

ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF SOUTH LAWRENCE)
UTILITIES, INC. FOR AUTHORITY TO) CAUSE NO. 43688
ISSUE BONDS, NOTES, OR OTHER)
OBLIGATIONS)

PETITION OF SOUTH LAWRENCE)
UTILITIES, INC. FOR AUTHORITY TO)
INCREASE ITS WATER RATES AND) CAUSE NO. 43720
CHARGES AND FOR APPROVAL OF A)
NEW SCHEDULE OF RATES AND) APPROVED: AUG 18 2010
CHARGES APPLICABLE THERETO)

BY THE COMMISSION:

David Lott Hardy, Chairman

Angela Rapp Weber, Administrative Law Judge

On May 13, 2009, South Lawrence Utilities, Inc. ("Petitioner" or "South Lawrence") filed a petition with the Indiana Utility Regulatory Commission ("Commission") for authority to issue bonds, notes or other obligations, which was docketed as Cause No. 43688. On June 29, 2009, Petitioner filed a petition for authority to increase its water rates and charges and for approval of a new schedule of rates and charges applicable thereto, which was docketed as Cause No. 43720. Cause Nos. 43688 and 43720 were consolidated by a Docket Entry issued on July 13, 2009. Petitioner prefiled its Case-in-Chief on July 24, 2009. The Indiana Office of Utility Consumer Counselor ("OUCC") prefiled its Case-in-Chief on November 12, 2009. Petitioner prefiled its rebuttal evidence on November 25, 2009.

Pursuant to notice published as required by law, proof of which was incorporated into the record by reference and placed in the official files of the Commission, an Evidentiary Hearing was held in this Cause on December 4, 2009 at 9:30 a.m. in Room 222 of the National City Center, 101 West Washington Street, Indianapolis, Indiana. At the Evidentiary Hearing, the evidence and exhibits of the Petitioner and the OUCC were admitted into the record and cross-examination of their respective witnesses was conducted. No members of the public appeared.

Based upon the applicable law and evidence herein and being duly advised, the Commission now finds:

1. **Notice and Jurisdiction.** Due, legal, and timely notice of the hearings held in this Cause was given as provided by law. Petitioner is an Indiana not-for-profit corporation organized and existing under and by virtue of the laws of the State of Indiana. Petitioner is a "public utility" as defined by Ind. Code § 8-1-2-1 and is a "not-for-profit" utility as defined by Ind. Code § 8-1-2-125. Petitioner is subject to regulation by this Commission in the manner and to the extent provided by the laws of the State of Indiana. The Commission has jurisdiction over the parties and the subject matter of this Cause.

2. **Petitioner's Characteristics.** Petitioner is a not-for-profit utility providing water service to approximately 2,450 customers within rural areas and townships of Lawrence County, Indiana. Its principal office is located at 244 Carpenter Drive, Mitchell, Indiana.

3. **Existing Rates.** Petitioner's existing water rates and charges were established pursuant to the Commission's Order in Cause No. 43324 dated March 26, 2008.

4. **Test Year.** The test year used by Petitioner for determining Petitioner's annual revenue requirements in this Cause was the twelve months ended December 31, 2008, with adjustments for changes which are fixed, known, and measurable and which will occur within twelve months of the close of the test year. We find this test year to be sufficiently representative of Petitioner's ongoing operations to be used for ratemaking purposes.

5. **Relief Requested.** Petitioner seeks authority to increase its rates and charges by 24.41%, which would result in a \$311,964 increase in operating revenues. Petitioner also seeks authority to issue up to \$1,300,000 in long-term debt to be financed from the Drinking Water State Revolving Fund ("DWSRF") to enable South Lawrence to fund certain capital improvements. Specifically, South Lawrence seeks to construct a 200,000 gallon storage tank that will be larger and taller than the current tank to address low water pressure and capacity issues. South Lawrence also plans to use the funds to construct a new combined office/laboratory facility.

The cost of these capital improvements is estimated to be \$1,900,000. As presented in this Cause, Petitioner plans to fund approximately 30% of the project costs, or \$600,000, through an Office of Community and Rural Affairs grant and expects to fund the remaining \$1,300,000 through proposed debt for a term of twenty years with an anticipated interest rate not to exceed 2.88%. Finally, Petitioner seeks to increase its Bad Check Fee from \$10 to \$25.

6. **Evidence Presented in This Cause.**

A. **Water Storage Tank.**

1. **Petitioner's Evidence.** Petitioner's witness Brian A. Bullock, a Project Engineer and Principal of Midwestern Engineers, Inc., sponsored Petitioner's Preliminary Engineering Report ("PER"). Mr. Bullock first provided an overview of South Lawrence's existing water system, which includes one well field consisting of five wells, and six water storage tanks with a total capacity of 1,650,000 gallons. He testified that the area currently served by water storage tank number four has experienced low water pressure, particularly in the areas of higher elevation located along Kelso Road and at the end of the three-inch water main along S.R. 60 East. Customers have complained about the water pressure in these higher elevation areas. Mr. Bullock further testified that there have been numerous requests for possible development in this pressure zone, which will result in further decreases in water pressure and a need for additional water storage capacity. Mr. Bullock stated that a higher and larger water tank will provide adequate finished water storage to account for future growth in this area while improving water pressure throughout the zone. Mr. Bullock added that the PER provides greater detail for the proposed water tower.

