FILED
October 9, 2018
INDIANA UTILITY
REGULATORY COMMISSION

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

IN THE MATTER OF THE INDIANA UTILITY REGULATORY COMMISSION'S INVESTIGATION INTO THE IMPACTS OF THE TAX CUTS AND JOBS ACT OF 2017 AND POSSIBLE RATE IMPLICATIONS UNDER PHASE 1 AND PHASE 2 FOR AMERICAN SUBURBAN UTILITIES, INC.	)	**CAUSE NO. 45032 S 15**

RESPONDENT AMERICAN SUBURBAN UTILITIES, INC.'S MOTION REQUESTING ADMINISTRATIVE NOTICE

Respondent, American Suburban Utilities, Inc., ("ASU"), respectfully requests the Indiana Utility Regulatory Commission ("Commission") to take administrative notice of the following:

1. January 20, 1982 Order of the Commission in Cause No. 36696.

2. December 24, 1957 Order of the Commission in Cause No. 27527.

2. September 8, 1959 Supplemental Order of the Commission in Cause No. 27527.

3. March 8, 1989 Order of the Commission in Cause No. 38515.

These Orders relate to management discretion to elect accelerated depreciation methods for income tax purposes.

Respectfully submitted,

Nicholas K. Kile, Attorney No. 15203-53
Hillary J. Close, Attorney No. 25104-49
Lauren M. Box, Attorney No. 32521-49
BARNES & THORNBURG LLP
11 South Meridian Street
Indianapolis, Indiana 46204
Kile Telephone: (317) 231-7768
Close Telephone: (317) 231-7785
Box Telephone: (317) 231-7289
Facsimile: (317) 231-7433

Email: nicholas.kile@btlaw.com
hillary.close@btlaw.com
lauren.box@btlaw.com

Attorneys for Respondent
American Suburban Utilities, Inc.

CERTIFICATE OF SERVICE

The undersigned attorney hereby certifies that a copy of the foregoing has been served upon the following via electronic mail this 9 day of October, 2018 to:

OUCC:
William Fine
Abby R. Gray
Randall C. Helmen
Daniel LeVay
Tiffany Murray
Office of the Utility Consumer Counselor
115 West Washington Street, Suite 1500S
Indianapolis, IN 46204
wfine@oucc.in.gov
agray@oucc.in.gov
rhelmen@oucc.in.gov
dlevay@oucc.in.gov
timurray@oucc.in.gov
infomgt@oucc.in.gov

Nicholas K. Kile

DMS 13396919v1

ORIGINAL

IURC
RESPONDENT'S
EXHIBIT NO. AG nts 1
11-19-18
DATE REPORTER

STATE OF INDIANA

PUBLIC SERVICE COMMISSION OF INDIANA

IN THE MATTER OF ACCOUNTING PROCEDURES TO BE FOLLOWED BY PUBLIC UTILITIES SUBJECT TO THE JURISDICTION OF THIS COMMISSION WITH RESPECT TO ACCOUNTING FOR (1) THE AMORTIZATION OF EMERGENCY FACILITIES PURSUANT TO THE PROVISIONS OF SECTION 124A (NOW SECTION 168) OF THE INTERNAL REVENUE CODE, AND (2) ACCELERATED DEPRECIATION PURSUANT TO THE PROVISIONS OF SECTION 167 OF THE INTERNAL REVENUE CODE OF 1954)

CAUSE NO. 36696

APPROVED: JAN 20 1982

BY THE COMMISSION:
Audrey K. Grossman, Administrative Law Judge

On November 20, 1981, Indiana & Michigan Electric Company, Petitioner filed its Petition in this Cause for authority to change accounting procedures.

Pursuant to notice published 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 hearing in this cause was held in the Rooms of the Commission, 908 State Office Building, Indianapolis, Indiana, at 3:00 P.M., EST, on December 29, 1981.

The Commission, having considered the evidence presented and being fully advised, now finds:

1. Proper notice of the hearing held in this Cause was published by the Commission and the Commission has jurisdiction of the parties and the subject matter of this Cause.

2. On September 8, 1959, the Commission issued a Supplemental Order in Cause 27527 prescribing the accounting treatment for deferred federal income tax. The Supplemental Order authorized Petitioner and other utilities to charge deferred federal income tax to "Provision for Deferred Federal Income Taxes", and to credit either "Reserve for Deferred Federal Income Taxes" or "Restricted Surplus for Deferred Federal Income Taxes". On September 10, 1959, as required by the fifth ordering paragraph of the Supplemental Order, Petitioner filed its election to follow the restricted surplus treatment for deferred federal income tax.

3. Petitioner now seeks authority from the Commission to change its accounting procedures, to follow the reserve treatment for deferred federal income tax, and to transfer the balance of deferred federal income tax recorded in Account 216 to Accounts 281, 282 and 283, and thereafter account for deferred federal income tax in accordance with the FERC Uniform System of Accounts as adopted by this Commission.

4. The restricted retained earnings (surplus) accounting treatment for deferred federal income tax currently followed by Petitioner is an exception to the FERC Uniform System of Accounts as adopted by this Commission and is inconsistent with the accounting treatment followed by the other investor-owned electric utilities subject to the jurisdiction of this Commission. Petitioner's current treatment is also inconsistent with the Commission and the FERC, both of which regulate various aspects of Petitioner's business.

5. The change in accounting procedures requested by Petitioner will simplify its accounting for deferred federal income tax and will be consistent with the Uniform System of Accounts adopted by this Commission and the accounting treatment followed by other investor-owned electric utilities subject to the jurisdiction of this Commission.

IT IS THEREFORE ORDERED BY THE PUBLIC SERVICE COMMISSION OF INDIANA that Petitioner is authorized, on and after January 1, 1982, to transfer the balance of deferred federal income tax recorded in Account 216 to Accounts 281, 282 and 283, and to account for deferred federal income tax in accordance with the FERC Uniform System of Accounts as adopted by this Commission.

IT IS FURTHER ORDERED that this Order shall be effective on and after the date of its approval.

WALLACE, POWERS AND HARRIS CONCUR:
APPROVED: JAN 20 1982

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

Mark W Tucker
Secretary

INDIANAPOLIS POWER + LIGHT CO.
ACC. AMORTIZATION + DEPRECIATION

STATE OF INDIANA

PUBLIC SERVICE COMMISSION OF INDIANA

IURC
RESPONDENT'S
EXHIBIT NO. AG nts 2
DATE 11-19-18 REPORTER

IN THE MATTER OF ACCOUNTING PROCEDURES TO BE FOLLOWED BY PUBLIC UTILITIES SUBJECT TO THE JURISDICTION OF THIS COMMISSION WITH RESPECT TO ACCOUNTING FOR (1) THE AMORTIZATION OF EMERGENCY FACILITIES PURSUANT TO THE PROVISIONS OF SECTION 124A (NOW SECTION 168) OF THE INTERNAL REVENUE CODE, AND (2) ACCELERATED DEPRECIATION PURSUANT TO THE PROVISIONS OF SECTION 167 OF THE INTERNAL REVENUE CODE OF 1954.

NO. 27527

APPROVED:

December 24, 1957

BY THE COMMISSION:

The Commission, upon petitions filed by certain utilities under its jurisdiction in Causes Nos. 23828, 24783, 25126, 25311, 25842, 26396, 26460, 26523 and 26550, issued orders with respect to the procedures to be followed by such utilities in accounting for the deferment of Federal income taxes resulting from their election (1) to amortize certain property costs for tax purposes under the provisions of Section 124A (now Section 168 of the Internal Revenue Code of 1954) and (2) to use, for tax purposes, one of the accelerated methods of depreciation permitted by Section 167 of said Code.

In all of the orders so issued, the Commission has required the companies, during the period of tax deferment, to charge to "Provision for Deferred Federal Income Taxes" and to credit to "Appropriated Surplus Arising from Deferment of Federal Income Taxes" amounts equal to the reduction in taxes resulting from the use of the larger deduction for tax purposes permitted by said Sections 167 and 168.

This Commission has now made further investigation of the matter of sound accounting procedure in cases of deferment of Federal income taxes under such elections. In such investigation, this Commission has given careful consideration and study to the importance in the public interest of requiring uniformity of accounting treatment on this matter by all utilities under the Commission's jurisdiction, and to the questions of what accounting requirements by the Commission would result in the most clear and accurate recording of such transaction in the accounting records and would most effectively provide for investors the clearest information as to the situation, and of the effect which any general order made by this Commission in this matter might have on service or the cost thereof to present or future users of such service.

The desirability of requiring all utilities subject to the jurisdiction of this Commission to follow the same accounting treatment in respect of the tax deferrals seems self-evident and is clearly in the public interest. Uniformity of treatment will, therefore, be prescribed by this order.

The amounts charged to expense in connection with the tax deferrals above referred to are for the specific purpose of providing for taxes which will become payable in future periods when the annual deductions for tax purposes will be less than those provided in the accounts of the company making the tax deferral. The amounts provided are for this specific purpose; and, in the judgment of this Commission, the accounting treatment required by the previous orders is not consistent with the purposes sought to be achieved, and such amounts should more appropriately be credited to a "Reserve for Deferred Federal Income Taxes". Such crediting will be required by this order.

This Commission is firmly of the view that the requirements to be prescribed by this order are in the best interest of the users of the utility services, the investors in utility securities, and of the public generally.

IT IS THEREFORE ORDERED BY THE PUBLIC SERVICE COMMISSION OF INDIANA that each and every utility under this Commission's jurisdiction who has or may hereafter elect to use the provisions of either Section 167 or Section 168 of the Internal Revenue Code of 1954 (or both of them) is hereby directed to follow the accounting procedures hereinafter set forth in respect of those portions of the cost of its depreciable plant, property, equipment and related facilities which it may elect to amortize or depreciate for Federal tax purposes in accordance with the provisions of said Section 167 or said Section 168, and the resulting deferrals in Federal income taxes, to-wit:

(a) To account on its books for that portion of its properties which are the subject of amortization or accelerated depreciation pursuant to its election under said Section 167 or said Section 168 (or both of them) in the same manner as its other properties, and to accrue depreciation therefor at rates consistent with its rates for like property not subject to amortization or accelerated depreciation.

(b) During those years of the service life of any of its properties which are the subject of amortization or accelerated depreciation pursuant to its election under said Section 167 or said Section 168 (or both of them), in which a deferral of Federal Taxes on income results from the use of the amortization or accelerated depreciation deduction in lieu of the deduction allowable under the tax depreciation method heretofore followed, to charge to "Provision for Deferred Federal Income Taxes," and to credit to "Reserve for Deferred Federal Income Taxes" an amount or amounts in total for each year equal to such deferral of taxes.

(c) Commencing with the year in which its deduction of depreciation for Federal tax purposes in respect of any of its properties subject to amortization or accelerated depreciation is less than such deduction otherwise would have been if depreciation on such properties had been computed at rates consistent with its rates for like properties not subject to amortization or accelerated depreciation, and continuing until "Reserve for Deferred Federal Income Taxes," applicable to such properties, is exhausted, or such properties are retired from service, to charge to "Reserve for Deferred Federal Income Taxes" and to credit to "Portion of Current Federal Income Taxes Deferred in Prior Years" an amount or amounts in total for each year equal to the increase in Federal taxes on income resulting from such lower Federal tax depreciation deduction.

(d) Each utility shall keep the records supporting the entries to "Reserve for Deferred Federal Income Taxes" so that it can readily furnish a segregation of the respective amounts attributable to amortization and to accelerated depreciation.

IT IS FURTHER ORDERED that all previous orders of this Commission relating to the accounting to be followed by companies under its jurisdiction in recording the deferment of Federal income taxes resulting from the election of said companies to use the provisions of either Section 167 or Section 168 of the Internal Revenue Code of 1954 (or both of them) are hereby amended by the deletion, whenever they may appear, of the words "Appropriated Surplus Arising from Deferment of Federal Income Taxes" and the insertion in lieu thereof in each and every instance of the words "Reserve for Deferred Federal Income Taxes".

IT IS FURTHER ORDERED that each company subject to the jurisdiction of this Commission who, as a result of following the procedures prescribed in orders previously issued on this subject by this Commission, has a balance in "Appropriated Surplus Arising from Deferment of Federal Income Taxes" shall immediately transfer that balance to "Reserve for Deferred Federal Income Taxes", and that each such company shall, within sixty days from the effective date of this order, file with this Commission the appropriate journal entries recording such transfer.

IT IS FURTHER ORDERED that this order shall be and become effective immediately upon the entry thereof.

VAN NESS, SKELTON AND HAYMAKER CONCUR:
APPROVED: DECEMBER 24, 1957

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

CHAIRMAN

STATE OF INDIANA

PUBLIC SERVICE COMMISSION OF INDIANA

MATTER OF ACCOUNTING PROCEDURES	)
FOLLOWED BY PUBLIC UTILITIES	)
...CT TO THE JURISDICTION OF THIS COM-	) NO. 27527
...N WITH RESPECT TO ACCOUNTING FOR	)
THE AMORTIZATION OF EMERGENCY	) Supplemental Order
...LITIES PURSUANT TO THE PROVISIONS OF	)
...TION 124A (NOW SECTION 168) OF THE	) APPROVED:
...NAL REVENUE CODE, AND (2) ACCELERATED	) SEPTEMBER 8, 1959
...ECIATION PURSUANT TO THE PROVISIONS	)
SECTION 167 OF THE INTERNAL REVENUE CODE	)
1954.	)

RESPONDENT'S IURC ~~PETITIONER'S~~
EXHIBIT NO. Adm nt 3
11-19-18
DATE REPORTER

THE COMMISSION:

On December 24, 1957, the Commission, upon its own investigation and in "ex parte" proceedings, Cause No. 27527, issued its order (hereinafter called "... Order"), whereby, among other things, it (i) directed each and every utility ...ect to the jurisdiction of the Commission to follow the accounting procedures ... prescribed for tax deferrals resulting from taking amortization permitted ... Section 168 of the Internal Revenue Code of 1954 (hereinafter called "Code") ... from taking accelerated depreciation permitted under Section 167 of the Code, ... procedures included crediting to the balance sheet account "Reserve for ...red Federal Income Taxes" the amount of such tax deferrals and (ii) ordered ... and every utility, which, as a result of following procedures prescribed by ...ous orders of the Commission, had a balance in its balance sheet account ...opriated Surplus Arising from Deferment of Federal Income Taxes" to ...fer such balance to "Reserve for Deferred Federal Income Taxes."

Subsequent to the entry of the 1957 Order it has come to the attention of the ...mission that the Federal Power Commission has held extensive hearings ...ket No. R-159) on accounting procedures for tax deferrals resulting from taking ...oresaid amortization (referred to as "accelerated amortization" in the ...eedings before the Federal Power Commission and hereinafter in this order with ...ect to such proceedings) and accelerated depreciation (referred to as "liberalized ...eciation" in the proceedings before the Federal Power Commission and hereinafter ... order with respect to such proceedings), and that on May 29, 1958, the Federal ... Commission issued its order No. 204 (hereinafter called "Order 204") with ...ect to such accounting procedures.

