ("Petitioner"), by counsel, hereby submits its Proposed Order.

Respectfully submitted,



Nicholas K. Kile, Atty No. 15203-53

Hillary J. Close, Atty No. 25104-49

Lauren M. Box Atty No. 32521-49

Barnes & Thornburg LLP

11 South Meridian Street

Indianapolis, Indiana 46204

Telephone: (317) 231-7768

Fax: (317) 231-7433

Email: nkile@btlaw.com

hclose@btlaw.com

lbox@btlaw.com

Attorneys for Petitioner

INDIANA-AMERICAN WATER COMPANY, INC.

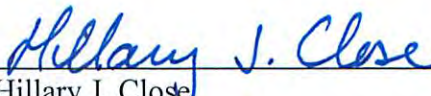
CERTIFICATE OF SERVICE

The undersigned certifies that a copy of the foregoing was served upon the following via electronic email this 28th day of February, 2017 to:

Daniel LeVay
Scott Franson
Office of Utility Consumer Counselor
PNC Center
115 W. Washington Street, #1500 South
Indianapolis, IN 46204
infomgt@oucc.in.gov
dlevay@oucc.in.gov
sfranson@oucc.in.gov

Robert M. Glennon
3697 N. 500 East
Danville, IN 46122
glennon@iquest.net

Jeffrey A. Earl
52 West Main Street
Danville, IN 46122
jeff@lewisandearl.com



Hillary J. Close

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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
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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” or “Company”) 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. 6-1.1-1 *et seq.* 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’s Docket Entry dated February 16, 2017. The Indiana Office of the 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 in this Cause. 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. EST 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 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 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. 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 the Company'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 the Company 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 the Company's distribution system. Mr. Hoffman described the key inputs to the Company's five-year capital investment plan as including a multi-decade forward projection of pipeline asset replacement needs, prioritization modeling of the Company'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 the Company'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 the Company'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 the Company'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 the Company 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 the Company’s prioritization model for identifying pipeline replacement investment needs. He stated that in July 2015, Indiana-American met with IURC staff as well as representatives of the OUCC, the City of Crown Point, and the Town of Schererville, to review details of the Company’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 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 the Company's length of service (LOS) plan, and meters replaced under the Company'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 10 years old or older as of November 30, 2016. He stated additions and cost of removals for the AAMR meters 10 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 the Company's financial system for these mass assets does not show original cost for this specific subset of 10 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 the Company 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, the Company 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 0.11711966% be applied to yield a Pre-Tax Rate of Return of 9.35% and (2) Mr. Corey's recommendation to exclude amounts for the cost of relocations of water mains less than 15 years old.

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 0.11711966%. 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 further testified that the OUCC proposed using an IURC fee of 0.11711966% (effective July 1, 2016) because it is the current IURC fee rate. Based on these recommendations, Mr. Corey proposed a Pre-Tax Rate of Return of 9.35%

With respect to the relocation of water mains less than 15 years old, Mr. Corey testified that the OUCC does not consider replacement of these assets to represent the replacement of aging infrastructure. He recommended that the Commission exclude \$125,876 for relocations of mains less than 15 years old from the DSIC calculation.

Mr. Seals also testified regarding the water mains relocations. Mr. Seals stated that the purpose of a DSIC proceeding is to replace aged infrastructure and cited to the Commission's decision to exclude replacing meters in service less than ten years in Cause No. 42351 DSIC-7 as support for excluding the relocation projects in this Cause. Mr. Seals ultimately recommended that the Commission exclude two relocation projects totaling \$125,876, because the projects involved relocations of mains less than 15 years old.

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 noted that as a wholesale municipal water customer, Crown Point is served 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 throughout Indiana-American's systems. He testified that Crown Point has its own municipal water utility infrastructure capital investment and improvements to make, in addition to other municipal infrastructure capital needs. Mr. Guerrettaz further testified regarding Petitioner's proposed relocation projects and recommended the exclusion of any relocation projects that have not been proven to be required as the replacement of aged or poor condition infrastructure. Mr. Guerrettaz also expressed concerns with Petitioner's plant removals.