2. OUCC's Evidence. OUCC witness Roger A. Pettijohn, a Senior Utility Analyst for the Water/Wastewater Division, expressed concern that the need for the water storage tank was not adequately supported by Petitioner's prefiled testimony and exhibits. More specifically, Mr. Pettijohn stated that while Petitioner described possible development requests as numerous, there is no evidence supporting these claims anywhere in Petitioner's evidence. He reviewed customer complaints relating to water pressure and noted that the vast majority of the complaints were the result of faulty pressure regulators.

Mr. Pettijohn acknowledged that South Lawrence may have issues with pressure stabilization and storage for peak demand. However, he considered additional factors when determining Petitioner's need for a new tank. Based on Mr. Pettijohn's examination of additional factors, he expressed concern that there would be a limited cost benefit to the overall customer base. He explained that there are no drawings of the proposed tank in the PER and, therefore, it was not possible to determine the tank's configuration and if it would benefit customers with respect to flow and storage.

Mr. Pettijohn also stated that the new tank could result in excess capacity since, according to the PER, at present only 67,300 gallons on average is being used from the existing 100,000 gallon tank. In addition, the new tank would cost all customers over \$800,000 but would serve only about 15% of the South Lawrence's residential customers. Mr. Pettijohn noted that tank four is only twenty-six years old. Tanks are depreciated over fifty years and remain in service for quite some time after full depreciation. Therefore, in Mr. Pettijohn's opinion, tank four has not reached the end of its useful life. Finally, Mr. Pettijohn testified that Petitioner did not adequately consider other reasonable, lower-cost options, including raising the existing tank or using booster pumps. Therefore, Mr. Pettijohn concluded that the Commission should disallow funding for the storage tank absent evidence to support its need.

3. Petitioner's Rebuttal. In rebuttal, Mr. Bullock responded to Mr. Pettijohn's concerns. He disagreed that insufficient evidence was provided with respect to low water pressure experienced in South Lawrence's system. He stated that Appendix A of the PER filed with his direct testimony contained hydraulic calculations for both the existing storage tank and the planned storage tank, which showed that static pressures were calculated to provide a range between thirty-eight psi and seventy-three psi, while residual pressures at Junction 321 were calculated to be between twenty-eight and sixty-three psi at peak flows. Mr. Bullock stated that the residual pressure at Junction 321 located at Kelso Road was calculated to be 29.9 psi with the existing storage tank. Mr. Bullock also sponsored chart recordings taken along Kelso Road that recorded pressures as low as twenty-five psi.

Mr. Bullock stated two customers complained of low pressure along Kelso Road. Pressure recordings taken at residences complaining of low water pressure confirmed that a low water pressure problem exists in the area to be served by the new storage tank. He explained South Lawrence is required to comply with Indiana Department of Environmental Management ("IDEM") regulations and the Ten States Standards, which state that the normal operating pressure in the water main shall not be less than twenty psi under all conditions of flow. Mr. Bullock provided recordings showing that the water pressure at one home along Kelso Road dropped below twenty psi numerous times. Mr. Bullock further stated that once new homes are connected to the system, these problems with water pressure will only worsen. Mr. Bullock opined if South Lawrence does not take appropriate steps now to address the low water pressure

issues, it risks being placed on a connection ban by IDEM, which would prevent new homes from being connected to South Lawrence's system until necessary improvements are made.

Mr. Bullock testified that, contrary to what Mr. Pettijohn claimed, the new storage tank would provide benefits to South Lawrence's entire system and customer base. He explained the new tank will reduce the burden on existing tanks and will support additional customers within the rest of the system. He also explained the new tank will allow South Lawrence to serve additional customers during an emergency situation, and it will not create an excess capacity problem. He agreed with Mr. Pettijohn that the new tank will have less frequent turn-overs than the existing tank, but stated the new tank's extra storage capacity will be extremely beneficial during the summer months. He noted other utilities provide this kind of storage capacity, and South Lawrence has not experienced issues with losing chlorine residual or freezing in its other tanks, which also provide extra capacity.