It appears from Order 204 that: the congressional purposes and intent which ... to the enactment of Sections 167 and 168 of the Code are that "funds generated ... the effect of accelerated amortization and liberalized depreciation be available ... utilities for plant expansion"; that "there are both advantages and disadvantages ... use of either the reserve or the restricted surplus treatment in accounting for lated deferred taxes"; that while it is argued that "the reserve treatment is or in more directly providing for future tax liability," nevertheless, "the treatment necessarily emphasizes a liability concept, although the lated tax deferrals cannot be said to represent an actual indebtedness"; that or of the restricted surplus treatment it is argued that the temporary classifi- of deferred tax amounts as equity capital sufficiently provides for such lations as may be needed for future taxes while improving the rating of the y's securities and reducing its cost of financing," but "it is evident that ication of tax deferrals as surplus, even though restricted, tends to disregard essential character as provisions from income committed to the single purpose iding for future taxes"; that the exclusive and sole use of the reserve method unting for such accumlated deferred taxes could "foreclose financial analysts, rs and others from considering these amounts as part of equity capital if nk proper, with such consequential benefits to the rating of the company's ies and costs of financing as may result therefrom"; that at said hearing the Federal Power Commission it was urged that accounting procedures be adopted "which would permit either a restricted surplus or a reserve ent"; that the Federal Power Commission established a new balance sheet ication to its Uniform System of Accounts for Public Utilities and Licensees d "Accumulated Deferred Taxes On Income"; that the deferred tax accounting ibed by Order 204 is "not mandatory for any utility which, in accordance with istent policy, elects not to follow deferred tax accounting even though accelerated ciation or liberalized depreciation is used in computing taxes on income," with sult that a utility can record only actual taxes paid as an expense and thus se net income and unrestricted earned surplus by the amounts of the temporary errals which would have been included as an expense in the normalizing ; and that the Federal Power Commission recognizes that state regulatory ssions, for state purposes, have the right and authority to prescribe different ependent accounting treatment for accumulated deferred taxes.

Since the entry of the 1957 Order, the Commission has observed that, consistent e findings of the Federal Power Comission, the mandatory use of the reserve ent in accounting for accumulated deferred taxes will deprive a utility of cost uity capital available for plant expansion, will reduce the ratings of any new ies of a utility with attendant increase capital costs and will require large nal equity financing with greatly increased cost of money; that such increased costs will further the need for rate increases and consequent increased costs payers; that pursuant to said previous orders of the Commission certain s have credited millions of dollars to the prescribed Appropriated Surplus and have made long range plans and decisions on the basis of said previous ; that the provisions of the 1957 Order requiring the amounts in such Appropri- rplus account to be transferred to "Reserve for Deferred Federal Income would be retroactive in its effect and be unfair and costly to a public utility had in good faith complied with the previous orders of the Commission; and results and effects of the 1957 Order are not in the best interest of certain , their rate payers and their investors or the public.

The Commission, by reason of the foregoing, has made an additional stigation of the subject matter in this cause, and now being duly advised in premises finds that the aforesaid contentions when applied to certain utilities true; that a utility should not be required to follow the 1957 Order if it is trary to the best interests of such utility and its rate payers and investors; the regulatory commissons of certain other states have permitted both the stricted surplus and tax reserve treatment in crediting the normalizing charge; accordingly the 1957 Order in this cause should be amended and supplemented hereinafter in this order set forth; and that such action is in the best interests the utilities of this state, their rate payers and investors and the public in general:

IT IS THEREFORE ORDERED BY THE PUBLIC SERVICE COMMISSION OF DIANA that the order heretofore entered in this cause on December 24, 1957 957 Order) be, and the same is hereby modified, amended and supplemented as llows:

1. Subdivision (b) of the first paragraph of the ordering part of the 1957 der (p. 3) be, and the same is hereby, changed to read as follows:

(b) During those years of the service life of any of its properties which are the subject of amortization or accelerated depreciation pursuant to its election under said Section 167 or said Section 168 (or both of them), in which a deferral of Federal Taxes on income results from the use of the amortization or accelerated depreciation deduction in lieu of the deduction allowable under the tax depreciation method heretofore followed, to charge to "Provision for Deferred Federal Income Taxes," and to credit either to "Reserve for Deferred Federal Income Taxes" or "Restricted Surplus for Deferred Federal Income Taxes" (such restricted surplus to be used only to provide for future Federal Income Taxes), as each and every such utility may elect as provided in the third paragraph of the ordering part of this order, an amount or amounts in total for each year equal to such deferral of taxes.

2. Subdivision (c) of the first paragraph of the ordering part of the 1957 er (p. 3) be, and the same is hereby, changed to read as follows:

(c) Commencing with the year in which its deduction of depreciation for Federal tax purposes in respect of any of its properties subject to amortization or accelerated depreciation is less than such deduction otherwise would have been if depreciation on such properties had been computed at rates consistent with its rates for like properties not subject to amortization or accelerated depreciation, and continuing until "Reserve for Deferred Federal Income Taxes", or "Restricted Surplus for Deferred Federal Income Taxes", as the case may be, applicable to such properties, is exhausted, or such properties are retired from service, to charge to "Reserve for Deferred Federal Income Taxes" or "Restricted Surplus for Deferred Federal Income Taxes", as the case may be, and to credit to "Portion of Current Federal Income Taxes Deferred in Prior Years", amount or amounts in total for each year equal to the increase in Federal taxes on income resulting from such lower Federal tax depreciation deduction.

Subdivision (d) of the first paragraph of the ordering part of the 1957 Order be, and the same is hereby, changed to read as follows:

(d) Each utility shall keep such records so that it can readily furnish a segregation of the respective amounts attributable to amortization and to acceleration depreciation.

The second paragraph of the ordering part of the 1957 Order (pp. 3 and 4) the same is hereby, changed to read as follows:

IT IS FURHTER ORDERED that all prior orders and parts of all prior orders of the Commission in conflict with the 1957 Order as modified and supplemented by this order are hereby rescinded and repealed, upon the express conditions, however, that any action taken or matter performed or carried out prior to the date hereof under any such prior order or orders shall be, and shall be deemed to be, valid and effective and in accordance with the requirements of the Commission.

The third paragraph of the ordering part of the 1957 Order (p. 4) be, and same is hereby, changed to read as follows:

IT IS FURTHER ORDERED that each utility subject to the jurisdiction of the Commission shall, within sixty days from the effective date of this order, file, with the Commission such utility's election in writing to follow either the aforesaid reserve or restricted surplus treatment for accumulated deferred taxes, and that upon such filing of such election, all past accumulated deferred taxes on income shall be credited to the proper account consistent with such election; provided, however, that each and every utility which shall fail to file such an election within said sixty day period, shall be deemed to have elected to follow, and shall follow, the aforesaid reserve treatment for accumulated deferred taxes. Each and every utility, upon having made an affirmative election in writing as aforesaid or having elected as aforesaid by failing to file such a written election, shall thereupon be bound by, and required to follow, the accounting treatment so elected with the same force and effect as though specifically ordered by the Commission so to do, subject only to change upon specific authorization of the Commission.

IT IS FURTHER ORDERED that the accounting procedures provided for in paragraphs numbered 1 and 2 of the ordering part of this order are established for accounting purposes, and the establishment of said accounting procedures shall not be, and shall be deemed to be, controlling of said accounting procedures for rate-making purposes.

IT IS FURTHER ORDERED that, except as specifically supplemented and modified this supplemental order, the original 1957 Order shall be and remain in full force and effect as entered.

IT IS FURTHER ORDERED that this supplemental order shall be and become ... immediately upon the entry hereof.

... AND DUVALL CONCUR, HAYMAKER DISSENTS
...TED: SEPTEMBER 8, 1959

... certify that the above is a true and ... copy of the order as approved.

...TARY

IURC
RESPONDENT'S
EXHIBIT NO. ad nts 4
12-19-13
DATE
REPORTER

1989 Ind. PUC LEXIS 113

Indiana Utility Regulatory Commission

March 08, 1989, Approved

Cause No. 38515

Reporter
1989 Ind. PUC LEXIS 113 *

Petition of Terre Haute Gas Corporation for Authority to Increase its Existing Rates and Charges for Gas Served and Gas Public Utility Services Rendered by it, and for Approval of New Schedules of Rates and Charges Therefor and Rules and Regulations Applicable Thereto

Core Terms

staff, recommend, calculate, customer, depreciate, working capital, annual, rate base, operating revenue, fair value, pro forma, capital structure, rebuttal, plant, decrease, operating expenses, original cost, volume, lag, property taxes, ratepayer, estimate, defer, rate of return, pension, premium, tariff, bonus, ratio, load

Panel: Corban, Bailey, Zagrovich and O'Lessker Concur: Duvall Dissents With Opinion

Opinion By: Frederick L. Corban, Commissioner; Don R. Mueller, Administrative Law Judge

Opinion

On March 30, 1988, Terre Haute Gas Corporation ("Petitioner") filed its petition and complaint with this Commission requesting authority to increase its rates and charges. A Prehearing Conference in this Cause was held in Room 907, State Office Building, Indianapolis, Indiana, at 1:30 P.M. EST, on May 6, 1988. During that hearing the Petitioner and the Utility Consumer Counselor ("Public") agreed upon procedural matters including a schedule of prefiling dates, hearing dates and agreed to conduct discovery on an informal basis. As a consequence of said Prehearing Conference an Order was approved by the Commission on May 18, 1988 and then duly issued.

In accord with the said Prehearing Conference Order a public field hearing was held on August 8, 1988 in the City Court Room, City Hall, in Terre Haute, Indiana at 6:00 P.M. EST on said date, pursuant to notice duly given and published. Both the Petitioner and the Public were represented at and during said hearing. Approximately 35 customers of the Petitioner were present at said **[*2]** hearing, thirteen of whom gave oral testimony which is a part of the record of this Cause. The said witnesses included three Terre Haute City Council members. There were no complaints made as to the quality of service rendered to the public by Petitioner.

On June 30, 1988 a public hearing was held on Petitioner's case-in-chief at 9:30 A.M.. EST, in Room 907, State Office Building, in Indianapolis, Indiana, pursuant to appropriate notices duly given and published. At that hearing, Petitioner presented evidence in support of its Petition herein. At the close of that hearing, this Cause was continued to August 24, 1988. Upon motion of the Utility Consumer Counselor, to which Petitioner made no objection and which was granted in docket entry made, this matter was continued again to September 9, 1988, by Order of the Commission dated July 26, 1988. The Commission again continued this Cause by Order dated September 7, 1988 to September 26, 1988, at 8:30 A.M. EST, in Room 907, State Office Building, Indianapolis, Indiana. The Public's case-in-chief was presented then on September 26, 1988. Petitioner also presented part of its evidence in rebuttal. At this hearing, witnesses of **[*3]** the Engineering, Accounting and the Economics and Finance Divisions of the Commission testified. Each of them presented a report, which reports were made a part of the record herein pursuant to the provisions of IC 8-1-1-5. The Staff witnesses were cross-examined on their reports, which cross-examinations are also a part of the record. The Commission staff witnesses were not sponsored by the Public. At the close of the day the hearing was continued to 10:30 A.M.. EST, on September 28, 1988 at the same place, at which time and place the Petitioner's rebuttal evidence was concluded. The Petitioner, by counsel, and the Utility Consumer Counselor, by an Assistant Consumer Counselor, participated in each of the hearings held herein.

The Commission, based upon the evidence herein and applicable law, and being duly advised in the premises, now finds:

1. Statutory Notice and Jurisdiction. Proper legal notices of the filing of the Petition herein were given and published by the Petitioner as required by law, and proper notice was duly given by Petitioner to its customers of its request for rate increase. Proper legal notice of the prehearing conference and of the public hearings **[*4]** held herein by the Commission were duly given and published as required by law. The Petitioner is a public utility, as that term is used in the Public Service Commission Act, as amended, and is subject to the jurisdiction of this Commission in the manner and to the extent provided by law. The Commission has jurisdiction over the parties and of the subject matter of this Cause.

2. Petitioner's Characteristics. The Petitioner is an Indiana corporation, having its principal office in Terre Haute, Indiana and is duly authorized to engage in the gas public utility business. It is a closely held corporation, all of its issued and outstanding capital stock is held by one shareholder. The Petitioner has issued and outstanding no debt securities of any kind. Petitioner provides gas utility services to the public by means of gas utility plant, equipment and facilities owned, operated, managed and controlled by Petitioner, and lawfully devoted to public service, in Clay, Parke, Vermillion and Vigo Counties, all in the State of Indiana. The City of Terre Haute, in Vigo County, is the largest municipality served by the Petitioner. As of December 31, 1987, Petitioner provided gas **[*5]** utility service to approximately 33,600 customers. Petitioner calculates its number of customers as the number of meters through which it renders gas service. During the 1987 test year, and before and since said period, Petitioner provided transportation service for delivery of customer-owned gas to and for certain of Petitioner's industrial customers, which gas had been transported to Petitioner's system by Petitioner's natural gas pipeline supplier, Texas Gas Transmission Corporation. Texas Gas Transmission Corporation is a "natural gas company" subject to regulation under the Federal Natural Gas Act, and is the sole supplier of natural gas to the Petitioner and the sole transporter of customer-owned gas to Petitioner's system.

3. Relief Requested. In its direct case-in-chief, filed May 24, 1988, Petitioner's proposed pro forma revenue increase was shown, as flowing from the tariff rates proposed, to be $3,338,462; as to rate classes the increase to its Rate 1 customers was $3,326,259, an increase to Rate 2 customers of $3,175, a reduction to Rate 3 customers of $10,317 and a gross increase of transportation charges of $19,345. Such proposed rates appear in the direct **[*6]** testimony of Edward W. Guntz, Petitioner's accounting witness, and in the direct cost of service testimony of Petitioner's witness John W. Strevell. The basic allocations of the increases requested were supported by the cost of service study of Petitioner's witness Strevell. Petitioner also proposed an increase in two of its non-recurring service charges, the reconnection charge and the dishonored check charge, in order to recover more nearly the actual costs thereof. Petitioner's proposed rate schedules increased monthly service charges and made minor changes in tariff language. Petitioner's existing base rates were placed in effect pursuant to order of the Commission in Cause No. 37384, approved September 11, 1984. In its case-in-chief, Petitioner's evidence showed that it was requesting the gross increase in its rates set forth above. We find the testimony in conflict regarding Petitioner's proposed development of pro forma revenues. Petitioner, the Public and the Commission staff accountant all presented evidence on pro forma adjustments to the test period, representative of normal operations. The Petitioner also offered evidence concerning adjustments on rebuttal. Substantial **[*7]** differences

exist between the Petitioner, Public and Staff concerning adjustments in several areas. The Commission will make specific findings and decide the issues regarding the adjustments which are in dispute and the Commission will approve those adjustments about which there is no dispute among the parties.

4. Test Year. By agreement of the parties at the Prehearing Conference, the test year to be used for accounting purposes is the twelve months ended December 31, 1987. The financial data for such a test year, adjusted as provided in the Prehearing Conference Order, fairly represents the annual operations of Petitioner. We conclude that such test year, with adjustments for changes which are known, fixed and measurable, is representative of the anticipated normal operations of Petitioner.

5. Operating Results Under Present Rates. Petitioner and Commission Staff presented evidence showing that Petitioner's actual test year utility operating revenues to be $30,772,935 and actual operating expenses to be $29,031,163 resulting in net utility operating income of $1,741,772.

Petitioner calculated pro forma revenues at present rates to be $31,281,870 (Pet. Exh. E1, **[*8]** p. 22) while Staff calculated the same pro forma revenue to be $31,762,473 (Staff Exh. No. 1, p. 11). The difference is $480,603. Petitioner's accounting witness, Mr. Edward Guntz, later accepted all Staff adjustments affecting pro forma revenues at present rates except the Staff's rejection of Petitioner's conservation adjustment. (Pet. Exh. ER, p. 3). Petitioner also accepted Public's upward adjustment for certain increased industrial sales as discussed in Finding No. 6(c) which offset Staff's downward adjustment for loss of industrial load.