He stated that “there should not be a cost for removal in instances where the old line is not removed,” and recommended documenting instances where old line is physically removed from the ground and the costs of such removal. Int. Ex. 1 (Guerrettaz), at 5.

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 the Company where the Company 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 the Company 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 the Company took all assets from the ground in their entirety upon retiring them, the Company 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 the Company 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 the Company'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 § 8-1-31-1 *et seq.* 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.

B. Approval of Proposed DSIC.

As noted in Petitioner's evidence in this Cause, this Commission has now had occasion, through nine prior DSIC proceedings brought by Petitioner, to determine the eligibility of various distribution system improvements. Almost all of the issues raised in this case have been determined to meet the DSIC eligibility requirements in a number of prior DSIC cases. Among our prior findings are the following:

- (1) "Distribution System": We established in our Order dated February 27, 2003 in Cause No. 42351 DSIC-1 ("DSIC-1 Order") that "distribution system improvements" for purposes of the DSIC statute is intended to limit recovery to items within the functional category of "distribution system" as generally understood in the industry (consistent with the American Water Works Association's (AWWA's) Manual: *Principles of Water Rates, Fees and Charges* and the NARUC Uniform System of Accounts), as opposed to source of supply, water treatment plant and general plant. DSIC 1 Order, pp. 14-15.

Generally speaking, mains (NARUC USOA Account 331), services (NARUC USOA Account 333), USOA Account 335) are thus eligible for DSIC recovery provided they meet the statutory requirements. *See* DSIC-1 Order, p. 18; 170 IAC 6-1.1-2. In addition, certain tank-related projects (NARUC USOA Account 330) are also eligible, as described below.

(2) Tank Related Projects: Tank rehabilitation projects are DSIC-eligible provided they are necessary rehabilitations of existing distribution infrastructure. Construction of new tanks that increase storage capacity are ineligible. In our Order dated December 27, 2012 in Cause No. 42351 DSIC-7 (the “DSIC-7 Order”), we 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. In authorizing the inclusion of the DSIC-7 tank-related projects, we specifically noted that the projects did not increase storage capacity and none of the work was for the purpose of adding new customers. *See* DSIC-7 Order, pp. 13-14 (distinguishing the tank rehabilitation projects included in DSIC-7 from the Hobart water tank project disallowed in DSIC-1).

(3) Meters:

(a) Length of Service (LOS) Plan: The evidence shows that the Company’s LOS plan 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 stuck and broken meters regardless of age. These meter replacements have been approved by the Commission for inclusion in the DSIC since DSIC-1.

(b) Accelerated Automated Meter Reading (AAMR) Plan: Replacements of meters ten years old and older with automated meters are eligible for recovery in DSIC and have been approved for inclusion since DSIC-8. *See* Order of the Commission dated December 18, 2013 in Cause No. 42351 DSIC-8 (“DSIC-8 Order”), p. 13; *see also* DSIC-7 Order, p. 13.

(c) Uninstalled Meters: Uninstalled meters have been held by the Commission to not qualify for recovery through a DSIC as they are not considered “in service” for ratemaking purposes. DSIC-7 Order, p. 13.

(4) Replacement Mains: Scheduled main replacements have been considered eligible for DSIC recovery since DSIC-1. Unscheduled main replacements have also been held to be DSIC eligible. Specifically, we have rejected arguments from the OUCC that unscheduled main replacements constitute “emergency water main repairs” and are thus not planned replacement of distribution system eligible for DSIC recovery. We held that unscheduled main replacements work is identified and included in the Company’s strategic capital expenditure plan and those replacements are therefore “planned” within the meaning of the Commission’s DSIC rules. Order of the Commission dated May 4, 2016 in Cause No. 42351 DSIC-9 (“DSIC-9 Order”), pp. 15-16. We have also found it unnecessary to impose a materiality threshold for DSIC eligibility. *Id.* p. 17.