Mr. Bullock then described why the alternatives suggested by Mr. Pettijohn (i.e., the use of a booster pump or elevating the existing tank) would not be cost effective or a viable long-term solution. Mr. Bullock explained that while booster pump stations could temporarily improve water pressure, the cost of such a project would likely exceed \$505,000. In addition, Mr. Bullock stated South Lawrence would have to use two booster pump stations to remedy low pressure issues in two areas and would have increased electricity and maintenance expense. He noted that even if booster pumps were used, South Lawrence would not have the added capacity that will be provided by the new storage tank, limiting the ability of South Lawrence to serve customer growth in the future or react to emergency situations.

With respect to Mr. Pettijohn's suggestion that South Lawrence elevate the existing tank, Mr. Bullock stated, based upon an estimate by a leading tank contracting company, the cost of such an alternative would be approximately \$420,000, which considers the costs associated with repainting the tank. Mr. Bullock added that this estimate does not include any additional costs which would be necessary if structural improvements to the existing tank are necessary. Mr. Bullock noted the cost estimates for the alternative projects did not include any soft costs, such as engineering plans, land acquisition, legal and permitting costs, and other costs which would have to be incurred.

Mr. Bullock concluded that Mr. Pettijohn's alternatives would not provide a long-term solution to the water pressure problems and would not offer any additional water storage capacity. Conversely, Mr. Bullock believed that the proposed new tank will be a much more cost-effective and prudent solution to South Lawrence's needs, with lower operations and maintenance costs, lower energy costs, and a lower likelihood of significant problems down the road.

B. Office and Laboratory Building.

1. Petitioner's Evidence. Mr. Bullock testified that South Lawrence currently performs all of its water testing in a facility constructed in 1969. He stated that the lab testing equipment and facility is outdated and that as regulations increase, the lab will no longer meet the needs of the water system. Thus, Petitioner proposes to demolish its existing office and construct a new lab/office facility, which will be combined in order to save costs. He testified

that there are no anticipated adverse environmental impacts from this project because Petitioner proposes to reuse its existing land.

2. OUCC's Evidence. OUCC witness Mr. Pettijohn described the existing office as small but utilitarian. He stated that although some improvements might be reasonable, there is no support for the proposed \$650,000 cost to construct a new building. He opined that tests for chlorine, phosphate, iron, PH, and many other constituents can be performed on a six to eight foot work or laboratory bench, and testing equipment consists of reagents, probes and light sensing table-top instrumentation. Also, a new lab/office would not provide delivery or water quality benefits. Mr. Pettijohn suggested it might be more reasonable for Petitioner to remodel and expand its existing office, and therefore he recommended that the Commission deny funding for the new facility.

3. Petitioner's Rebuttal. In rebuttal, Petitioner's witness Mr. Nelson Terrell, President of the Board of Directors of South Lawrence, testified as to the need for the lab/office facility. He stated Petitioner has used the existing renovated garage for as long as it can, but the garage no longer meets its needs now, let alone in the future. He also indicated South Lawrence now has a number of certified operators who can perform the required daily water quality tests, and a new facility will enable South Lawrence to monitor its water system and water testing more efficiently.

Mr. Terrell further explained that the current structure has experienced significant water damage to its walls, creating potential health concerns for Petitioner's employees. He stated South Lawrence's employees have complained about the current working conditions, and one employee had to leave employment with the utility due to breathing problems. He believed constructing a new building, rather than attempting to renovate the existing garage, is a proactive approach to avoid the potential for future health problems while addressing the limitations of the existing facility.

Mr. Bullock provided additional testimony in response to Mr. Pettijohn. He noted that the current office building is a 1,000 square foot, 1950s-era renovated garage that has experienced water damage and is poorly equipped to meet South Lawrence's existing and future needs. He stated there are a number of areas in the building that may not be compliant with the Americans with Disabilities Act, including the main entrance and the restroom facilities. He also noted that the facility is used for all of the water utility board meetings, which have to be open to the public. He opined that the cost estimate for the building is reasonable and within expectations for a project of this nature. He noted Petitioner proposes to reuse existing land that it owns and combine the laboratory and office functions in order to reduce the cost of the project.

In response to questions from the Presiding Officers at the Evidentiary Hearing, Mr. Bullock stated that the proposed building is modeled after a similar building used by East Lawrence Water Authority. (Tr. at BB-3). He testified the projected cost per square foot is consistent with the cost for a typical office building, and the new building would have a projected lifespan of at least thirty years. Mr. Bullock concluded that the Commission should approve Petitioner's proposed office/lab building.

C. Commission Discussion and Findings. South Lawrence seeks authority to issue debt to finance the construction of capital improvement projects, namely a new 200,000-gallon storage tank and a new combined office/laboratory facility pursuant to Ind. Code § 8-1-2-78 and Ind. Code § 8-1-2-79. In order to approve a debt issuance, we must consider whether the

issuance is prudent and in the public interest. Such consideration includes a wide range of issues related to the nature of the underlying project, as well as the proposed debt.