6. Pro forma Adjustments to Test Year Results. Petitioner, the Public and the Commission Staff Accountant presented evidence for pro forma adjustments to the test year operating results in order to make the test period representative of normal operations. Substantial differences exist between the Petitioner, Public and Staff concerning adjustments in several areas. The Commission will make specific findings and decide issues regarding the adjustments which are in dispute:

(a) Adjustment for Warmer Than Normal Test Year to Operating Revenue. Petitioner's accounting witness Guntz and the Commission Staff Accountant Michael **[*9]** G. Cox differed in their adjustments to test year operating revenues of $30,772,935, so as to adjust the same for the warmer than normal test year. Petitioner adjusted test year revenues upward by $1,430,934. The Commission's Staff Accountant Cox adjusted revenues upward by $1,953,633. Petitioner's calculation incorporated a composite thirty year normal from the four weather stations which surround the Terre Haute service area, namely Greencastle, Rockville, and Spencer Indiana, and Paris, Illinois. The Commission Staff Accountant incorporated the thirty year normal temperatures of the Terre Haute weather station. Petitioner's reason for using the four station composite thirty year normal was that this was consistent with the factor used in its latest prior rate case, Cause No. 37384, when the Terre Haute weather station weather information was incomplete. In Petitioner's subsequent rebuttal testimony, it agreed that the Commission's Accounting Staff adjustment is more representative of the normal weather adjustment. The Commission agrees with that conclusion. In addition, having reviewed Staff's Accounting Report, Petitioner's Exhibit E-1 and Public's Exhibits sponsored by **[*10]** Mr. Brosch, it appears that the problem sought to be addressed by Public in its "balancing adjustment" arises from the revenue distortion generated by Petitioner's weather normalization calculation. Petitioner has used a base rate less the GCA rate to assign a dollar value to the volume adjustment for a warmer than normal test year (Petitioner's Exhibit E-1, page 29). Public's witness, Mr. Brosch, apparently accepted Petitioner's weather normalization calculation. But in performing this calculation, Petitioner has twice counted test year GCA revenues for weather normalized volumes. Therefore, the Commission finds that the Commission Accounting Staff's adjustments to revenues and expenses for warmer than normal test year are appropriate and that test year operating revenues should be adjusted upward by $1,953,633 for such reason.

(b) Adjustment of Test Year Consumption for Conservation. Petitioner adjusted revenues downward by $652,573 to reflect projected continued decreases in annualized consumption levels of the residential and commercial space heating customers in service after the test year. Petitioner's witness Guntz testified this adjustment recognizes the fact that **[*11]** residential and commercial space heating customers historically have used less gas to meet their needs each year as a result of conversion to more energy efficient appliances and other conservation steps and that this "trend" toward conservation represents a post test year known and measurable phenomenon.

Conservation effects were said to be illustrated by a study prepared by Terre Haute Gas personnel based on the utility's actual weather adjusted sales per customer from the year 1972 through 1987. W.C. Cottrell, a Vice-President of the Petitioner whose area of responsibility includes gas supplies of Petitioner, testified in respect thereto. The results of his study are summarized in graphs which are in the record. Each graph, residential and commercial, is a plot of the temperature normalized annual average customer requirements over the fifteen year period from which Petitioner's witnesses used a linear regression trend line to project post test year conservation effects.

Neither the Public nor Staff Accountant Cox made a conservation adjustment, because they explicitly reject Petitioner's proposed adjustment. Staff witness Cox was of the opinion that this type of adjustment **[*12]** is not fixed, known or measurable, and so testified. Michael L. Brosch, for the Public, argued that this projected future sales level of Petitioner is not known and measurable. In addition, Mr. Brosch rejects the Petitioner's adjustment for several other reasons, including (1) consistency would require that after positive post test year sales considerations, such as customers added during the year 1988 should have been considered, (2) the study is flawed because it is focused upon widely disparate gas market and price environments and thereby ignores a price elasticity variable that may be involved in predicting gas demands, and (3) the Petitioner's study is flawed by using inconsistent weather data. Furthermore, Public's witness Brosch recalculated Petitioner's own linear regression using only the last five year's data, instead of Petitioner's longer term sixteen year analysis, and concluded that "the last five years support no adjustment" (Public's Exhibit MLB-1, Page 38). We note that Petitioner failed to answer the criticisms of its conservation adjustment leveled by the Public and Staff witnesses, instead holding steadfastly to its trend line "history predicts the future" **[*13]** position. In its Proposed Form of Order at page 8, Petitioner admits that it "has not sought to establish future reductions in usage per customer will occur which are known and fixed." We find that Petitioner's proposed conservation adjustment is not known, fixed, and measurable, consistent with the requirements of the Prehearing Order and should be excluded from the determination of adjusted operating income herein.

(c) Normalization of Gas Cost Adjustment Revenues. Petitioner, the Staff and the Public each submitted differing evidence as to the adjustment to test year operating revenues for normalization of gas cost adjustment revenues. Petitioner proposed a gas cost adjustment (GCA) increasing revenues by approximately $2,015,000. Staff, on the other hand, has proposed an upward GCA revenue adjustment of $1,456,892, a difference of $558,108. The Public's GCA revenue increase is much higher than Petitioner and Staff primarily due to the $468,558 GCA revenue/expense balancing adjustment proposed by witness Brosch in Supplemental testimony (Public's Exhibit MLB-3, p. 5).

According to the Accounting Report, Staff Exhibit No. 1, the primary reason for the difference **[*14]** in the GCA revenue adjustment is the different sales volumes used. Because of the method used by Staff, revenues and expenses are matched (see adjustments 1 through 9 on pages 12 through 16 of Staff Exhibit No. 1). Staff calculated purchased gas (adjustment 4 on page 14 of Staff Exhibit No. 1) from test year sales, subtracting sales adjustments and adding company gas use and unaccounted for gas. We find little room for distortion in Staff's calculation as alleged by Public in its Exhibit MLB-3, page 5. We conclude that Public's "balancing adjustment" in Public's Exhibit MLB-3 would effectively double count the matching process already adjusted for by Staff in the aforementioned calculation. Staff, on the other hand, has not double counted the GCA revenues associated with the weather normalized volumes. We find that Staff has properly calculated the gas revenue and expense adjustments except for the additional sales volumes identified by Public and accepted in Finding No. 6(d).

Having accepted Staff's calculation of gas revenue and expense adjustments, we also find that Staff has correctly calculated Petitioner's pro forma GCA factors of $ (.5126)/Dth for Rate 1; $ (.6869)/Dth **[*15]** for Rate 2; and $ (.4310)/Dth for Rate 3. However, we must adjust these factors to reflect the increased sales volume of 27,032 MCF identified by Public and accepted in Finding 6(d). Accordingly Petitioner's adjusted GCA factors which should be approved are: $ (.5126)/Dth for Rate 1; $ (.6963)/Dth for Rate 2; and $ (.4321)/Dth for Rate 3. The base costs of gas for these Rate groups are $3.6479/Dth, $2.8137/Dth and $2.9915/Dth respectively. In accordance with GCA factors and base cost of gas accepted herein, the GCA normalization adjustment is found to be $1,437,488.

(d) Loss of Industrial Load. Petitioner, the Commission Accounting Staff and the Public submitted different adjustments recognizing Petitioner's loss of industrial load. Petitioner showed this loss by decreasing test year operating revenues by $848,275. At the hearing of June 30, 1988, when Petitioner presented its case-in-chief, certain direct testimony indicated that Indiana Gas and Chemical Corporation, parent of Petitioner, was ceasing operations during the year 1988 and would no longer be an industrial customer. While not included in Petitioner's original calculation, as stated, the Commission's Accounting **[*16]** Staff did include this information in calculating its adjustment in recognition of the loss of industrial load, which further decreases the test year operating revenue by an additional amount so that the total decrease is $977,694. The Public not concur at first with the recognition of the decrease in sales attributed to the loss of Indiana Gas and Chemical, as it was not included in Petitioner's adjustment, but in its subsequent review of industrial customers, proposed that test year operating revenues should be decreased by $754,400. In subsequent testimony of Petitioner's witness Guntz, Petitioner agreed with the Commission Accounting Staff's inclusion of the additional loss of industrial load due to the cessation of operations by Indiana Gas and Chemical and to the inclusion of increases in new industrial load proposed by the Public's review which is represented by the increased industrial sales of $93,875. Public's upward adjustment of $93,875 recognizes sales not included in Staff's analysis (See MLB-2, schedule C2 and Staff Exh. No. 1, p. 13). This increase of $93,875 is under Petitioner's Rate 2 and 3. By multiplying the increased volumes identified by Public in Rate **[*17]** 2 and 3 by the GCA factors approved in Finding No. 6(c), we find that Public's proposed upward adjustment of $93,875 should be revised to $93,705 to reflect the new GCA factors approved herein. Subtracting $93,705 from Staff's downward adjustment of $977,694 leaves a net decrease of $883,989 in test year operating revenues. Thus, we find that Petitioner's test year operating revenues should be decreased by $883,989. We find this adjustment known, fixed and measurable, reflects the additional industrial load increase proposed by the Public of $93,875 as well as Staff's total downward adjustment and such pro forma change in revenue is known, fixed and measurable. We find that Petitioner's total pro forma sales volume 6,239,393 MCF generating pro forma sales revenue of $31,836,774

(e) The Tax Reform Act Required Revenue Reduction. This adjustment to test year operating revenue is to reflect decreases in existing gas rates as a result of Federal Income Tax decreases to be incurred in the year 1987. Petitioner's adjustment was a decrease in test year operating revenues of $506,177 while the Staff's adjustment is a decrease of $513,319. Since this is partially based on annualized **[*18]** volumes, with respect to which the Petitioner has accepted on the record Staff's calculations, we find, after examining all the contentions made, that the proper amount for such purpose should be based upon the adjusted volume accepted in Finding No. 6(d) which reflects both Staff and Public's adjustments. Accordingly, we find that the revenue reduction required by the Tax Reform Act should be $513,319.

(f) Purchased Gas Cost Increase. Petitioner, the Staff and the Public presented different adjustments to the test year operating expenses for increased purchased gas cost, in accordance with the various sales volumes assumptions made by each. Petitioner's increase in test year purchased gas cost was $1,461,676. The Staff's increase was $1,938,565, while the Public's increase for additional industrial load was $80,462. Based upon the sales volume accepted in Finding No. 6(d), we find that the increase in purchased gas costs to the sales volume which we have incorporated in this Cause is $2,005,946.

(g) Adjustment for Normalized Insurance Expense Including Workmen's Compensation, Public Liability Insurance, Automobile and Injuries and Damages Insurance. Petitioner, **[*19]** the Staff and the Public each presented different adjustments to the test year operating expenses for the above-mentioned insurance expenses. However, it was agreed that, excluding the question of the capitalization a portion of this expense which we will consider hereinafter in Finding No. 6(o), this amount should be ($36,780). We find that the proper adjustment reflective of the ongoing level of these expenses is a decrease in test year operating expenses in the amount of $36,780.

(h) Adjustment for Uncollectible Account Expense. Petitioner, the Staff and the Public each presented arguments as to normalization of this expense. Petitioner has proposed a ratio of 0.75% of gas sales for such bad debt expense and contended that there is a fairly constant, or linear, relationship of gas sales to bad debt expense. Staff's exhibit incorporated a ratio of 0.58% of gas sales to bad debt expense and concurred that there is a general linear relationship between gas sales and bad debt expense. Public's exhibit proposed a ratio of 0.60% of gas sales to bad debt expense, but suggested that the historical experience of Terre Haute Gas does not support the conclusion that there is a **[*20]** linear relationship between gas sales and bad debt expense. We find the position of the Commission Staff is most representative of the realities of the matter, due to the fact that the much greater portion of the proposed rate increase in this instant Cause is upon the residential class and the Gas Cost Adjustment proceedings do not provide for the recovery of increases in bad debt expense. Therefore, the increase in test year operating expenses is $5,585 based on the pro forma test year sales of gas at present rates and further that there is a linear relationship between gas sales and bad debt expense and the use of a percentage of gross billings for such purpose is proper.

(i) Adjustment for Wage and Salary Increases and Executive Bonuses. Petitioner and the Staff had similar adjustments for the handling of wage and salary increases and the handling of executive bonuses. This is represented by Staff's increase to test year operating expenses for wages and salary increases of $107,326. The Public excepted to the allocation of executive bonuses between Terre Haute Gas and Indiana Gas and Chemical and suggested that the proposed level of executive bonuses allocated to Terre **[*21]** Haute Gas expense be reduced by $25,025. The witness for the Public did not disagree with or criticize the total level of executive "bonuses" for Indiana Gas and Chemical and Terre Haute Gas employees, but disagreed with the allocation thereof. The Public's witness was of the opinion that, among personnel paid by both Petitioner and Indiana Gas and Chemical, the bonuses should be divided in exactly the same proportions as the regular pay. Petitioner argues that Public in effect was asking for a reduction in bonus. Petitioner states the "regular" salaries of certain personnel would be very low, if the so-called "bonuses" were not paid, so that the overall annual salaries of the persons who are paid a bonus has the effect of making the annual salaries, reasonable and not objectionable. There is no question whether the bonus payments were made directly to the employees as compensation for services. They were. Petitioner notes In Re Indianapolis Power and Light company, Cause No. 37837, approved August 6, 1986, and cited in the recent Kokomo Gas and Fuel Company rate case before this Commission in its Cause No. 38096, approved July 29, 1987 that the Commission observed: **[*22]**

"Decisions in this regard are sensitive and difficult managerial ones, and, absent provable evidence of or imprudende, the unreasonableness, excessiveness or imprudence, the Commission is reluctant to interfere with such decisions."

The Commission recognizes there has been no claim that the amounts paid the employees are unreasonable or excessive, or imprudent. Petitioner, on the other hand, fails to recognize both the argument made by Public and the facts which distinguish Indianapolis Power and Kokomo Gas from this Cause. Both in Indianapolis Power and Kokomo Gas, the principal issue was the appropriateness of total compensation for certain employees of those utilities. There was no question of wage and salary expense allocation between a regulated utility and a related, unregulated company in either of these prior causes. Here the issue is simply why should the proportion of bonus expense allocated to Terre Haute Gas be greater than the proportion of salary expense allocated for executives serving both companies. Petitioner presented no evidence that the bonus allocation benefited utility ratepayers, reflected expenses necessary to provide adequate utility service or **[*23]** was made by a formula which related expense allocations to regulated/unregulated activity.

Management does have the power to decide compensation levels but this Commission still must determine whether any expense is necessary and reasonable in determining and fixing the rates a utility is permitted to charge. (See *I.C. 8-1-2-48*) Based on the evidence, we find that the allocation of executive bonus expense to Terre Haute Gas expense should be in the same proportion as the allocation of related executive salary expense. Therefore, we find the adjustment to test year wage and salary expense should be an increase of $82,301.

(j) Adjustment for F.I.C.A. Changes. In finding for the Staff's position in the matter of salary and wage increases and Public's handling of executive bonuses, and since F.I.C.A. expense is a function of the above payroll changes, we find that an increase of $19,233 to test year operating expenses is accurate and represents the ongoing level operations for F.I.C.A. expense and is approved.