(5) Upsizing and Relocations: Relocation projects are eligible for DSIC recovery so long as they meet the statutory requirements for eligibility. Mains that are relocated because they are located in the right-of-way and conflict with roadway or other projects are eligible; and we specifically rejected Crown Point’s request “that we impose a new restriction on relocation projects . . . [by] requiring that those relocation projects be shown to replace aged or poor condition infrastructure.” DSIC-9, p. 19. We have declined to further limit eligibility and have rejected arguments historically made by Intervenor Crown Point that the upsizing of those mains renders them ineligible for DISC recovery. We have held that with respect to main replacements a utility may replace mains with larger diameter mains in response to or in anticipation of new customers, yet still be DSIC eligible. DSIC-7 Order, p. 14, DSIC-1, p. 20. We have also held that the possibility of new customers eventually connecting to replacement or reinforcement mains in the future does not impact whether those projects are initially eligible for DSIC recovery. DSIC-9 Order, p. 19, DSIC-8 Order, p. 14. We further stated this is an issue we consider to have been determined. DSIC-9, p. 19.

(6) Reinforcement Mains: Reinforcement mains have also been included in the Company's DSIC since DSIC-1. While Crown Point has in the past attempted to argue that these projects should also be disallowed as creating the potential for connecting new customers, as noted above, we have rejected those arguments. *Id.*

(7) Retirements and Costs of Removal:

(a) Retirements: In its DSIC-8 Order, we held that, consistent with the methodology established in DSIC-1, the accounting treatment for DSIC requirements should be to calculate the net original cost of eligible distribution system improvements by netting distribution plant additions against related distribution retirements. DSIC-8 Order, pp. 6 & 13.

(b) Costs of Removal: We have previously rejected arguments by intervenors that the Company had not adequately supported removal costs for service line replacements because they were allocated as a percentage of total costs given that contractor invoices did not contain a line item dedicated to the costs of removal. DSIC-9 Order, p. 18. An issue also arose in DSIC-9 with respect to service line retirements where a corresponding service line replacement was not installed. On reconsideration, we upheld our determination that the removals of abandoned service lines constituted improvements to the distribution system that is still in service and were therefore DSIC-eligible. Commission's Order on Reconsideration dated July 20, 2016 in Cause No. 42351 DSIC-9 ("DSIC-9 Order on Reconsideration"), p. 2. The Commission noted that the inclusion of removals of abandoned plant would depend on the fact scenarios presented. *Id.*

It is in the context of these prior determinations that we address the issues raised by the OUCC and Crown Point in this Cause.

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 above, this Commission has previously made clear that it will not impose additional restrictions on

relocation projects by requiring that they be shown to have replaced aged or poor condition infrastructure. Moreover, projects in the right-of-way had to be removed and as such, had no remaining life. *Southern Indiana Gas & Elec. Co. v. Dep't of Highways*, 533 N.E.2d 1289 (Ind. Ct. App. 1989). Stated another way: regardless of the age or condition of the main, the main can no longer be used and must be replaced in order to maintain service. The DSIC-9 Order addressed this precise issue, holding:

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.

The DSIC-9 Order is clear and unambiguous on this issue and we decline to disallow DSIC recovery on these main relocations. Nor would this Commission have the power to impose an additional limitation where it is not established by the statute. “The Commission possesses only those powers conferred on it by statute.” *Indiana-American Water Co.*, Cause No. 44450 S1, Order on Reconsideration (IURC 3/25/2015), at 4 (citing *Micronet, Inc. v. Ind. Util. Regulatory Comm'n*, 866 N.E.2d 278, 294 (Ind. Ct. App. 2007)). “Unless a grant of power can be found in the statute, we must conclude that there is none, and any doubt about the existence of authority must be resolved against a finding of authority.” *Id.* This is an issue we consider to have been determined.

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.” Int. Ex. 1 (Guerrettaz), at 5, lines 3-5. We agree with

Petitioner's testimony that Mr. Guerrettaz is misunderstanding the definition of "removal" in "cost of removal" to mean physically removing line from the ground, as opposed to the proper definition of removing the 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." 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 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. Upsizing. The OUCC appeared to raise upsizing at the evidentiary hearing. This issue was not raised by any OUCC witnesses. This is now the 5th time we have decided upsizing challenges. In DSIC-9, we were clear: "This is an issue that we consider to have been determined." DSIC-9, p. 19. The OUCC's new argument is that if a main is increased in size from smaller than 8 inches to 8 inches or larger, perhaps there are existing customers who were previously not charged for public fire protection who now are. The OUCC asked no questions in discovery related to proving its hypothesis and only offered speculation that perhaps there could be such a situation. We note that such speculation is inconsistent with the statutory manner for charging for public fire protection. Inside the corporate limits of municipalities that adopt the customer surcharge approach, all customers are charged the public fire protection surcharge. Ind. Code §8-1-2-103(d)(2). Outside the corporate limits of such an adopting municipality, the applicability of the charge depends upon the customer's vicinity to a hydrant. Ind. Code §8-1-2-103(f). Accordingly, merely increasing the size of an upstream main which might improve the