The Commission finds that Petitioner has failed to meet its burden of proof with respect to the need for a new water storage tank. South Lawrence argued that the new tank is needed because of low-pressure issues experienced in the area and the need for additional capacity as a result of development in the area. However, Petitioner's evidence regarding current and future growth does not support the additional capacity that a new 200,000-gallon tank would provide. South Lawrence provided Exhibit KA-R2, which consists of a letter from Bennett Construction Company dated November 18, 2009. The letter states that Mr. Bennett "would like to see more water volume and pressure for future development" in the area of the replacement tank. This statement does not constitute a commitment or even intention toward developing the area.

Also, the PER, Exhibit BAB-1, depicts population projections from the STATS Indiana website for Lawrence County. This data indicates only a .9% population increase since year 2000. Even if the Commission were to consider the County estimate as reasonably predictive for Petitioner (and specifically for the pressure zone served by the replacement tank), that would mean approximately sixty customers would be added over the next twenty years to the existing 330 customers. Using the 200 gallon average daily demand per customer allocation shown on page six of the PER, this growth would add an additional 12,000 gallons a day, well within the existing tank's available capacity. Growth does not appear to be a problem, and we believe the existing tank appears to be adequate for the next twenty years.

In denying the Petitioner's request on this issue, the Commission finds troubling South Lawrence's failure to meaningfully consider alternatives to the construction of a new water tank. Page nine, Chapter four of Petitioner's PER lists the alternatives to the construction of a new tank considered by Petitioner. The PER discusses only two alternatives: the no-action alternative and the removal of an existing control valve. Mr. Pettijohn described two additional alternatives that should have been considered and discussed in Petitioner's PER, which are the elevation of the existing tank or the use of booster pumps to increase pressure in the area of the replacement tank. Mr. Bullock did provide rebuttal testimony concerning Mr. Pettijohn's alternatives. However, booster pumps and the elevation of the tank should have at least been explored as possible solutions to South Lawrence's issues in the PER.

Under questioning at the Evidentiary Hearing concerning why the booster pump option had not been considered, Mr. Bullock explained, "When discussing that with the Board, with the past issues they've had with booster stations, they were not wanting to pursue that any further; so, we did not evaluate it any further than that." (Tr. at BB-17). While South Lawrence has considerable input into how its system is configured, the fact that the most basic of options were not considered at the direction of the Petitioner calls into question the integrity of the PER. The Commission perceives this as an inappropriate results-driven approach because it appears that Petitioner chose the solution to its issues without considering sufficient and available options and the unbiased advice of its consulting engineer.

Further, in response to Mr. Pettijohn's suggestion that the existing tank could be raised, Petitioner provided Exhibit BAB R-6, a letter from Phoenix Fabricators, which listed the cost to elevate the existing tank as \$420,000. Under cross-examination, Mr. Bullock indicated that Phoenix provided the \$155,000 figure to repaint the existing tank. (Tr. at B-6 – B-7). We note that the \$420,000 tank-raising estimate in Phoenix's letter includes "sand-blasting and painting

the entire finished structure.” (BAB-R at 9). Reducing the \$420,000 figure by the \$155,000 for tank painting, which South Lawrence is already collecting through its tank painting program, would bring the actual cost of elevating the tank to approximately \$265,000. This amount is more than half a million dollars less than Mr. Bullock’s \$776,000 estimate for the construction of the new tank shown in Section 4C on page 9 of the PER. This is an alternative that should have been more fully investigated and presented to the Board of Directors of South Lawrence as part of the PER.

The Commission also notes that like the existing tank, the replacement tank will serve only 330 customers in its pressure zone. Thus, it will provide little benefit to the remaining 86.4% of Petitioner’s customers. With an average flow of only 67,000 gallons per day from the 100,000-gallon tank, the current unused capacity would handle another 50% increase in demand.

With respect to Petitioner’s assertion that its system experiences issues with low pressure, Mr. Bullock’s rebuttal refers to two complaints concerning water pressure and includes Exhibit BAB-R1, which is a pressure recording chart. We note from the chart several spikes above and below a more constant line of approximately forty psi. The Commission also notes that the date of the readings is August 15, 2005, which may not be current today. There is insufficient evidence of record for us to determine whether Petitioner improved the situation through repairing leaks or if the condition worsened because of additional homes. Further, while system pressure at forty psi is acceptable, pressure readings below twenty psi initiate boil advisories. However, no boil water advisories issued to customers were submitted as evidence. While RAP Attachment 2 to Mr. Pettijohn’s testimony shows substantial pressure and water quality complaints, Mr. Pettijohn testified that the pressure complaints stem from faulty home pressure regulators, leaks, or in one case, a clogged home filter. Significantly, water main pressure is not listed or indicated as a cause for the low pressure complaints.