(k) Pension Expense Adjustment. Petitioner's employees fall into two separate general groups - union and non-union. Petitioner's collective bargaining agreement **[*24]** with a local of the United Steel Workers of America, covering its union employees for the period October 31, 1987 to October 30, 1990, provides for increased pension benefits and there are consequent increased costs. The Petitioner's non-unit (non-union) pension plan was restated by a document executed September 14, 1985, to which there have been three amendments, the latest effective January 1, 1987 and dated September 9, 1987. As to the third amendment, the Internal Revenue Service issued a favorable determination letter dated January 12, 1988. Increased contributions are required by reason, particularly, of the third amendment. No criticism of the properiety of either of Petitioner's pensior plans was made by any of the witnesses. The plans appear to be in the best interests of Petitioner and its employees. The Petitioner retains an actuarial firm to advise it with respect to such pensions and consistently follows its advice in matters respecting its two pension plans. Both Petitioner and Staff incorporated the same increase in test year operating expenses of $122,166 for additional pension expense to the level experienced in the 1987 test year. This incorporated a suggested **[*25]** annual minimum contribution level of $109,300 for the non union employees for the year 1987 and payable in 1988. The actuarial study for the year 1987 suggested annual minimum contribution of $105,111, and $106,000 was actually and timely paid in 1988, for 1987. The amount paid obviously was rounded. The Public, in its exhibits (exclusive of the capitalization question which is addressed in Finding No. 6(o) hereinbelow) has included $102,283 as the suggested annual minimum for non union employees based on an actuarial study that included the effects of the payment of $106,000 and represents the suggested annual minimum contribution level for the year 1988 payable in 1989. We find that the suggested level of $102,283 is not the level of expense occurring within twelve months of the end of the test year, and therefore, the proper level of expense should be the $106,000 which actually was paid in the year 1988 for 1987. The suggested minimum contribution for 1987 payable in 1988 was $105,111, as Petitioner established. The suggested minimum contribution for 1988, payable in 1989 (not later than the time of filing of Petitioner's Federal income tax return for 1988) has been determined **[*26]** by Petitioner's actuarial advisor as $102,283. Therefore, we find that the suggested increase of $122,166 in total pension expense should be reduced by the difference between the estimate of $109,300 and the actual experience as represented by Terre Haute Gas payment of $106,000 and that the increase in test year operating expense for Petitioner's total additional pension expense is $118,866.

(l) Employee Health Insurance Adjustment. Petitioner, Staff and the Public submitted different adjustments in recognition of this increase in employee health insurance. Petitioner adjusted test year operating expenses by an increase of $75,217, Staff's increase was $67,846 and Public proposed an increase of $38,277. Staff's expense increase represents a more current representative monthly billing than was available to Petitioner at the time its testimony was prefiled. The proposed premiums were slightly reduced. Public's lower adjustment is due to its method of capitalization of a portion of this expense which is addressed herein in Finding No. 6(o) which we reject. Therefore, we agree that the Staff's adjustment of an increase of $67,846 to test year operating expenses is representative **[*27]** of the ongoing operations of Petitioner in respect of this item, and the Staff's said adjustment of $67,846 is hereby approved.

(m) Property Tax Adjustment. Petitioner, the Staff Accountant and the Public each provided adjustments to the test year operating expense for increases in property taxes. Petitioner's proposed increase was $50,242, the Staff's increase was $46,637 and Public's was $30,548. Petitioner and Staff used estimated tax rates in the computation of the increase in expense, whereas the Public's witness used the actual tax rates that were later available. Public further reduced the level of property tax to be included in rates by allocating 1.38% thereof as the part of property tax attributed to three asset categories: Non-Utility Property, Plant Held for Future Use and Utility Acquisition Adjustment. Petitioner's accounting witness further testified that Petitioner was not opposed to allocating a portion of the property tax to Non-Utility Property but took exception to the further property tax reductions for Plant Held for Future Use and Utility Acquisition Adjustment. Petitioner's position raises property taxes above the level proposed in the Public's **[*28]** computation by $6,487.

We note that Petitioner's rate base does not include Plant Held for Future Use or Utility Acquisition Adjustment. It is clearly inappropriate to charge ratepayers for property taxes on assets that are not included in the rate base. Therefore, Public's adjustment increasing property tax expense by $30,548 is approved.

(n) Abnormal Maintenance Expense and Elimination of Manufactured Gas Expenses. Petitioner submitted an adjustment to recognize the Company's discontinuation of its manufactured gas plant operations. The proposed adjustment reduced expenses by $41,342 reflecting elimination of all test year expenses in Account 717 Liquefied Petroleum Gas Expense. Public's witness Brosch explained that Petitioner had discontinued all manufactured gas operations yet its adjustment failed to eliminate all manufactured gas expenses. Petitioner's Exhibit E-1 at pages 14 and 16 set forth test year actual manufactured gas expenses as follows:

Account	Description	Test Year	
	Manufactured Gas Expenses-		
710	Supervision and Engineering	$ 6,031	(Public eliminated)
717	Liquefied Petroleum Gas Exp.	41,324 (Pet. eliminated)	
712	Power Form Other Sources	2,337 (Public eliminated)	
742	Maintenance of Prod. Eqpmt.	3,584 (Public eliminated)	
	Total Manufactured Gas O&M	$53,276	

[*29]

The issue before us is whether, upon discontinuance of gas production by Petitioner, any production related expenses should remain within its expenses for ratemaking purposes. On rebuttal, Petitioner speculated that the monies previously expended to supervise, maintain and power the manufactured gas facility would continue to be expended in some other undefined part of its business. In a sense, Petitioner argues that Accounts 710, 712 and 742 contain expenses that are unavoidable, even when the facility to which they relate has been retired. We fail to understand why Petitioner is unable to avoid such costs and agree with the Public that the expenses for all of Petitioner's discontinued manufactured gas expenses, totalling $53,276, should be eliminated.

(o) Additional Capitalization of Administrative Expense. The Public identified certain administrative costs which it claimed were not properly capitalized. Those costs are Workmen's Compensation and Public Liability Insurance in the amount of $42,152, Employee Health Insurance in the amount of $37,899 and Pension Expense in the amount of $14,678. These items represent an additional decrease of $94,729 in test year operating **[*30]** expenses. Neither Petitioner nor Staff made this adjustment. The Public, in its original presentation, testified that these adjustment. were made because Petitioner did not allocate any employee benefit cost to construction, to reflect that part of payroll costs are properly allocated to construction. This position was refuted clearly by Petitioner's accounting witness in his rebuttal testimony which showed that the amount of $146,451 of administrative and general operations expenses was in fact capitalized in the test year. Public then took exception to that because the administrative and general transfer credit reflected on the books is a 10% loading of construction costs and not based on an overhead study, although it has been used for many years by Petitioner and believed by its accounting supervisor to be reasonably accurate. We find that Petitioner has capitalized a reasonable amount of the Administrative and General Expenses in the test year and on a pro forma level, and its adjustment in such respect is approved, and that the adjustments proposed by the Public should not be accepted.

(p) Adjustment for Indiana Gross Income Taxes. The Public and Staff proposed that **[*31]** the provision for Uncollectible Revenues should be deducted from gross income in the computation of the proper Indiana Gross Income Tax expense. The Staff claims that the level of annual uncollectible accounts was $176,619, which amount is not in dispute. A similar deduction was not incorporated in the accounting exhibits of Petitioner. We find that the Indiana Gross Income Tax is a gross receipts tax and, therefore, such an elimination for uncollectible revenues is reasonable and proper. We find further that this adjustment for Indiana Gross Income Tax varies directly with the level of revenues, identified as the pro forma operating revenues, and similarly any revenue adjustment approved in this Cause carries with it an adjustment of such tax, as that tax varies directly with changes in taxable receipts.

The revenue increase reflecting weather-normalization and net change in industrial sales requires an upward adjustment from book-expenses for Indiana Gross Income Tax but recognition of uncollectibles reduces the amount of the upward adjustment. Based upon our foregoing Findings and the Indiana Gross Income Tax rate of 1.20%, we find that Petitioner's Indiana Gross Income Tax **[*32]** expense should be adjusted upward $19,380.

(q) Adjustment for Contributions Deduction - Income Tax Expense. Petitioner, with Public's concurrence, incorporated the below-the-line item of expense of the ten percent maximum contribution level in the calculation of the pro forma level of Federal Income Tax Tax Expense. It has been the policy of Expense. It has been the policy of Petitioner for many years to make the largest possible charitable contribution deductible under the Federal income tax laws, and that policy continues. This adjustment of Petitioner benefits the ratepayers as it reduces Terre Haute Gas revenue requirements. Staff's computation did not reduce the Federal Income Tax expense because Terre Haute Gas did not collect contributions from the ratepayer. Therefore, the Staff's position is that said ratepayers are not entitled to the benefits accruing from such contributions. We agree with Staff that such below-the-line expense should not be considered in calculating Petitioner's Income Tax Expense for ratemaking purposes.

(r) Depreciation. Petitioner presented a depreciation study made by Mr. Richard Johnson, a consulting engineer, appraiser and management **[*33]** consultant whose conclusion, expressed in terms of a percent of the original cost of the depreciable gas utility plant of Petitioner which was lawfully devoted to public service in Petitioner's gas utility business as of December 31, 1987, was a composite depreciation accrual rate of 2.95% per annum. In his staff report for the Engineering Department, Mr. Eric Wolf stated that, after thorough review of Petitioner's study, the staff had found that Petitioner exercised reasonable judgment and properly applied well-known depreciation methodologies in developing its depreciation proposal and recommended that the Commission approve the Petitioner's proposed composite whole life depreciation rate of 2.95% for its gas utility plant property which is lawfully devoted to public service. This proposal results in a decrease of $18,600 in the annual accrual which changes from $916,176 (3.01% composite rate) to $897,576 (2.95% composite rate) based upon year-end 1987 account balances. We agree with Staff's recommendation and, the Public having made no objection, find that such composite depreciation rate of 2.95% should be applied. Petitioner has also proposed a 20% annual depreciation rate **[*34]** for transportation equipment which is supported by Staff. There being no objection, the Commission finds that such annual depreciation rates proposed by Petitioner for such properties are proper and reasonable. Petitioner's annual depreciation expense is found to be $897,576. The resulting downward adjustment to test year depreciation expense is [33,622] for general depreciation expense and [33,315) for transportation depreciation expense.

(s) Revised Adjustments and Conclusions. The Commission rejected Petitioner's proposed conservation adjustment as discussed in Finding No. 6(b) and accepted the adjustments proposed by Staff and Public to Petitioner's industrial load as discussed in Finding No. 6(d). The adjustments thus approved in Finding No. 6(c), multiplied by the appropriate GCA rates approved in Finding No. 6(d), yield pro forma revenues at present rates which we find to be $31,836,774 based upon adjusted test year volumes of 6,239,393 MCF.

Pursuant to the foregoing Findings concerning adjustments, and considering like adjustments made by Petitioner, Public, and Commission Staff accounting witnesses, and revising adjustments, the calculation of which is dependent **[*35]** upon the foregoing Findings, the Commission finds Petitioner's pro forma operation revenues and expenses at present rates to be:

Operating Revenues test year	
Sales of gas	$29,493,745
Other operating revenues	1,279,190
Sub total	30,772,935
Adjustments to operating revenues	

Weather normalization	1,953,633
Loss of industrial load	(883,989)
Gas Cost Adjustment normalization	1,437,488
Tax Reform Act revenue adjustment	(513,319)
Overbilling and variance adjustment	(954,454)
Minimum billing adjustment	(7,288)
Transportation revenue adjustment	31,768
Total Operating Revenues	$31,836,774
Operating expenses test year	
Cost of gas	$21,261,766
Operation and maintenance	4,238,646
Depreciation	931,198
Taxes other	1,492,314
Federal Income taxes	1,107,239
Sub total	29,031,163
Adjustments to operating expenses	
Purchase gas adjustment	2,005,946
Insurance expense adjustment	(36,780)
Uncollectible account expense adjustment	5,585
Wages and salaries adjustment	82,301
F.I.C.A. Adjustment	19,233
Pension expense adjustment	118,866
Employee health insurance adjustment	67,846
Property tax adjustment	30,548
Abnormal expense and manufactured gas expense adjustment	(53,276)
Capitalization of administrative expense	
Rate case expense (amortized over 3 years)	45,453
Advertising expense adjustment	(2,355)
Maintenance contract and postage normalization	12,319
I.U.R.C. fee (0.00105)	(14,526)
Depreciation expense	(33,622)
Depreciation transportation expense	(33,315)
Ind. Gross Income Tax adjustment (1.20%)	19,380

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Ind. Supplemental Net Income Tax adjustment	(49,937)
Decrease Federal Income Tax	(519,316)
Total Operating Expenses	$30,695,513
Utility Operating Income	$ 1,141,261

[*36]

The Commission specifically approves each of the foregoing adjustments to test year revenues and expenses.

7. Rate Base. To determine whether Petitioner's present rates are unjust and unreasonable as alleged, it is necessary to determine the value of Petitioner's property and investment devoted to utility service and to determine whether Petitioner's present rates generate sufficient operating income to provide a fair return on that investment.

(a) Original Cost of Petitioner's Used and Useful Property.

(i) Net Utility Plant in Service. Petitioner's, Staff's and Public's exhibits evidence that, after consideration of production plant to be retired in the amount of $145,540 and elimination of property held for future use and the acquisition adjustment, that Petitioner's net utility plant in service at original cost on December 31, 1987 is $22,961,001.

(ii) Materials and Supplies. Petitioner and the Public differed as to the proper level of allowance for materials and supplies. Petitioner's computation of $355,950 is based on the historical thirteen month average of the test period and included gas appliances in the amount of $1,602 and propane inventory **[*37]** of $32,611. Public excluded these two items in determining on ongoing level of $321,737. We find that the thirteen month test year average of $355,950 is representative of the normal ongoing balance for materials and supplies but must be reduced to: (a) exclude appliance inventories which are used in Petitioner's non-jurisdictional merchandising operations, and (b) eliminate propane inventories which are no longer maintained by Petitioner. The resulting materials and supplies balance proposed by Public of $321,737 is approved.

(iii) Working Capital Allowance. The other disputed issue concerned allowance for working capital. Petitioner proposed a working capital allowance of $1,131,329, which included consideration of a special deposits balance sheet account in the amount of $444,811. Staff's calculation of working capital resulted in a negative balance of $153,496. Staff's calculation differed from Petitioner's calculation in only two respects: first, the Staff calculation did not include consideration of the special deposits balance sheet account and, second, the Staff treated property tax expense differently. The Accounting Staff calculated a negative working capital **[*38]** requirement of $835,895 for property taxes, using a 404.5 day expense lead. Petitioner calculated a positive working capital requirement of $4,119 for property taxes using a 39.5 day expense lead. Petitioner's calculation is based on the fact that property taxes actually are paid every year from revenue of that year, while the Accounting Staff's calculation is based on the premise that revenues collected from ratepayers for any given year are for property taxes which are actually not paid until the following year.

The Public in its computation of working capital found a negative balance of $687,985; in addition, the Public further reduced rate base by the computation of a historical 13 month average of the test period of deferred gas costs to determine a decrease in rate base of $1,365,024 and further developed a hypothetical deferred tax reserve to decrease the rate base by an additional $1,615,142. This results in an overall decrease in original cost rate base of $3,668,151.

Public in its computation of working capital differed from Petitioner and Staff by using a different revenue lag of 38.14 days compared to Petitioner's 41.29 day lag. Petitioner and Staff revenue lag calculations **[*39]** are based upon an accounts receivable turnover analysis using month-end account receivable balances, whereas Public's revenue lag calculation utilizes an average of 365 daily account receivable balances for the test year. Differences were also found with regard to the expense lead days for Purchased Gas, Health and Life Insurance, Pension Expense, Bad Debts, Other Operation and Maintenance Expenses, F.I.C.A. Tax and Property Taxes.