quality of the public fire protection through that hydrant plays no role in whether the customer is charged for public fire protection. Further, Petitioner has made clear that the purposes of its main replacement and reinforcement projects were to replace poor condition pipe, to replace pipe that reached the end of its useful life due to road construction or other projects, to improve pressures and flows for public fire protection, and to improve service reliability. We note these are all types of distribution system improvements we have approved in prior DSICs. The purpose of these projects was not to increase revenue by connecting new customers to the distribution system. We find the OUCC's new upsizing argument should be rejected.

iv. Indiana State Income Tax Rate and IURC Fee. The OUCC recommended an adjustment to the Indiana state income tax rate of 6.5% used by Petitioner in its case-in-chief. Mr. Corey proposed using a blended rate of 6.0625% reflecting a rate of 6.25% for the three months of April through June of 2017, and a rate of 6.0% for the months of July 2017 through March 2018. On rebuttal, Mr. VerDouw proposed using the current state income tax rate of 6.25% in order to remain consistent with the methodology used in DSIC-9. This is not the first time we have faced the question of the changing State Income Tax rate. In DSIC-9, the OUCC raised the issue of the reduced rate¹ and proposed that Petitioner use the rate in effect at the time of filing the petition; Petitioner agreed with this approach, and we approved of that methodology without requiring full litigation over the issue. The OUCC now seeks to deviate from the method it proposed and which Petitioner accepted in DSIC-9. Suffice it to say that we agree with Mr. VerDouw's contention that it would be improper to incorporate a future adjustment to the state income tax rate when the DSIC calculation in this Cause does not incorporate a forward-looking time frame in any other instance.

¹ The legislation lowering the corporate income tax rates every year until 2021 was enacted in the 2014 Session of the General Assembly, prior to the filing of DSIC-9. Ind. Code §6-3-2-1(b) and Ind. Acts, P.L. 80-2014, Sec. 9.

The use of the current state income tax rate in the Pre-Tax Rate of Return calculation is simple and clear, and should be applied in this and future DSIC proceedings.

We note that changing to the current IURC fee rate of 0.1171996% from the rate of 0.1319% used in Petitioner's case-in-chief constitutes a change from prior practice and is immaterial to the outcome of this Cause. As such, we decline to order Petitioner to make this change to its methodology for calculating the DSIC. However, if ever the change in the IURC fee would have an impact -- whether up or down -- on the ultimate DSIC charge that is approved, we will revisit the OUCC's recommendation to use the current IURC fee.

v. 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.

vi. 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 adjustment to

the current Indiana state income tax rate of 6.25% is \$8,307,026. We have reviewed Mr. VerDouw's calculations provided on Attachment GMV-2R and agree that adjusting the IURC fee to the current rate of 0.1171996% does not change the DSIC rate or the final revenue requirement. As shown on Attachment GMV-1R, the state income tax rate adjustment changed the DSIC Percentage to Apply to Bill from 6.62% to 6.61%. 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 § 8-1-31-1 *et seq.*, is \$6,659,513. The revenue requirement for depreciation on the Improvements is \$1,647,513. The total revenue requirement associated with the DSIC-9 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 6-1.1-1 *et seq.* Further, Petitioner's proposed DSIC is non-discriminatory, reasonable and just. Petitioner is therefore authorized to collect from each of its present and future water customers a DSIC as set forth in Attachment GMV-1R.

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 (“DSIC”) calculated on a percentage of bill basis and designed to generate \$8,307,026 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/Wastewater 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, FREEMAN, HUSTON, WEBER AND ZIEGNER CONCUR:

APPROVED:

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

Mary M. Becerra
Secretary to the Commission