Accordingly, the Commission finds that South Lawrence’s request for funding to construct a new 200,000-gallon water tank should be denied. South Lawrence failed to present sufficient evidence that an issue with water pressure warrants construction of a new tank. Further, Petitioner’s PER failed to meaningfully consider alternatives to the construction of the water tank to resolve issues with water pressure. South Lawrence also failed to demonstrate that development in the area is such that additional capacity is needed. Based on the evidence presented, the Commission finds that construction of a new water tank is not in the public interest at this time. Therefore, the Commission denies Petitioner’s request to issue long-term debt for the construction of a new water tank.

Likewise, the Commission finds that Petitioner failed to meet its burden of proof regarding its request for a new office and laboratory building. In its Case-in-Chief, Petitioner failed to list or describe the tests it is currently unable to perform but would be able to perform in the new facility. Petitioner’s witnesses also indicated at the Evidentiary Hearing that even with the new lab facility, certain tests currently performed by outside labs (test year amount of \$1,545) will still be required to be performed by outside labs. (Tr. at A-62). Further, Petitioner did not submit a prepared report, drawings or specifications with respect to how the space would be allocated and utilized. South Lawrence also did not provide analysis concerning the construction of a smaller building or an estimate concerning the number of people the new building would be able to accommodate.

In denying Petitioner's request to construct a new, \$650,000 lab/office facility in this case, we are not making a determination as to whether a more modest structure might be appropriate, only that the pending proposal is not supported by the evidence. Therefore, the Commission is unable to determine Petitioner's need for a new lab/office facility. In light of the above, the Commission finds Petitioner's request to issue long-term debt to construct a new lab/office facility is not in the public interest and is hereby denied.

7. **Rate Case Issues.** Petitioner's witness Mr. Terrell testified that Petitioner requires additional revenue to adequately meet its revenue requirement needs. He stated that since Petitioner's last rate case, it has become apparent that the relief granted was simply insufficient to cover the costs of providing safe, reliable water service to South Lawrence's customers, particularly during this economically challenging time. Mr. Terrell stated there have been increases in many of South Lawrence's expenses. As a result, South Lawrence has been unable to properly fund its debt service reserve account. Petitioner's witness John Seever testified that Petitioner requires a 24.41% increase in annual revenues, or \$311,964. The testimony of Mr. Harold H. Riceman, a Utility Analyst with the OUCC, proposed approval of 11.93% across-the-board rate increase, which amounted to an increase of approximately \$153,700. We discuss each of Petitioner's annual revenue requirements separately below:

A. **Operating Revenues.** Both parties agreed that Petitioner's adjusted operating revenue at present rates is \$1,288,046.

B. **Operation and Maintenance Expenses.** Petitioner's test year operation and maintenance ("O&M") expenses were \$655,495, and its *pro forma* O&M expense adjustments totaled \$152,051. The OUCC's calculation of *pro forma* O&M expense adjustments totaled \$112,542, which reflects adjustments for salaries and wages, periodic maintenance, chemicals, taxes other than income and Commission fees. The OUCC accepted Petitioner's adjustments for health insurance, liability insurance and capital/nonrecurring expenses. Petitioner did not contest the OUCC's adjustments for salaries and wages, chemicals, taxes other than income, and Commission fees. The Commission therefore finds that Petitioner's adjustments for health and liability insurance and capital/nonrecurring expenses are reasonable, supported by the evidence and should be approved. We also find that the OUCC's adjustments to salaries and wages, chemicals, taxes other than income, and Commission fees should be approved.

OUCC witness Mr. Pettijohn recommended that South Lawrence base its annual amortization of tank painting expense on a fifteen-year interval for painting. According to Mr. Pettijohn, fifteen years is a better estimate of the life of tank painting based upon the current understanding of surface preparation and significantly improved coating systems with the enhancement of epoxy and urethane paints. The OUCC included in its proposed operation and maintenance expenses funds to paint the proposed 200,000 gallon tank.

In rebuttal, Petitioner's witness Mr. Allen noted that in South Lawrence's last rate case, a ten-year tank painting cycle was used. While Mr. Allen did not believe that a fifteen-year interval was unreasonable, he noted that Mr. Pettijohn provided no support for his claim that improved coating systems make a fifteen-year interval more appropriate. Mr. Allen concluded that he believes a twelve-year tank painting cycle, as initially recommended by Petitioner, is appropriate in this case. In addition, Mr. Bullock states in rebuttal that the existing 100,000-

gallon tank has not been painted for sixteen years. There is no mention of its need for painting in this Cause, however the tank will need to be painted in the future.

Based on the evidence presented in this Cause, the Commission agrees with Mr. Pettijohn that as a result of better paint quality and the point lifecycles, a fifteen-year time frame is appropriate for tank painting cycles. Therefore, we find Petitioner's total O&M expense to be \$742,091, which includes an accrual for funds to paint Petitioner's existing 100,000 gallon tank instead of funds to paint the 200,000 gallon storage tank.