The Commission in the past has determined that the inclusion of certain balance sheet accounts in the computation of working capital do not reflect investment by Petitioner and its shareholders and, if included in the computation of working capital, tend to overstate or understate the results of said computation. We find that the inclusion of special deposits, as proposed in Petitioner's computation, overstates the actual requirement of Petitioner for working capital. We also find that Public's revenue lag calculation, which utilizes the average of 365 daily account receivable balances is more representative than Petitioner's revenue lag calculation.

While not included in its working capital calculation, Public also recommended a reduction of ratebase **[*40]** for a balance sheet account Deferred Gas Cost. Further, Public proposed a reduction of ratebase for a deferred tax reserve which Public reconstructed under assumptions concerning accelerated depreciation and the expected tax effect of such assumptions. These two items, deferred gas cost and imputed deferred tax reserves are discussed infra.

A review of Public's working capital calculation indicates that a major difference between Petitioner and Public concerns the expense lead days applied to purchased gas expense. Petitioner has used 37.21 lead days while Public has used 41.03 lead days. Petitioner's calculation is based upon the assumption that remittance for purchased gas is on the due date as specified in its contract. Payment after this due date incurs an interest expense. Public's lead days calculation is based upon the actual test year payment dates for purchased gas. This difference amounts to $244,348 between the two calculations. It is not good business practice for Petitioner to pay its purchase gas invoices after the due date. Approval of a working capital calculation based on consistent late payment gives the wrong indication to Petitioner and should be **[*41]** rejected. Therefore, we find that Petitioner's calculation of payment lag days is more appropriate and should be used.

A second significant difference between Petitioner's and Public's calculation involves itemizing pensions and bad debt items separately from other operating and maintenance expense. Public's evidence separating contributions to the pension fund maintained for employees covered by the labor agreement and the pension plan covering non-union employees, segregating the impact of bad debt on working capital and assigning lead or lag times to the remaining operating and maintenance items appears appropriate because of the different factors involved. No evidence was presented by Petitioner in opposition to Public's characterization of a 45.08 day lag in the payment of the remaining other operating and maintenance expenses. Petitioner did not question the zero lag characterization of the bad debt requirement. Petitioner did present evidence on both the magnitude of the non-union pension contribution and the timing of this payment. We have found supra that the amount of the non-union pension contribution should be $106,000. Public has characterized the lag in this **[*42]** payment as 441.50 days because the contribution for the 1987 requirement was made on September 15, 1988. It is not clear from Petitioner's evidence submitted on rebuttal whether a September 15 contribution date for the preceding pension plan year is appropriate. The letter of McCready and Keene Incorporated to Mr. Steward refers to the suggested minimum contribution required for the 1988 plan "if the Funding Standard Account Minimum Contribution had been made for 1987 . . .". Given the evidence of record, we find that the 441.50 day payment lag proposed by Public is appropriate.

A recalculation of the working capital requirement reflecting the findings above indicates a negative working capital requirement of $494,164. Even if we were to use Petitioner's revenue lag of 41.29 days rather than Public's revenue lag calculation of 38.14 days, the working capital requirement appears to be a negative $226,173. In previous cases where a negative working capital figure has been proposed, we have indicated that a deduction from ratebase should be considered with caution. We stated "the Commission must determine whether the Petitioner has on hand an amount of ratepayer generated cash **[*43]** which exceeds the amount required to meet Petitioner's day to day cash operating expenses" . (In Re Utility Center, Inc. Cause No. 37787 Order dated December 27, 1985) Further, the Commission has expressed a preference for lead/lag studies but has noted that this method is subject to limitations of input. We stated In Re Northern Indiana Public Service Company, Cause No. 38045, Order dated July 15, 1987, "Both estimates of recovery time and payment lead or lag are based on averages. We recognize that from case to case and from month to month these determinants will vary." The major concern was whether ratepayers consistently provided a source of cost free capital. In these previous cases, we found they had not. This case, however, seems distinguishable from previous cases. We note that Petitioner has no long term debt, has presented no evidence that it uses short term debt to provide working capital, and has due from its parent, Indiana Gas and Chemical, $9,599,581 as of December 31, 1987. Petitioner has significant needs for working capital to pay for purchased gas, payroll and property insurance but collects in advance through revenues even larger amounts for its non-union **[*44]** pension contribution and property taxes. Petitioner and Staff have proposed that the difference between Petitioner's positive working capital requirement evidence and Staff's calculation of a negative working capital requirement justify a zero working capital allowance. If the relative figures were closer to a zero amount, given the uncertainty of both the balances owed and the timing of revenue and payment, such a compromise might be appropriate. The evidence, however, clearly suggests that Petitioner's working capital requirements are not supported from investment from the shareholders but rather from revenues provided by the ratepayers. We find, based on the evidence of record, that Petitioner's ratebase should include a negative $494,164 allowance for working capital.

(iv) Customer Advances. All evidence of record in this Cause shows that a further downward reduction in rate base for customer advances for construction in the amount of $17,198 is appropriate, and it is so found.

(v) Public's Proposed Simulated Tax Reserves. The Public, through its witness Brosch, proposed a "simulated" deferred tax reserve balance for the reason that Petitioner did not elect to **[*45]** use accelerated depreciation under provisions of the Internal Revenue Code, thereby acting imprudently. The rate base, under Public's proposal, would then be reduced by the amount of Public's simulated deferred tax reserve so that ratepayers would be protected from Petitioner's alleged imprudence in failing to take advantage of available tax deductions associated with the use of accelerated depreciation under the provisions of the Internal Revenue Code (Public's Exhibit MLB-1, p. 28).

This Commission has recognized over a period of about thirty years that whether a utility uses any of the accelerated depreciation permitted under the Internal Revenue Code is a matter of election on its part. (See Orders in Cause No. 27527, approved December 24, 1957 and Supplemental Order entered therein on September 8, 1959, Petitioner's Rebuttal Exhibits AR-6 and AR-7) This order, as supplemented, has been recognized by the Commission as having continuing effect. An order was subsequently entered under it as recently as January 20, 1982 in the Commission's Cause No. 36696 (Petitioner's Rebuttal Exhibit AR-8). The two earlier orders referred to clearly have application to accounting procedures **[*46]** to be followed by utilities "resulting from their election" to use accelerated depreciation. The utility's right to elect is recognized.

The evidence is uncontroverted that Petitioner has never elected to use accelerated methods of depreciation permitted under the Internal Revenue Code. Testimony by Petitioner's Vice President of Finance, Mr. John Steward, establishes that over the past twenty years Petitioner has had five rate orders in which the Commission has not disturbed Petitioner's present method of depreciation. Evidence of the accounting procedures ordered by this Commission for accelerated depreciation, Petitioner's Exhibits AR-6, AR-7 and AR-8, does not require Petitioner to elect accelerated depreciation. Petitioner argues that these orders, arising out of generic proceedings, should be dispositive of the issue of Petitioner's depreciation methodology until the Commission initiates a formal investigation into a more appropriate regulatory treatment of Petitioner's method of depreciation.

We find that Public's proposed reduction of the rate base in response to Petitioner's failure to use accelerated depreciation constitutes a form of retroactive ratemaking. We **[*47]** have previously declined to offset authorized revenue (as Public's simulated deferred tax reserve would accomplish) to compensate rate payers for past earnings not available to meet utility expenses. See In Re City of Tipton, Cause No. 37376, June 20, 1984 and discussed in In Re Town of Nashville Cause No. 38481, August 31, 1988, at page 7.

Aside from the rule against retroactive ratemaking, we cannot set rates based upon a hypothetical practice (i.e. accelerated depreciation) of which Petitioner has had no notice that it would be required by this Commission. Election to take accelerated depreciation is not automatic but requires the approval of the Internal Revenue Service. Our Supreme Court has held that a utility, "cannot be charged in a rate hearing for failure to engage in a large scale financial operation that has never taken place and was never in issue by any pleadings and on which no specific order was ever made. The statute does not permit the fixing of rates on a hypothesis or a situation never in existence." Public Service Commission v. City of Indianapolis (1956) 131 N.E. 2d 308, 316-317. The Supreme Court then characterized the Commission's disallowance **[*48]** of a portion of a utility's federal tax expense by assuming a hypothetical capital structure as both arbitrary and unlawful and directed the Commission to consider only the actual taxes paid. (id). A hypothetical tax situation similar in purpose to the simulated deferred tax reserve proposed here was struck down by the Court of Appeals in holding that the Commission cannot "arbitrarily allow a tax expense computed on the basis of a separate tax return when such return was not actually filed." City of Muncie v. Public Service Commission (1978) Ind. App., 378 N.E. 2d 896. We find the law is clear that this Commission cannot set rates based upon a hypothetical tax treatment such as the one proposed by Public.

(vi) Deferred Gas Costs in GCA Process. The Public, by its witness Brosch, proposed a reduction of original cost rate base by deducting $1,365,024 of deferred gas costs, related to the Gas Cost adjustment procedures. This amount is the average balance of deferred gas costs in Accounts 253.1, 253.3 and 253.4 in the Commission's Uniform Classification of Accounts for the test year. Public's witness treated such balances as a rate base deduction to recognize the fact **[*49]** that cash flows resulting from the GCA process influence that amount of investor-supplied capital needed to support rate base. Petitioner did not rebut the fact that deferred gas balances directly impact Petitioner's capital requirements. Instead, Petitioner pointed to recent monthly balances at the end of August 1988 for Account 253.1 of $8,183 and for Account 253.4 at negative $104,234, as shown by Petitioner's Rebuttal Exhibit AR-14. Mr. Brosch responded to questions in this regard by referring to his Schedule B-1 (Public's Exhibit MLB-2) and explaining that monthly balances of deferred gas cost do fluctuate but are typically credit balances, indicating consistent over-recovery of gas costs. On cross examination, Mr. Brosch could not establish in what direction the balances were moving in 1988. Mr. Brosch did agree on cross examination that consistent over-recovery of gas costs can be appropriately addressed by the Commission within the gas cost adjustment process. We are not persuaded that the month end 1987 average balances presented by Mr. Brosch are predictive of the balances which now exist. Due to the nature of the GCA process, such balances cannot be known, fixed **[*50]** and measurable for future periods. While Public may be correct in drawing an inference that consistent over-recovery of gas cost produces an incentive to management to overestimate gas cost when applying for GCA rates, we note that the Commission must find a utility's estimate of prospective gas costs is reasonable and gives effect to actual gas costs in previous periods before an adjustment is approved. There is adequate protection against over-estimation within the GCA process. The inclusion of deferred gas costs as a reduction of rate base is inappropriate for the reason that there are inevitably fluctuating balances to be reconciled within the GCA process and these changes are not known, fixed and measurable.

(b) Original Cost Rate Base Summary. Based on the evidence of record, the Commission finds that the Petitioner's rate base used and useful for the convenience of the public, valued at original cost, at December 31, 1987 is $22,665,807, determined as follows:

Net Utility Plant in Service per books	$23,393,127
Less: Property held for future use	(286,586)
Less: Manufactured gas production	
plant to be retired	(145,540)
Total	22,961,001
Add: Materials and supplies	321,737
Add: Working capital	(494,164)
Less: Customer advances for construction	(17,198)
Less: Pre-1971 I.T.C.	(105,569)
Total	$22,665,807

[*51]

(c) Fair Value of Petitioner's Used and Useful Property. *I.C. 8-1-2-6* requires us to value all property of every public utility actually used and useful for the convenience of the public at its "fair value" . This section of the code was initially enacted in 1913. In 1933 the Code was amended to provide that "fair value" be construed as the "current, fair cash value". In 1947 this section of the Code was further amended by inserting the words "giving such consideration as the Commission deems appropriate in each case to all bases of evaluation which may be presented or which the Commission is authorized to consider" by the pre-existing provisions of the act. The words "current" and "cash" which had been inserted in 1933 were deleted. This amendment appears to have been intended to give the Commission more flexibility.

It is the apparent intention of the Legislature that a utility is entitled to earn a return on its investment in property actually used and useful to serve the needs of its ratepayers. This assumption was confirmed by the Indiana Court of Appeals ("Court") in its decision on the review of the Commission's order re Indianapolis Water Company in *Cause No. 37612, at Ind. App., 484 N.E.2d 635 (1985).* As noted by this Commission in its Order on Remand, issued in Cause No. 37612 on July 3, 1986, the Court gave the Commission four basic directives regarding the concept of "fair value" . These directives are as follows:

That it is upon the statutory "fair value" of its used and useful property that a utility should be allowed to earn a return.

That "fair value" is not an either/or situation as to original cost or reproduction cost new, but "fair value" is a conclusion or final figure, drawn from all the various values or factors to be weighed in accordance with the statute by the Commission.

That in its determination of "fair value" the Commission may not ignore the commonly known and recognized fact of inflation.

That while original cost is one of those factors which the Commission should consider in arriving at a "fair value" figure, it is not necessarily, in and of itself, an accurate reflection of the "fair value" of the company's property.

The Court in the Indianapolis Water Company case, supra, explained how the determination of "fair value" is, in large part, a tool or methodology to be used by the Commission to balance **[*53]** the interests of the utility's shareholders or investors with the interests of their consumers or ratepayers:

The Courts will not limit the Commission to any one or more methods of valuation, be it prudent investment, original cost, present value, or cost of reproduction. This Court has held that cost of reproduction depreciated is a proper item to be considered under the statute in arriving at a "fair value" figure. *Public Service Commission v. Indianapolis, supra,* (1948), *225 Ind. 656, 76 N.E. 2d 841.* The ratemaking process involves a balancing of all these factors and probably others; the balancing of the owners or investor's interest with the consumers interest. On the one side, the rates may not be so low as to confiscate the investor's interest or property; on the other side rates may not be so high as to injure the consumer by charging an exorbitant price for service and at the same time giving the utility owner an unreasonable or excessive profit.

Thus, the Court has made it clear that this Commission's fixing of a specific "fair value" is an aid available to us in balancing the financial interest of utilities and their investors with the financial interest of their **[*54]** rate paying customers. Our function in fixing a "fair value" should, in part, enhance and stabilize our state's economy by protecting both utility owners and customers. Such "fair value" is a specific matter which we must determine on a case-by-case basis.

Several ratepayers of Petitioner who appeared at the hearing in Terre Haute, Indiana on August 8, 1988, questioned Petitioner's evidence concerning the fair value of its property. They said they could not understand what justification there was for allowing a return on such a high claimed investment when it is several times the original cost of the property. It was clear from the statements of these witnesses that there is a misunderstanding about the concept of fair value. First, as noted above, the Court has clearly directed the Commission to consider factors such as inflation in determining the current value of a utility's property to be considered part of the rate base. If a utility's property has been kept in good repair, it would be reasonable to expect that the property could be sold to another investor for more than the value of the plant shown on the books. This is true because the book value is actually the original [*55] cost less the depreciation in value which occurs over time, because of wear and tear. Inflation causes the value of the dollar to decline over a period of time; therefore, the purchase of new replacement facilities would be more expensive that the original investment in a utility's plant. A prospective investor would be willing to pay more than the book cost of the plant but obviously less than the cost to reproduce the facilities with new equipment. The rates for service allowed a utility as a result of evaluating the evidence in a case are designed to allow the opportunity to earn a fair return on the current investment of the utility. This Commission has stated on many occasions that fair return is not simply the cost of capital of the utility because the current cost of capital required by purchasers of stock or lenders to the utility also includes a factor for inflation. The Commission's final decision on both value of the rate base and the appropriate rate of return will consider this duplication of factors. A rate base including a value of utility plant higher than original cost does not yield rates which are abnormally high.

In this Cause, Petitioner presented a valuation [*56] study of Petitioner's properties as of December 31, 1987. Such valuation was based on a Reproduction Cost New Depreciated (RCND) cost of Petitioner's plant and properties, less observed depreciation. Petitioner's total property and plant was so valued at $56,258,657, based on such current cost depreciated, as of December 31, 1987, which is one of the measures the Commission will consider in determining the fair value of Petitioner's properties devoted to public service.