C. Taxes Other Than Income. Petitioner did not dispute the OUCC's proposed payroll taxes of \$22,946. Therefore, the Commission finds Petitioner's Taxes Other Than Income of \$22,946 is approved.

D. Extensions and Replacements. Petitioner proposed a *pro forma* annual revenue requirement of \$117,896 associated with its capital improvement plan. The OUCC recommended an adjustment of (\$9,280) based upon Mr. Pettijohn's proposal to move Petitioner to a fifteen-year meter replacement program. In rebuttal, Mr. Allen explained that South Lawrence is not requesting a variance from the normal ten-year meter testing and replacement cycle. He believed that the Commission's rule regarding meter replacement leaves it up to the utility, not the OUCC, to determine whether a variance is necessary. Mr. Allen testified that even if the Commission's rules permitted the OUCC or other parties to propose a different meter replacement interval, the OUCC provided no relevant evidence supporting a move from the current ten-year replacement cycle to a fifteen-year cycle.

Based on the evidence presented, the Commission agrees that sufficient evidence does not exist to determine that the useful life of Petitioner's meters is more than ten years. Therefore, the Commission finds that Petitioner's proposed extensions and replacements of \$117,896 should be approved.

E. Working Capital. Petitioner proposed an annual revenue requirement for working capital of \$10,780. OUCC witness Mr. Riceman calculated an annual working capital revenue requirement of \$8,178, amortized over a three-year period. Mr. Riceman's figure is based upon his exclusion of \$24,276¹ in payroll taxes, which he indicated Petitioner pays in arrears. Petitioner did not contest this adjustment. However, as mentioned above, the Commission adjusted Petitioner's operation and maintenance expense to include funding to paint a 100,000 gallon tank, which resulted in an O&M revenue requirement of \$742,091. Accordingly, the Commission finds Petitioner's working capital to be \$8,053, as depicted below:

¹ The Commission notes that on page seven of Public's Exhibit No. 1, Mr. Riceman explains that he excluded the \$24,276 related to payroll taxes from his working capital calculation. However, as shown on OUCC Schedule 4, payroll taxes proposed by the OUCC is actually \$22,946.

Operation and Maintenance Expense	\$742,091
Less: Purchased Power	\$55,726
Sub-total	\$686,365
Divided By: 8	8
Working Capital Requirement	\$85,796
Less: Cash on Hand	\$61,638
Additional Working Capital Needed	\$24,158
Divided By: 3 years	3
Working Capital Revenue Requirement	\$8,053

F. Debt Service. Petitioner proposed an annual debt service of \$555,568, which included the debt service associated with its proposed construction projects. Mr. Riceman reduced Petitioner's debt service by \$86,414 because of Mr. Pettijohn's recommendation that the funding of the proposed storage tank and lab/office building be eliminated. Since we have not approved Petitioner's request for financing authority, the Commission finds that the OUCC's adjustment should be accepted. However, the Commission is adopting a three-year debt service average to correspond with the life of the rates. Mr. Seever testified in response to questions from the bench that three years is more indicative of the life of the proposed rates. (Tr. at A-6).

In addition, the Commission notes that neither Petitioner nor the OUCC included 2010 when calculating Petitioner's five-year average for debt service. Petitioner's 2001 RRF Bonds should be recovered in rates, even if payments are required for one year of the three-year average. The OUCC also included in its five-year average for debt service sixty months of payments for Petitioner's vehicle loan. However, the vehicle loan will be paid off in twenty-nine months, which should be included in the Commission's three-year average for debt service. Therefore, the Commission finds that an annual debt service of \$480,599, which is based on a three-year average, is reasonable, supported by the evidence and should be approved.

G. Debt Service Reserve. Petitioner calculated a debt service reserve requirement of \$109,774 to fully fund its debt service reserve in five years. Mr. Edward R. Kaufman, a Senior Utility Analyst with the OUCC, calculated a debt service reserve requirement of \$89,150 per year to reflect (1) the removal of the long-term debt for the proposed projects and (2) inclusion of interest that will accumulate based upon a projected interest rate of 2.0% for five years. Based on the evidence presented, and our disallowance of the proposed debt, the Commission accepts the OUCC's proposed debt service reserve funding, but we disagree with OUCC's use of 2.0% for the interest rate.

Mr. Kaufman provided no evidence in direct testimony to support a 2.0% rate. In determining his debt service reserve, Mr. Kaufman only states: "If Petitioner earns 2.0% interest per year, it will only need to collect \$89,150 per year in rates to accumulate a total of \$463,925 in five years." (Public's Exhibit No. 3 at 4). Without support from published documents, the Commission cannot find a 2.0% interest rate to be credible. Likewise, the Commission finds the 0% interest used by Petitioner to be not supported by evidence and unreasonable. Petitioner provided no evidence that when it deposits the debt service reserve funds in a financial institution it will earn 0% interest.