Public, Petitioner and Staff's exhibits evidenced Petitioner's net utility plant in service at original cost on December 31, 1987, to be $22,961,001. Adjustments were made thereto as set out in these findings above, with which the Commission agrees and approvies. After examining and considering evidence of all parties, the Commission finds that Petitioner's rate base, used and useful for the convenience of the public, valued at original cost, is $22,665,807, determined as set forth in these findings above.

Giving consideration to the original cost, the cost of bringing Petitioner's property to its present state of efficiency and other relative factors we find that the fair value of Petitioner's property, [*57] used and useful in its gas utility business, including materials and supplies, is not less than $35,605,000.

8. Return for Petitioner. (a) Test Applied to Determine. The United States Supreme Court in *Bluefield Waterworks and Improvement Company v. the Public Service Commission of West Virginia, (1923) 262 U.S. 679, 43 S.Ct. 675* and *Federal Power Commission v. Hope Natural Gas Company, (1944) 320 U.S. 591, 210 S.Ct. 281,* held that a rate of return for a utility must be (i) comparable to the return on investemtns in other enterprises having corresponding risks and (ii) sufficient to assure confidence in the financial integrity of the utility, maintain support of the utility's credit and attract capital as reasonably required by the company. This Commission has frequently noted, the cost of capital is not synonymous with, equivalent to, or the sole criterion to be considered in determining, the fair rate of return to be allowed on the fair value of a public utility's property used and useful for the convenience of the public. As this Commission noted in its Order in In Re Indianapolis Water Co. Cause No. 37612, issued March 20, 1985:

While capital attraction [*58] criteria enunciated in Hope are a major consideration in determining just and reasonable rates, the Hope criteria scarcely exhausts the relevant considerations for balancing of the investor and the consumer interest. The "end result" of this Commission's Orders must be measured as much by the success with which they protect the broad public interest entrusted to our protection as by the effectiveness with which they maintain credit and attract capital.

We will discuss the evidence presented by Petitioner, Commission Staff and the Public in determining the fair rate of return to be authorized.

(b) Summary of Fair Return Evidence. Petitioner, Commission Staff, and the Public offered evidence on Petitioner's annual cost of capital in this case. Petitioner's witness, Mr. Henry Mulle, relying on comparable earnings, a risk premium approach and a discounted cash flow (DCF) analysis, estimated the annual cost of equity capital to be respectively 13%. From this result, Mr. Mulle proposed a factored-up return on "book value equity" to be 14%. His 14% equity return recommendation resulted in an overall rate of return recommendation of 13.83% on the original cost rate base, and [*59] 12.89% on the fair value rate base which the calculated as $41,246,399.

In the Economic and Finance Division's Staff Report, prepared by Ms. Karen D. McKinney, a cost of and return on common equity of 13.00%, based upon risk premia and DCF analyses ranging from 12.75% to 14.00%, was recommended to the Commission. Her judgment was then applied to reflect the financial and business risks peculiar to the Petitioner. Staff's weighted overall recommended cost of capital was 12.85%, in the manner in which its said witness calculated it.

The Public's witnesses, Dr. Pradeep K. Sircar and Michael L. Brosch, relying on DCF and capital asset pricing model (CAPM) analyses and a downward adjustment of 250 basis points below their computed industry average of 12.85% cost of equity recommendation, concluded that a cost of equity of 10.35% is reasonable. Public's recommended return on equity produced a weighted overall cost of capital result of 10.24% (Public's Exhibit MLB-2, Sched. D).

As reflected in the above recommendations of those witnesses offering evidence on the cost of capital, and specifically, the cost of equity capital, the recommended returns on equity vary markedly, from 10.35% **[*60]** offered by the Public, to 13.00% offered by both Petitioner (on market value) and Staff, to 14.00% offered by Petitioner when cost of equity is boosted by a market-to-book factor up. This divergence of claimed expert opinion on the cost of equity capital produces a wide range in recommendations on the cost of equity of 365 basis points. Petitioner's market/book factor-up accounts for 100 basis points in this spread and Public's recommendation that the industry average equity return rate of 12.85% found by Dr. Sircar be reduced by 250 basis points (to shield ratepayers from the high pretax cost of Petitioner's 100% equity ratio) accounts for most of the remaining spread in recommendations.

There is a similarity in basic DCF results where Petitioner recommends 13% (no market-book factor-up), Staff recommends 13% and Public recommends 12.0% (before considering 100% equity ratio) .

(c) Evidence of Petitioner, Staff and Public. We will discuss further the evidence presented by Petitioner, the Commission Staff and the Public with respect to the fair rate of return to be authorized in this matter.

(i) Petitioner Evidence. Petitioner's witness, Mr. Henry Mulle, recommended **[*61]** that this Commission award Petitioner a 14.00% return on book common equity based upon a 13% fair market equity which he calculated at $41,246,399. Mr. Mulle based his recommendation on the results of a comparable earnings on book value study, a risk premium analysis and a DCF analysis for a group of 25 gas distribution utilities that he considered most comparable to the Petitioner. He also discussed the investment risks of the gas industry in general and the Petitioner in particular.

On his Schedule 8 of Exhibit FR-1, Mulle lists five results from his different analyses resulting in his recommended return on equity of 14%. We note at the outset of this discussion that during the proceeding, the Public made a motion to strike that result which reads "Risk Premium Market Approach for Small Companies" on the grounds that the underlying data allegedly supporting the result of Schedule 11 was unavailable to the Public and to Mulle. The motion was granted, therefore, the Public was precluded from conducting any cross-examination on that element of Mulle's analysis. Because of that ruling, that result will be ignored. Given this determination, we direct our attention to the four **[*62]** remaining recommendations of witness Mulle

On Schedule 8, the first result listed is "Indicated Cost of Common Equity by Discounted Cash Flows" and the result shown is 13%. This line references the reader to Schedule 9 of Petitioner's Exhibit F-1. During cross-examination on this schedule by the Public, it was pointed out that the actual DCF result from Schedule 9 is 12.53%, and not 13% as shown on Schedule 8. The 12.53% figure represents the result of a DCF analysis of a type presented to this Commission on a regular basis by a number of witnesses. This type of analysis has been commonly accepted as one proper methodology of determining the return on equity for regulated utilities in the state of Indiana.

Witness Mulle, however, does not recommend the 12.53% return which is the result of his DCF analysis. Mulle, after further analysis, recommends a 13% return for Petiticner. The 13% DCF result is composed of two figures: a sample average of 12.53% and truncated average of 13.77%. Theoretically, this truncated average should be the average of those results falling within a one standard deviation range of the mean, or the middle 68%. Mulle established this one standard deviation **[*63]** range to be 10.73% to 14.33% for his comparable group. But what was clearly pointed out during cross-examination and what can clearly be seen from witness Mulle's Schedule 9, column 10, is that Mulle selected companies that do not fall within the one standard deviation range. Apparently, he was able to successfully identify the middle 68% standard deviation range for each of the component variables that enter into the DCF equation, but then fails to do so for the DCF results. Again, Schedule 9 from Petitioner's Exhibit F-1 reveals that in columns 1 through 8, Mulle correctly denotes the companies that fall in the middle 68% with an asterisk. In columns 10 and 11, however, Mulle includes DCF results above the top of the middle range listed (including the single highest observations from each column), and excludes many relevant results near and below the sample average. A correctly determined middle standard deviation average for the market-based DCF is not the 13.77% relied upon by Mulle, but is actually lower than the original sample average by 31 basis points, or 12.21% as is shown in Public's Exhibit UCC-3. Witness Mulle, was unable to explain this error in his Schedule **[*64]** 9 on cross examination. Based on the correction of the exhibits as noted above, Mr. Mulle's methodology would call for averaging 12.53% with the 12.21% result which yields a market DCF recommendation of approximately 12.38%. This would be the correct result of Mr. Mulle's approach but we find no support in the record for the contention that averaging the mean return of all companies in a sample with the mean return of some companies in the sample has any meaning. It may be that an average based on the companies whose return fall within one standard deviation of the mean of the entire sample is a more appropriate representation of typical companies, but this is not the argument or the result presented to the Commission. The averages to be considered, therefore, are 12.53% for the sample companies and 12.21% for those companies within one standard deviation of the mean.

(b) Referring back to Schedule 8 of Exhibit FR-1, Witness Mulle's next recommendation is "Indicated Return On Equity (1.10 Book Value) by DCF . . ." with a recommended return on equity of 15%. We must admit, that this recommendation is highly suspect on its face given the fact that this Commission recently awarded **[*65]** Northern Indiana Public Service Company, in Cause No. 38380, approved October 28, 1988, a return on common equity of 13.5%. Upon more in depth analysis, our suspicions are confirmed. Mulle's 15% equity recommendation is fatally flawed in two respects. First, this recommendation suffers from the same flaw as was pointed out in paragraph (a), supra. That is, the companies selected by Mulle to fall within the standard deviation range do not, in fact, fall within that range. Again referring to Petitioner's Exhibit F-1, Schedule 9, column 11, the result of witness Mulle's analysis is a contrived DCF result of 14.25%, and he shows a 15.72% average for the middle 68%. This 15.72% average is wrong. If the correct calculation is made using Mulle's methodology, the average is actually 13.83%. If you then average the contrived DCF result of 14.25% with the 13.83%, the result is a recommendation by Mulle of 14.04%. This Commission, however, does not mean to imply that it accepts Mulle's contrived DCF result, but only felt that it was important to point out this error in Mulle's testimony.

Most importantly, the second fatal flaw to Mulle's 15% equity recommendation is his use of **[*66]** a market-to-book ratio adjustment which inappropriately inflates the return on equity figure. Both the Commission Staff and the Public voiced their strenuous opposition to such an adjustment. As was stated by Staff Economist Karen McKinney:

Staff feels the book value adjustment is wrong for two reasons. First, the DCF model calls for the current market price, not some subjective substitution. An examination of the literature discussing the DCF model confirms this. Second, if the book value adjustment is correct, it should cut both ways. When the market-to-book ratio is below one, this adjustment would necessitate an authorized rate of return below the cost of capital. Making the book value adjustment in this situation makes a bad situation worse.

The apparent purpose of Mr. Mulle's adjustment is to drive up the cost of equity and nothing more. . . . We do not feel that reliable, market-based price data should be replaced in cost of equity computations by subjective price data.

There is no basis for the bookvalue adjustment and its use should be rejected.

Staff Economist's Report at p. 14-15. (Emphasis added.)

We agree with the conclusion of Public's witness, [*67] Dr. P. K. Sircar, that "this Commission should reject the book value analysis of the DCF method as used by Mulle because the approach defies economic justification, logic and common sense." See Public Exhibit PKS-1 at p. 37. The record reveals substantial evidence in opposition to making a market-to-book ratio type adjustment as proposed by Mulle, and Mulle was unable to present any studies, other witnesses, or state commission that have accepted his approach. In fact, the Missouri Public Service Commission recently rejected the very same market-to-book ratio type adjustment to the DCF presented by Mr. Mulle, finding that such adjustment is unreasonable. In Re St. Louis County Water Company, Case No. WR-88-5, issued May 27, 1988, at p. 13. After consideration of all the evidence, the Commission determines that an adjustment to the DCF analysis based upon a market-to-book ratio, as proposed by Mulle in this Cause, is specifically rejected. This determination is based upon several facts arising from the evidence. First, the substitution of an inflated book value for the market price in the DCF calculation eliminates the most desirable quality of the DCF model, that is, a [*68] market-based measure of expected returns. Without a market variable, the DCF does not capture the risk/return expectations of investors and use of the model becomes meaningless. Second, the type of adjustment to the DCF proposed by Petitioner exacerbates an already extreme situation, which is that during periods of substantially high market-to-book ratios, an adjusted book value DCF will significantly overstate expected returns, and, if authorized, would signal a further increase in the market price. The converse is true as well: in a period of very low market-to-book ratios, an adjusted book value DCF would understate the expected returns and, if authorized, would further depress the market price.

Therefore, witness Mulle's second recommendation of a 15% return on equity is rejected for the foregoing reasons. Based upon the foregoing discussion, Mulle's equity recommendation should be reduced to the same level as his equity recommendation discussed in paragraph (a), or approximately 12.38% return on common equity. We will accept 12.38% as Mr. Mulle's recommendation as a result of his DCF analysis.

(c) With regard to Schedule 8, FR-1, witness Mulle's next recommendation, [*69] entitled "Restored Comparable Earnings Return on Book Value Equity," results in an equity return recommendation, after correction for errors made by Mulle, of a 13.65% return on equity (Schedule 10 of Exhibit FR-1).

On his Schedule 10, witness Mulle first derives the average achieved return on equity for his twenty-five company comparable group for each of the years 1983 through 1987. These results can be seen on the line entitled "Average Achieved ROE." Witness Mulle then adjusts that result for an inflation factor which has the result of increasing the equity recommendation with regard to this schedule. Mulle's revised Schedule 10 recommendation is a 13.65% return on equity for Petitioner.

We note from simple observation of the average achieved returns on equity that for every year since 1984 the return on equity has been declining. Finally, we note that in Witness Mulle's prefiled direct testimony, each of his five recommendations on Schedule 8 were equally weighted in arriving at a final recommendation. Under cross-examination, however, Mulle stated that the inflation restored comparable earnings estimate should receive the most weight of the five estimates. After discovering [*70] his error in that schedule, the error being a misread decimal place in the 1987 return for Washington Energy, Mulle then relies upon the five equally-weighted estimates. This error suggests that Mr. Mulle's analysis is not an accurate representation of relative returns demanded by investors in the marketplace. Therefore, we do not believe that it is appropriate to factor inflation in again to numbers presented in Value Line or determined by this Commission for returns on equity.

(d) Mulle's final recommendation appearing on Schedule 8 is entitled, "Risk Premium Market Approach" and results in an equity recommendation of 13.2%. In this analysis, Mulle draws on information provided by the Ibbotson and Sinquefield studies, with some charges. With regard to this schedule, we believe that the recommendation should be taken for just what it is, that being a measure of the risk premium for the general market, and not necessarily for natural gas distribution utilities with 100% equity capital structures. Given the evidence presented concerning Petitioner's risk in this case, it is clear that Terre Haute Gas is less risky than the average natural gas distribution utility, and that [*71] the average natural gas distribution utility is certainly less risky than the market in general. As Mulle stated on cross-examination, this is market risk premium and not a risk premium developed for Petitioner. Therefore, while the number may be correct for the market, it should be given limited weight in determining the proper return on equity for Petitioner in this Cause.

(ii) Commission Staff's Evidence. Staff witness Karen D. McKinney presented testimony supporting a 13.0% return on equity for Terre Haute Gas. Ms. McKinney's analysis is based on two DCF analyses of companies that are listed and traded on stock exchanges, and a risk premium analysis. Ms. McKinney then adjusted the results of her analyses to give weight to the specific investment risks associated with Terre Haute Gas.

Ms. McKinney's comparable group analysis consisted of estimating the return on equity for eight (8) companies considered of near comparability to Petitioner. Stock prices used by Ms. McKinney were "the midpoint of the observed stock price range from November, 1987, through June, 1988." The dividend used in her DCF analysis was the current dividend at the time the analysis was performed, **[*72]** adjusted upwards by one-half the growth rate. The dividend yield, thus, as calculated by Ms. McKinney was 7.335%. Adding to this yield a growth rate, which the witness calculated to be 5.588%, resulted in an estimated cost of common equity of 12.923%.