The Commission does not believe using a projected interest rate is reasonable. While interest rates are historically low, we are unable to speculate as to whether interest rates will decrease or increase over the next five years. Furthermore, the interest rate earned on an account depends on the dollar amount in the account, where the funds are deposited (e.g., local financial institution or national financial institution) and in which type of account (e.g., saving account or money market account). The evidence presented provides the Commission with a range of 2.0% to 0% for the interest on Petitioner's debt service reserve account. Having reviewed the evidence, the Commission finds that 0.9% is reasonable. Based on the interest rate of 0.9%, we find that Petitioner's annual debt service reserve requirement is \$90,560.²

Based upon the above findings, the Commission finds that Petitioner's revenue requirements are as follows:

Operation and Maintenance Expenses	\$742,091
Taxes Other Than Income	\$22,946
Extensions and Replacements	\$117,896
Working Capital	\$8,053
Debt Service	\$480,599
Debt Service Reserve	<u>\$ 90,560</u>
Total Revenue Requirements	\$1,462,145
Less: Interest Income	<u>\$1,554</u>
Net Revenue Requirement	\$1,460,591
Less: Revenue at Current Rates	\$1,288,046
Plus: Additional IURC Fee	<u>\$185</u>
Net Revenue Increase Needed	<u>\$172,730</u>
Recommended Percentage Increase	<u>13.41%</u>

As indicated above, the Commission finds that Petitioner's *pro forma* revenues at current rates equal \$1,288,046. The Commission further finds that the rates and charges currently in effect for services rendered by Petitioner are inadequate to provide for Petitioner's annual revenue requirement and should be increased. Petitioner requested that its revenues be increased by 24.41% or \$311,964. However, based on the evidence presented, the Commission finds that South Lawrence's rates and charges should be increased by 13.41% across-the-board to produce \$172,730 of additional annual operating revenue, for a total of \$1,460,778.

8. Non-Recurring Fees and Charges. Petitioner proposed to increase its Bad Check Fee from \$10 to \$25. OUCC witness Mr. Riceman correctly observed that Petitioner failed to provide any supporting documentation for this increase. In rebuttal, Mr. Allen explained that Petitioner based its proposal on the fee charged by its bank for bad checks, as well as the administrative costs associated with a letter of notification to the customer, a work order for disconnection, travel time for the disconnection, time spent re-depositing the check or debiting the account for the check amount and the NSF fee, reconciliation of bank statements, and other related tasks. He believed that the proposed charge was not unreasonable or

² The interest on the debt service reserve account was calculated by using each year's average balance as if the account were funded in equal installments throughout the year.

inconsistent with similar charges at other utilities and did not believe South Lawrence should have to incur the additional costs associated with addressing this issue in a thirty-day filing.

A breakdown of applicable costs, which includes time expended to perform each task required to process a bad check, hourly and benefit rates of the employee who processes a bad check, and equipment and material costs used to process a bad check is required by this Commission for any proposed change to a utility's non-recurring charges. Petitioner did not provide the Commission with this specific information, but instead explained only the general duties and bank fees required to process a bad check. Based on the evidence presented, the Commission denies Petitioner's request to increase its bad check fee.

9. Over-Collection of Debt Service. OUCC witness Mr. Kaufman testified that if Petitioner is authorized to issue debt in this Cause, it will likely collect rates for debt service before closing on the loan and incurring actual debt service expense. Mr. Kaufman stated that because DWSRF loans typically defer principal payments for up to two years (the loan is initially interest only), Petitioner could continue to collect revenues in excess of its actual debt service until it is making full interest and principal payments. He indicated that one solution to this discrepancy would be to phase-in Petitioner's rate increase. However, in light of Petitioner's under-funded debt service reserve, Mr. Kaufman instead recommended that any revenue requirement for debt service in excess of the actual debt service payment should be deposited in Petitioner's debt service reserve fund. Nevertheless, because of the Commission's decision to not approve the requested new debt, this issue is moot.

10. Operational Issues and Reporting Requirements. In its testimony, the OUCC identified operational issues, including Petitioner's under-funded debt service reserve, water loss percentage and use of the RE-Ox chemical. With respect to Petitioner's debt service reserve, OUCC witness Mr. Kaufman stated Petitioner has failed to fund its debt service reserve in both of its last two rate cases and there is little reason to believe Petitioner will abide by any restrictions placed on it in this case absent enforcement provisions or restrictions imposed directly by the Commission. In response, Petitioner's witness Mr. Terrell disagreed that greater restrictions are needed. He argued essentially that because Petitioner never placed any funds in its debt service reserve account, South Lawrence complied with the Commission's directive that any funds placed in its restricted accounts were not to be used for any other purpose.