Witness McKinney also performed a second DCF analysis utilizing a sample group comprised of all gas distribution companies surveyed by Value Line's investment service. Dividend yields for each company in the group were those published by Value Line. To determine the growth rate, the witness averaged Value Line's earnings per share, dividends per share, and book value per share, similar to the method employed by Petitioner. Averaging the DCF results of the 18 individual company calculations, Ms. McKinney determined the estimated cost of equity here to be 13.26%.

Ms. McKinney also performed a risk premium analysis as an alternative to the DCF (discounted cash flow) method. The risk premium method assumes that investors require a premium for equity investments over the returns for less risky investments. To establish the debt/equity risk premia, Ms. McKinney compared the cost of debt and required returns on equity from **[*73]** four separate risk premium studies. The cost of equity in each approach was based on DCF, and the yield on AA rated public utility debt was used to establish the spread. The resulting debt/equity risk premia were added to the then current cost of 10.38% for AA rated long-term utility debt. The risk premium analysis indicated an estimated cost of equity of 14.02%.

Finally, Ms. McKinney utilized a CAPM (capital asset pricing model) analysis involving two presentations of U.S. Treasury data -- one historical and one projected. The two respective results were 12.58% and 12.90%, for an average for CAPM methodology of 12.74%.

Based on the results of these analyses, McKinney concluded that the range for the cost of equity capital was between 12.75% and 14%. Her overall recommendation was 13% per annum. She also considered the period of time she expected the rates approved in this case will be in effect.

To determine Petitioner's business risk, McKinney analyzed revenue and sales data by customer class, changes in those classes and the likelihood for trends in customer changes to continue or abate.

(iii) Public's Evidence. The Public utilized two witnesses on the subject of **[*74]** cost of capital and rate of return. Witness Dr. P. K. Sircar was the primary witness, and concluded that an industry-normal 12.85% cost of common equity, reduced to 12% or less was appropriate due to the almost 100% common equity ratio employed by Petitioner. (All parties concluded that with Customer Deposits and Investment Tax Credits, the common equity was 93.35% of capitalization.) Public's witness Michael L. Brosch then concluded that a penalty of 250 basis points below Dr. Sircar's 12.85% industry norm was the appropriate return to be allowed on common equity, or 10.35%.

Dr. Sircar's analysis involved a DCF analysis and a CAPM analysis, which he tested by a series of statistical computations. Dr. Sircar found the industry norm to be 12.85%, with suggested downward adjustments for the lack of debt in the capital structure of between 65 and 130 basis points. He settled on 85 basis points. The range of this witness would provide for a lower equity cost bound of 11.55% (12.85 - 1.30), and an upper equity cost bound of 12.20% (12.85 - .65), In this area, Witness Brosch appears to contradict the Public's more qualified economics witness, Dr. Sircar, in concluding in a 250 basis **[*75]** point penalty for the same lack of debt in the capital structure -- hence his 10.35% conclusion.

In his DCF analysis, Dr. Sircar concluded in a 12.55% industry average return. For his DCF result Dr. Sircar used the same 25 comparison utilities identified in Value Line by Witness Mulle, and his industry result of 12.55% is very close to Mr. Mulle's unadjusted market result of 12.58%. For his CAPM result, again using the same 25 gas distributors, Dr. Sircar arrived at a 13.14% average for the group. Approximately splitting the difference, he concluded with 12.85% as being appropriate.

The Commission notes that the combined 10.35% equity cost conclusion of witness Brosch, applied by him to a 93.35% common equity ratio is substantially the same to that which would be obtained by use of a hypothetical capital structure of 53.5% debt and 36.5% equity (which he approved as a proper capital structure), assuming 11% cost of debt. Wittingly or not, we believe Brosch actually was seeking, by his penalty technique, to achieve the full effect of such a hypothetical capital structure. Such hypothetical structures have been held to be illegal in Indiana, but the 53.5/36.5 capital structure **[*76]** above was described by him in his testimony as a proper capital structure. We treat the testimony of witness Brosch in this respect to be in the nature of suggestions only. He imposes a major (250 basis points) penalty to conclude with a rate of return on equity much below that of the other witnesses obviously qualified to make informed conclusions in these respects. He substantially lowered the rate proposed by the Public's own rate of return witness, Dr. Sircar. This Commission has consistently held in accord with Indiana law stated above that it cannot use a hypothetical capital structure to fix rates. *Public Service Commission et al. v. City of Indianapolis et al. (1956) 131 N.E. 2d 309;* See: the order of the Commission re Northern Indiana Public Service Company, Cause No. 38045, approved July 15, 1987, and order re Indianapolis, Water Co., Cause No. 37612, approved March 20, 1985. His suggested penalty procedure here seems to be a round about way of arriving at a conclusion, which is, either by accident or design, the result of a hypothetical capital structure. We do not believe we can do indirectly what we cannot do directly. As a matter of fact, in Brosch's **[*77]** direct testimony, at page 75, he recommended "a downward adjustment to the equity return rate to be allowed by the Commission as an explicit restatement for THG's uneconomic capital structure". In other words, he has "restated" the capital structure by a penalty device. The result obtained by Brosch is in fact obtained by a false syllogism; he attains a result without benefit of a risk analysis, by an accounting exercise using premises which are in fact unlawful in Indiana. He attains a result simply by the use of what he referred to as an exercise to attain a penalty and cited, in his testimony, some language from an Arizona Corporation Commission case involving Citizens Utilities Company where, in fact, that Commission apparently considered a hypothetical capital structure for the utility, which hypothesis included a larger percentage of debt than actually existed, but claimed it did not use.

The case is interesting and probably was cited to quote some interesting language. In any event, the case was appealed, settled and has no application at all in this case. Our statutory authority to impose a "penalty" is strictly limited. This Commission does not have the authority **[*78]** to impose a penalty, directly or indirectly, except when it is specifically authorized to do so. We disapprove the suggestions of the witness Brosch with respect to rate of return on equity which should be allowed to Petitioner herein, and the same will not be used.

(d) Cost of Equity Conclusion. This Commission has repeatedly adhered to its standard as recently expressed in the Indianapolis Water Co. matter, its Cause 37837, at page 17:

"It is our belief that in order to be fair to both Petitioner's investors and ratepayers, this Commission should authorize a return that recognizes the state of the capital markets in which Petitioner functions."

The evidence does not support, nor will this Commission authorize, a 14% return on equity, given the Petitioner's actual financial risks. Nor can the Commission subscribe to a return on equity as low as that suggested by UCC, as we determined above, which is below current debt costs, even if the faulty premises, the basis of Brosch's conclusion, were disregarded. We take the Petitioner's capital structure as we find it, without indulging in hypothesis or simulation. We further refuse to penalize the Petitioner for employing **[*79]** a capital structure consisting of all equity, when no debt was required. Ms. McKinney pointed out that in fact, such a capitalization may well have insulated Petitioner against more severe business risks when industrial customers left the system. It is clear, however, that Petitioner has much less financial risk than the average gas utility.

Based upon the record as a whole, this Commission concludes that a 12.50% return on equity is appropriate and should be adopted for the purposes of this proceeding. Such an authorized return on equity specifically recognizes the slight financial risk attendant to Petitioner's common equity investors, and the business risks of its enterprise.

9. Adjustments to Petitioner's Capital Structure. Both Petitioner and Commission Staff included in Petitioner's capital structure $105,569 as pre-1971 investment tax credit at zero cost. The Commission notes that the Internal Revenue Code at 26 C.F.R. Sec. 46(f)(2) requires that the pre-1971 investment tax credit be removed from Petitioner's capital structure. Accordingly, we have deducted $105,569 from said capital structure which is reflected in our Findings below.

10. Petitioner's Common [*80] Equity. Petitioner's common equity on December 31, 1987 appears in its books and records as $30,859,659. Both Petitioner and the Commission Staff reduced Petitioner's common equity to $21,260,078 to reflect the unpaid balance of the items shown as Accounts Receivable-Associated Company, an account which Petitioner characterized as a zero-interest, open account receivable from Indiana Gas and Chemical Corporation, Petitioner's parent. The evidence in this Cause indicates that no ratebase investment is supported by these funds and it is therefor inappropriate to consider in the capitalization of Petitioner for ratebase purposes. Because all of Petitioner's stock is owned by Indiana Gas and Chemical, we find the unpaid balance in this account is a proper deduction from Petitioner's common equity for ratemaking purposes. Nothing in the evidence indicates whether this account receivable will ever be repaid but based on the evidence presented by Petitioner we find that it should be considered a constructive dividend paid from Petitioner's retained earnings. Therefor, the Commission find Petitioner's common equity for ratemaking purposes is $21,260,078.

11. Overall Cost of Capital. [*81] In order to comply with the law, we must determine Petitioner's overall weighted cost of capital by assigning a cost to Petitioner's investment tax credit, which is no less than the overall weighted cost of capital determined by assuming "that such capital would be provided solely by common shareholders, preferred shareholders, and long-term creditors in the same proportions and at the same rates of return as the capital actually provided to the taxpayer by such shareholders and creditors." *I.R.C. § 1*.46-6(B)(3)(II)(B)(2)(1986). We determine that § 1.46-6(b)(3)(ii)(B)(2)(1986). We determine that the cost which should be assigned to this investment tax credit is, therefore, 12.50%.

Considering the previous findings and testimony, a weighted overall cost of capital of 12.41% is found reasonable for determining Petitioner's annual revenue requirements. This is based on a 12.5% cost of equity, eliminating remaining pre-1971 investment tax credits, a 6% cost of customer deposits and the 12.50% cost of post-1970 investment tax credits. We find that the Petitioner's capital structure, weights, and cost then are as follows:

Description	Amount	Percent of Total	Cost of Capital	Weighted Cost of Capital
Common Equity	21,260,078	93.79%	12.50%	11.72%
Customer Deposits	300,015	1.32	6.00	0.08
Invest. Tax Credit				
Post-1970	1,107,957	4.89	12.50	.61
TOTAL	22,668,050	100.00%		12.41%

[*82]

12. Petitioner's Revenue Requirements. Based upon all of the evidence of record and considering all relevant factors discussed above, we find that Petitioner should be authorized to earn a 7.9% return on the fair value of its used and useful property.

As noted above, Petitioner's current rates should generate annual operating income of approximately $1,141,261, which provides Petitioner an opportunity to earn a 5.04% return on its original cost rate base and a 3.21% return on the "fair value" of its property as we have determined it to be for the purposes of this matter. The said net operating income of $1,141,261 is insufficient to provide a reasonable return for Petitioner on its property lawfully devoted to public service in the gas utility business. Therefore, we find that Petitioner's current rates are inadequate to provide a reasonable return on Petitioner's investment in its utility property used and useful for the convenience of the public, and are confiscatory and unlawful.

On the basis of the evidence presented in these proceedings and in light of this Commission's experience in such matters, we find that Petitioner should be authorized to increase its rates and [*83] charges to produce additional operating revenue of $2,702,968 over adjusted test year revenues found herein, resulting in total annual operating revenues allowed of $34,539,742, Total annual operating revenue $34,539,742 will be an approximate 8.54% increase in sales revenues, over adjusted test year sales revenues, and is reasonably estimated to allow Petitioner the opportunity to earn annual net operating income of $2,812,827, as follows:

Operating Revenues:	$34,539,742
Operating Expenses:	
Operation and Maintenance	
Including Cost of Gas	27,716,991
Depreciation Expense	897,576
Taxes Other than income	1,423,841
Income Taxes	1,688,507
Total Expenses Pro forma	
at approved rates	31,726,915
Net Operating Income	$ 2,812,827

Net operating income of $2,812,827 represents a 7.9% return on fair value rate base of $35,605,000 which we have found, which is equivalent to a 12.41% return on the original cost rate base we have found. Such net income should provide Petitioner with a 12.5% return on equity. The Commission finds that rates estimated to produce the aforementioned results are just, fair and reasonable and will allow Petitioner the opportunity to earn a reasonable [*84] and fair return on its investment in its property dedicated to providing gas service to the public.

13. Cost of Service - Rate Design. (a) Costs Study. The only Cost of Service Study presented in this case was prepared and sponsored by Petitioner's witness, John W. Strevell. Comments or objections to this study were made by the Public's witness Tjun S. Wong and Commission Staff witness Donald J. H. Engerer. The Public's (OUCC) witness, Wong, did not present a cost of service study, but he did comment on and make recommendations as to Petitioner's study. Utilizing Mr. Strevell's cost of service study, he adjusted the figures to illustrate his recommendations. He has summarized his study in terms of rate of return under present rates as follows:

Rate 1	
Residential - non heating	0.89%
Residential - heating	3.05%
Commercial - non heating	19.57%
Commercial - heating	4.69%
Industrial	39.05%
Rate 2	3.60%
Rate 3	11.25%

The Commission Staff did not present a cost of service study. However, Staff's witness Engerer made certain objections to the study presented by Petitioner. Staff presented the following statistics relative to meter and regulator investment [*85] for Rate 1 from Petitioner's cost of service which we believe are pertinent, and which we consider in our determinations:

Meter & Reg.

Customer Group	No. Customers	Investment Per Customer
Residential	286	$110
Residential Heating	29,562	110
Commercial	185	1,567
Commercial Heating	2,866	239
Industrial	17	5,779
TOTAL	32,916	

Based on these statistics, Staff recommended that commercial and industrial customers be removed from Rate 1.

Because it appears that D-2 costs are based on Petitioner's historical usage, Staff recommended that D-2 costs be allocated based on pro forma sales. (D-1 and D-2 referred to herein are references to the demand charges in Texas Gas Transmission Corporation rates). Further, since Low Priority Rate customers have had little curtailment over the last five years, Staff recommended that the peak day demand allocator for this rate be 80% of the peak day usage, rather than 50% as recommended by Petitioner and used by the Public's witness.

(i) D-2 Allocator - Mr. Strevell allocated the D-1 and D-2 cost on basis of the design day or peak day usages of the classes of service. There seems to be no objection **[*86]** to Mr. Strevell's estimate of peak day usage, but only to his use of such factor for the allocation of the D-2 costs. Mr. Wong, the Public witness, stated that costs should be allocated on the basis of causality and concludes that since the D2 cost is based on an historic annual volume of sales that such costs should be allocated on annual usages. He does recognize that the use of historic volumes is impractical and therefore recommends the use of pro forma class usages. Mr. Engerer also recommended the use of customer class consumption allocators. In rebuttal testimony, Mr. Strevell conceded that peak day usage might not be absolutely accurate for allocating D-2 costs, but that normalized annual volumes were not absolutely accurate either. He stressed that proposed D-2 nominations represented extreme conditions for the periods involved. Mr. Wong also stated Petitioner's proposed D-2 nomination level consists of the estimated annual demands of its service classes plus a safety margin for colder-than-normal weather and potential growth.

If the FERC were to accept the Company's proposed D-2 nominations, then they might be acceptable for use in determining this allocator. However, **[*87]** the likelihood of these nominations being accepted by the FERC exactly as filed and with dispatch is very small. Mr. Strevell recommended that D-2 costs be allocated 50% on peak day usages and 50% on pro forma annual usages as an appropriate method for this case.

(ii) Demand Allocator Discount - Mr. Strevell allocated demand costs to the Low Priority rate based upon 50% of their potential peak day usage. This is a judgmental result figure, which, as we observe, are many cost of service study components. Since the rate is interruptible, it should not receive a full share of demand costs. It would not be wise or fair to establish a rate for interruptible service which makes no contribution to the company's fixed charges. Therefore, he chose the 50% number, and stated that a more important factor to consider is the fact that interruptible service should normally be priced less than firm service. Mr. Wong felt a 50% discount in the D-2 cost attributable to the Low Priority Class is fair and reasonable, and he made no objection to a similar discount on the D-1 costs. Mr. Engerer stated in his report that since these customers have had little curtailment over the last five **[*88]** years, Staff recommends that the peak day demand allocator for the Low Priority customers be 80% rather than 50% of the peak day usage. In rebuttal to Mr. Engerer's proposal, Mr. Strevell made the following two statements "My best judgment is that 50% is the maximum demand charge that we could expect this rate to bear" and "If 80% of the demand charges were assigned to Rate 3 customers, Terre Haute Gas Corp. would probably experience customers switching to firm gas service or an alternate fuel." This is not a possibility which would benefit Petitioner or its ratepayers, nor would it be in the public interest to force such a result.

Mr. Strevell's ominous predictions of the effect of an 80% factor are based on his judgment. However, with the Company's recent experience of loss of industrial load, we must take heed. The fact that these customers have had little curtailment over the last five years does not negate the possibility of considerable curtailment in some future year. year. Using a 50% factor, the Low Priority Rate is contributing to fixed charges and maintaining a lower rate for other classes. Raising that factor to 80% could increase that contribution or it might cause **[*89]** loss of load, resulting in higher rates for the remaining customers, a risk that should not be taken.

(iii) <u>Commercial and Industrial Customer Under Rate 1.</u> - Staff recommended that Commercial and Industrial customers be removed from Rate 1 based primarily on meter and regulator investment per customer. We note that the meter and regulator investment for commercial heating is much closer to the residential investment than to the other commercial and industrial investment.

We find, therefore, that Mr. Strevell's later proposal, in his rebuttal testimony, as to D-2 allocators should be accepted for this case and future GCA filings, and that D-2 costs should be allocated as he has proposed, in the percentages hereinafter set out. We find in favor of the 50% demand factor for the Low Priority Rate as proposed by Messrs. Strevell and Wong. We also find that Staff's arguments for removing commercial and industrial customers from Rate 1 are not so compelling as to require a change from a rate design, fair and reasonable to consumers, which appears to be working with no real complaints from any class of customer of Petitioner.

(b) <u>Allocation of Increases - Summary.</u> The only **[*90]** proposed rate schedules submitted in this case were those explained by Petitioner's witness Strevell. Schedule TH12 contains the rate schedules in his Exhibit D-2. Schedule TH11, contains the revenue calculations under the present and proposed rates. Schedule TH10 is a summary of revenue and return by rate and Schedule TH9 contains pro forma revenue requirements by cost causation. It can be seen in Schedule TH10 that the rate of return under present rates for both the Large General Rate (21.33%) and the Low Priority Rate (14.94%) are already above the overall return being sought by the Petitioner. Petitioner has proposed that most of the increase be placed on the General Rate (Rate 1). The proposed increase of 12.91% would have brought the return for this rate from 2.51% to 13.00% which increase would have eliminated 94% of the subsidy. In Petitioner's rebuttal testimony (Exhibit DR), Mr. Strevell notes the following rates of return based on his revised D-2 cost allocator on the basis of the 13.62% return requested by Petitioner:

	Present Rates	**Public's Proposal**	**Strevell Proposal**
Rate 1			
Residential - non heat	1.08%	8.83%	12.08%
Residential - heat	2.28%	11.63%	13.98%
Commercial - non heat	21.64%	21.37%	28.75%
Commercial - heat	3.54%	17.75%	10.51%
Industrial	44.33%	46.55%	47.20%
Total Rate 1	3.18%	13.32%	13.78%
Rate 2	12.83%	20.55%	16.31%
Rate 3	13.25%	13.29%	11.51%
Overall	4.79%	13.62%	13.62%

[*91]

The Public's witness, Mr. Wong, testified that returns should recognize the inherent risks of the various classes of service. He did not propose specific rates, but he did propose certain percentage increases for each class should Petitioner fully receive its request for a $3,338,462 revenue increase, which concept we believe is appropriate for use here. In the event that Petitioner is granted a revenue increase by this Commission less than what is requested, he proposed that any increase still be spread among the various classes of service on the basis of the recommended relative class percentages which he proposed, and which are found in Column G of his Appendix TSW-5.

Mr. Wong summarizes his proposal on said Appendix TSW-5. The pertinent data follows:

	Present	**Public's Proposal**		
	Rate of Return	**Rate of Return**	**Percent Increase**	**% of Request** (Column G)
Rate 1				
Res. - non heat	0.89%	8.65%	18.00%	0.33%
Res. - heat	3.05%	12.37%	12.70%	67.81%
Comm. - non heat	19.57%	19.39%	0.50%	0.08%
Comm. - heat	4.69%	18.86%	13.25%	26.75%
Industrial	39.05%	41.49%	2.08%	0.37%
Total Rate 1	3.93%	14.04%	12.36%	95.35%
Rate 2	3.60%	11.68%	15.50%	3.84%
Rate 3	11.25%	11.38%	0.60%	0.81%
Overall	4.79%	13.62%	10.74%	99.99%

[*92]

Commission Staff's witness, Mr. Engerer, did not agree with the customer groups included in Petitioner's proposed Rate 1 (the same as now exists) and recommended that commercial and industrial customers be removed from Rate 1. He also disagreed with the reduction in subsidy resulting from Mr. Strevell's proposed rates.

In his rebuttal testimony Mr. Strevell stated Mr. Wong had made specific increase proposals for each group; that Mr. Engerer did not make such specific recommendations but that those suggested by Mr. Wong would meet most of Mr. Engerer's criteria. There was no objection to this statement, Mr. Strevell proposed, in his rebuttal testimony, rates which he said would yield revenues by class quite close to those recommended by Mr. Wong. He also stated if the Commission were to accept Mr. Wong's recommendations, he would propose that they be implemented with a single General rate as exists now rather than to implement two additional rates as proposed by Mr. Engerer. There were no further objections by other parties to these rates included in Mr. Strevell's rebuttal.

Revenue increases from the rates included in Mr. Strevell's rebuttal testimony, stated in terms of percent **[*93]** increase and percent of total request, are compared to those proposed by Mr. Wong as follows:

	OUCC Proposal	**Strevell Rebuttal**		
	Percent Increase	**Percent of Request**	**Percent Increase**	**Percent of Request**
Rate 1				

	OUCC Proposal	Strevell Rebuttal		
	Percent Increase	Percent of Request	Percent Increase	Percent of Request
Res. - non heat	18.00%	0.33%	18.29%	0.34%
Res. - heat	12.70%	67.81%	13.85%	74.42%
Comm. - non heat	0.50%	0.08%	8.89%	1.42%
Comm. - heat	13.25%	26.75%	9.72%	19.75%
Industrial	2.08%	0.37%	4.23%	0.76%
Total Rate 1	12.36%	95.35%	12.46%	96.69%
Rate 2	15.50%	3.84%	12.43%	2.50%
Rate 3	0.60%	0.81%	0.60%	0.81%
Overall	10.74%	100.00%	10.67%	100.00%

Within the constraints of practical rate making, rate increases included in Mr. Strevell's rebuttal testimony reasonably approximate those proposed by Mr. Wong, and the total rate increase herein allowed should be allocated among Rate 1, 2 and 3 customers as proposed by Mr. Strevell in his rebuttal testimony, set forth above, and we so find.

Petitioner's transportation charges are presently made under a commodity cost credit methodology. Such manner of calculating the transportation rates of the Petitioner is found to be appropriate, should be continued and is hereby approved.

We find **[*94]** that the rate sheets included in Petitioner's original filing, except for rate levels, should be accepted. We further find that the rate levels be designed to spread the allowed revenue requirements as closely as possible. The total rate increase of $2,702,968 herein allowed should be allocated as follows:

to Rate 1	96.69%
to Rate 2	2.50%
to Rate 3	0.81%

This should provide Petitioner with total operating revenues of $34,539,742 (which includes $145,955 of forfeited discounts and $40,303 other operating revenues, leaving an allowed gross amount to be directly derived from rates of $34,353,484).

We reject the Staff's proposal to remove commercial and industrial customers from Rate 1 for the reasons herein stated.

It is the Commission's opinion that a cost of service study, in a proceeding such as this, should result in continued progress toward cost based rates for utility service. Careful judgment should be exercised as to the extent to which movement to cost based rates should be tempered to avoid rate shock to any customer class and to mitigate the possibility of further erosion of industrial load. Messrs. Wong and Strevell have each attempted to achieve those **[*95]** results. We are convinced that we have, so far as it is possible at this time, achieved a result whereunder the costs of service are allocated among the various customer classes on a fair and equitable basis aimed toward gradually approaching the ideal result, the burden thereof being imposed among the customers, according to the costs of the service received. Measurements of costs of service are, by the very nature there of determined in great measure by the viewpoint of the measurer. The measurers we heard here reached reasonably similar results, however. We believe we have melded the viewpoints of each of the experts who testified on the subject and that we have achieved a result which recognizes the prime concerns of each, the situation of the Petitioner and of its various classes of customers, as hereinabove found.

Petitioner should be directed to file its tariffs with the Engineering Division, consistent with the total operating revenue authorized and the commodity cost methodology method approved herein. Petitioner proposed a number of minor changes in its tariff language, which we approve. The new rates should be filed on a therm basis, converted on the basis of a BTU **[*96]** value of 1,026 BTU's per cubic foot as approved by the Engineering Staff of the Commission. We approve the methodology used in Petitioner's cost of service study used to develop the cost of gas. In filing new schedules of rates herein, Petitioner should revise its gas cost adjustment rates in effect at the time of filing. Petitioner should file with the Commission's Engineering Division new schedules of rates and charges and a "proof of revenues", showing the revenues to be produced therefrom by class.

14. Gas Cost Adjustments. In filing new schedules of rates to effectuate the increases authorized herein, Petitioner should revise its GCA filings to reflect the following base rate costs of gas:

Rate Schedule	Base Rate Cost of Gas Per Dth per month
General Service - Rate 1	$3.6479
Large General Service Rate 2	$2.8137
Low Priority Service Rate 3	$2.9915

Such base rate costs are based on demand allocations as follows:

	D-1	D-2
General Service - Rate 1	90.12%	82.16%
Large General Service Rate 2	2.76%	7.71%
Low Priority Service Rate 3	7.12%	10.13%

Such demand allocators plus base costs should be used in future GCA filings, subject to further **[*97]** order of the Commission.

15. Particular Engineering Staff Recommendations. Recommendations. Petitioner is in compliance with the Pipeline Safety Act. Petitioner is in substantial compliance with the Commission's rules and regulations for gas utilities; however, to be consistent with Commission rules Petitioner should make a copy of its tariffs available to the public at its business offices and call attention to the availability of the tariffs with a suitable placard. This requirement is consistent with the Commission's rules. The Engineering Staff recommends that the Petitioner's request for a proposed bad check charge of $10 and a reconnection charge of $40 be approved, on the basis that such proposed charges are reasonable. We find them so to be. The Petitioner should file an amendment to its Rule 14, particularly Original Sheet No. 104 of its General Rules and Regulations, so as to change the charge for processing a check returned unpaid by any bank from $3 to $10. The aforementioned reconnection charge shall be contained in the tariffs to be filed by the Petitioner.

The form of tariffs submitted by Petitioner are approved.

Petitioner now purchases gas from Texas **[*98]** Gas on a Dth basis, and Petitioner proposes to convert to therm billing. The Staff recommends such conversion on the basis of 1,026 btu's per cubic foot, and the same is approved.

The Engineering staff recommended that Petitioner should review for cost effectiveness its practice of testing meters on all meters which are removed from service for any reason. We are reluctant to order any change in testing practices which might result in less accurate or less safe meters in service. We will leave such matter to the judgment of Petitioner unless and until such time it is shown that such existing meter testing policies are unduly expensive to its customers.

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

1. The Petitioner, Terre Haute Gas Corporation, be, and it hereby is, authorized to increase its rates and charges in accordance with the findings herein, to produce an increase in annual operating revenue of $2,702,968 over adjusted test year revenues so as to produce total annual operating revenues of $34,539,742, with annual operating expenses of $31,726,915 so as to provide Petitioner the opportunity to earn net annual operating income of $2,812,827, **[*99]** as we have found to be proper.

2. (a) Petitioner, prior to charging new rates hereunder, shall file a new schedule of rates and charges, together with "proof of revenues", with the Commission's Engineering Division. That proof of revenues filing shall include the assignment of the revenue increases and the allocation of those increases to the various rate classes of Petitioner as found appropriate within this order. A copy of the same shall be served upon parties of record at the time said documentation is filed with the Commission. The tariffs so designed shall be in substantially the form as submitted by the Petitioner herein and shall conform to the Commission's rules for the filing of utility tariffs. Such filing shall include also a filing of Transportation Commodity Cost Credit Appendices to its Rate 2 and Rate 3, substantially in the form as now existing, with respect to the commodity cost credit to be used in calculating and providing for its transportation rates. Such tariffs shall be effective upon filing with and approval by the Engineering Division and shall apply to gas usage from and after the date of approval. Petitioner's billings shall be calculated and filed **[*100]** on a therm basis as approved in the foregoing findings, as recommended by the Engineering Staff.

(b) Petitioner shall file revised gas cost adjustments to replace those in effect at the time of filing new base rates. Such revised GCA rates shall reflect the base rate gas costs set forth in the findings of this order and appropriate adjustments thereto, to be effective upon filing with and approval by the Engineering Division to be effective when the new tariffs are effective. The demand charge allocations used in the new rates approved shall be used in such gas cost adjustments and in subsequent gas cost adjustment proceedings, subject to further order of the Commission.

3. Petitioner's proposed increased bad check charge of $10 is approved and it is directed to file an amendment of its General Rules and Regulations to conform thereto, and the proposed new reconnection charge of $40 is hereby approved, the same to be contained in the tariffs hereinabove mentioned.

4. The proposed annual composite depreciation rate of 2.95% for Petitioner's utility plant and properties and 20% annual depreciation rate for its transportation equipment are approved.

5. Petitioner is ordered **[*101]** to make its tariffs available to the public at its business offices and call attention to the availability thereof with a suitable placard, pursuant to the findings herein.

6. This order shall be effective on and after the date of its approval.

DISSENTING OPINION OF LESLIE DUVALL:

I am not prepared to embrace the

I am not prepard to embrace the doctrine of negative allowance for working capital as a deduction to rate base as incorporated in this Order.

The computations going into working capital are at best esoteric. For many years this Commission routinely granted working capital as a part of rate base by simply computing 45 days of operating revenues. That method was arbitrary and has given way quite properly to the lead lag time study. Now in many cases, probably most, this Commission allows no working capital allowance at all as a part of rate base. That too is a result in which I concur.

Now for the first time in the history of this Commission the majority determines a negative allowance for working capital and subtracts it from the utility's rate base. This exception is justified by distinguishing this case from earlier cases on the basis that this Petitioner has [*102] no long term debt, does not use short term debt to provide working capital and is owed an account receivable from its parent.

It seems to me we are penalizing a utility which has elected to operate debt free. I have not been aware until now that such conduct required a penalty. It is also elementary that this Commission cannot base rates on hypothetical capital structures. Technically, we are not doing that in this Order. What we are doing is saying because of your capital structure we're going to assess a negative allowance for working capital as a deduction to your rate base.

The suggestion recited in the Order of a zero compromise between Staff and Petitioner should have been accepted. Today's Order opens the door for increasing litigation in every future rate case of any magnitude involving this issue. It would be preferable in my judgment simply to drop working capital out of rate base consideration rather than enter the quagmire which we are entering today for the first time.

I dissent.

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NICHOLAS KILE