While debt service reserve funds, collected through approved rates, were not deposited in the debt service reserve account, the Commission finds that the imposition of enforcement provisions or restrictions on the South Lawrence at this time is not in the public interest. Instead, Petitioner is directed as a condition of this Order to make monthly deposits into its debt service reserve account in the amount of \$7,547. Petitioner shall file semi-annual reports with the Commission under this Cause reflecting such deposits. Petitioner shall not use funds from this account for other purposes. Should Petitioner violate this directive by either failing to make a monthly deposit or by withdrawing funds from this account, Petitioner shall notify the Commission within three business days of the event.

As to Petitioner's water loss, OUCC witness Mr. Pettijohn testified that South Lawrence had significant water loss of 38.3% in 2008, but the 2009 loss percentage may end up in the low twentieth percentile. He stated that Petitioner purchased residential meters, regularly calibrates its finished water meter and has calibrated at least some large meters. However, Mr. Pettijohn

noted that Petitioner has not bought leak detection equipment and has not reduced water loss to acceptable levels. Mr. Pettijohn therefore recommended that Petitioner continue to report semi-annually on this issue.

Petitioner's witness Mr. Allen responded that improving water loss continues to be a priority for South Lawrence, but that this process is made difficult by the rural nature of Petitioner's service area and the terrain through which its pipes operate. At the Hearing, Mr. Allen confirmed that South Lawrence's water loss has dropped to the mid-twentieth percentile following the recalibration of Petitioner's flow meter in January 2009. (Tr. at B-46). Because Petitioner's unaccounted-for water still exceeds 15%, the Commission finds a semi-annual reporting requirement filed under this Cause to be reasonable. Petitioner shall file these status reports with the Commission under this Cause.

With respect to chemicals used to treat South Lawrence's water, Mr. Allen testified that Petitioner decided to use RE-Ox because phosphate costs have increased significantly. According to Petitioner's chemical supplier, RE-Ox would be a better and more cost-effective alternative. Additionally, Petitioner's chemical supplier tested South Lawrence's water and believed that RE-Ox should help clean the pipelines and, in time, reduce dirty water problems.

OUCC witness Mr. Pettijohn stated that most of South Lawrence's water quality complaints stem from dirty or colored water, which is likely caused by dissolved iron tinting the water. RE-Ox may address this issue. While Petitioner's decision to test the RE-Ox product was not opposed by OUCC, Mr. Pettijohn testified that one of the primary functions of the chemical is to strip or dissolve build-up on the interior of main piping. As a result, an increase in water quality complaints may occur for some time after Petitioner begins to use RE-Ox. Thus, Mr. Pettijohn recommended that Petitioner should report to the Commission and the OUCC regarding the effectiveness and continued use of RE-Ox.

Further, pursuant to the Final Order in Petitioner's last basic rate case, Cause No. 43324, Petitioner was directed to file a semi-annual report with the Commission concerning water loss monitoring and prevention, E&R account balances, hydrant flushing, customer complaint tracking, debt service reserve account deposits and balances, and other recordkeeping items. In this proceeding, the OUCC recommended that Petitioner continue to file this report with the Commission. Petitioner's witness Mr. Terrell did not object to providing the Commission with this type of information.

The Commission is cognizant of our prior reporting requirement and finds that continued reporting on the majority of those items is no longer necessary. Petitioner shall continue to provide a report to the Commission on a semi-annual basis detailing its water loss monitoring and prevention and Petitioner's deposits into and withdraws from its debt service reserve account. South Lawrence shall also detail in the semi-annual report the use and effectiveness of RE-Ox, including customer complaints received concerning water quality. In accordance with the Commission's Order issued in Cause No. 43324, South Lawrence's next report is due on October 30, 2010. However, this report shall now be filed under this Cause.

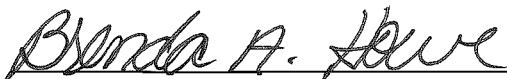
IT IS THEREFORE ORDERED BY THE INDIANA UTILITY REGULATORY COMMISSION that:

1. Petitioner shall be and hereby is authorized to increase its rates and charges for water utility service by 13.41% across-the-board in order to increase annual operating revenues by \$172,730.
2. Petitioner's request for authority to issue additional long-term debt in the principal amount of \$1,300,000 is denied.
3. Petitioner's request to increase its Bad Check Fee from \$10 to \$25 is denied.
4. Petitioner shall file with the Commission's Water/Sewer Division new schedules of rates and charges before placing in effect the rate increases authorized herein. The schedules, when approved by the Water/Sewer Division, shall become effective and shall cancel all previously approved schedules of rates and charges.
5. Petitioner shall comply with the reporting requirements described in Finding Paragraph 10 concerning the use of RE-Ox, funding of its debt service reserve account, and water loss.
6. This Order shall be effective on and after the date of its approval.

HARDY, ATTERHOLT, MAYS AND ZIEGNER CONCUR; LANDIS ABSENT:

APPROVED: AUG 18 2010

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



**Brenda A. Howe
Secretary to the Commission**