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INDIANA UTILITY REGULATORY COMMISSION

PETITION OF THE CITY OF EVANSVILLE, INDIANA,)
FOR AUTHORITY TO ISSUE BONDS, NOTES, OR) CAUSE NO. 45073
OTHER OBLIGATIONS, FOR AUTHORITY TO)
INCREASE ITS RATES AND CHARGES FOR WATER)
SERVICE, AND FOR APPROVAL OF NEW SCHEDULES) APPROVED: DEC 05 2018
OF WATER RATES AND CHARGES.)

ORDER OF THE COMMISSION

Presiding Officers:

David L. Ober, Commissioner

Loraine L. Seyfried, Chief Administrative Law Judge

On March 29, 2018, the City of Evansville, Indiana (“Evansville” or “Petitioner”) filed its Petition seeking authority to issue bonds, notes, or other evidence of indebtedness, to increase Petitioner’s rates and charges for water service, and for approval of new schedules of water rates and charges. On that same day, Evansville filed its case-in-chief.

Pursuant to Ind. Code § 8-1-2-61(b), the Commission conducted a public field hearing at Benjamin Bosse High School in Evansville, Indiana on June 25, 2018, at 6:00 p.m. at which members of the public offered oral and written comments.

On July 20, 2018, the Indiana Office of Utility Consumer Counselor (“OUCC”) filed its case-in-chief. On August 10, 2018, Evansville filed its rebuttal testimony and exhibits.

An evidentiary hearing was conducted on September 5, 2018, at 9:30 a.m., in Room 222 of the PNC Center, 101 West Washington Street, Indianapolis, Indiana. Petitioner and the OUCC were present and participated. The parties offered their respective prefiled evidence, which was admitted without objection, and witnesses were cross-examined.

Having considered the evidence and applicable law, the Commission now finds that:

1. **Notice and Jurisdiction.** Due, legal, and timely notice of the hearings conducted in this Cause was given as required by law. Evansville is a municipally owned utility as defined by Ind. Code § 8-1-2-1(h). Under Ind. Code § 8-1.5-3-8(f)(2) Petitioner is required to obtain Commission approval of its water utility rates and charges, and under Ind. Code § 8-1.5-2-19 Petitioner is required to obtain Commission approval for the issuance of bonds, notes, or other obligations that are payable more than 12 months after execution. Therefore, the Commission has jurisdiction over Evansville and the subject matter of this proceeding.

2. **Petitioner’s Characteristics.** Petitioner owns and operates municipal waterworks facilities providing water sales and service to customers in and near the City of Evansville, Indiana. Additionally, Petitioner sells water at wholesale to certain other customers.

3. **Relief Requested.** In its Petition, Petitioner requested authority to issue bonds, notes or other evidence of indebtedness and increase its rates and charges by 48.30% on an across-the-board basis through

a three-phase rate increase: an increase of approximately 18.90% to be effective upon approval pursuant to the Commission's order in this Cause ("Phase 1"), an increase of approximately 15.50% to be effective on January 1, 2020 ("Phase 2"), and an increase of approximately 8.00% to be effective on January 1, 2021 ("Phase 3").

4. **Test Year.** The test year selected for determining Petitioner's actual and pro forma operating revenues, expenses, and operating income under present and proposed rates was the 12 months ended September 30, 2017. With adjustments for changes that are fixed, known, and measurable, we find that this test period is sufficiently representative of Petitioner's normal operations to provide reliable data for ratemaking purposes.

5. **Public Comments.** The Commission received both oral and written comments from Evansville's customers regarding requested relief in this Cause. The comments received generally opposed Evansville's requested rate increase. Some customers also questioned the spending priorities of Evansville, its operational efficiencies, and whether alternative means of funding the proposed capital projects might exist. Some customers also questioned the need for, and management of, the Refresh Evansville water main replacement program.

6. **The Parties' Evidence.**

A. **Evansville's Case-in-Chief.** Patrick R. Keepes, Water Superintendent for the Evansville Water and Sewer Utility, sponsored the three Resolutions approved by the utility's Board of Directors authorizing Evansville's requested 48.30% three-phase rate increase. Mr. Keepes also sponsored Evansville's 3-year capital improvement plan ("CIP"). Mr. Keepes described Evansville's CIP, which is divided into five categories: distribution system, booster station, treatment plant, wholesale projects, and annual capital improvement projects. He testified that each of the listed projects is reasonably necessary for the provision of reasonable and adequate service. He also noted that the costs contained in the CIP are estimates and that projects in the CIP may be substituted for other later planned projects due to priority changes.

Mr. Keepes testified that there are two major projects set forth in Evansville's CIP: (1) a new \$18 million clearwell needed to perform maintenance, inspections, and repairs on the existing 6.5 million gallon ("MG") clearwell and create redundancy in Evansville's system; and (2) \$107,535,200 of water main replacement projects to replace Evansville's aging water infrastructure. Mr. Keepes testified that approximately 60% of Evansville's system consists of cast iron mains with an approximate average age of 90 years that need replacement. He testified that Evansville's 1.5% replacement goal has been lower than anticipated because actual bid prices for the work were higher than anticipated.

Douglas L. Baldessari, a Certified Public Accountant and Partner with H.J. Umbaugh & Associates, Certified Public Accountants, LLP, reviewed Petitioner's rate needs and summarized its review in an accounting report ("Accounting Report" or "Report"). Mr. Baldessari testified the Report contains pro forma financial information for Evansville's test year, the 12 months ended September 30, 2017, adjusted for fixed, known, and measureable changes during the succeeding 12 months. He described Evansville's proposal to fund its CIP through the issuance of \$147,355,000 in debt to be issued in one or more series of waterworks district revenue bonds on the open market or through the State Revolving Fund ("SRF"). Mr. Baldessari testified that there are an additional \$132.5 million in planned distribution system projects in the CIP that are not included in the proposed debt- or rate-funded projects and will need to be deferred until there is funding available. He proposed that if other parties identify potential savings or offsets to

Petitioner's requested revenue requirement that the savings and/or offsets be used to fund these identified and unfunded distribution replacement projects.

Mr. Baldessari identified the fifteen adjustments to annual cash operating expenses made in the Accounting Report to arrive at the pro forma annual revenue requirement. Mr. Baldessari testified that Petitioner's pro forma revenue requirements incorporate its adjusted operation and maintenance expenses and payment in lieu of taxes as well as annual payments on outstanding debt, additional utility receipts tax, and replacements and improvements. He stated that the pro forma annual revenues are shown in three phases. Phase 1 reflects those expected requirements and revenues needed now through the end of 2019 with approximately \$7.1 million of the CIP included for extensions and replacements ("E&R") to help phase-in the required increase. Phase 2 reflects those expected requirements and revenues needed through 2020 with approximately \$8.3 million of the CIP for E&R, an increase in the payment in lieu of taxes, and an additional phase-in of the debt service on the proposed bonds. Phase 3 reflects those requirements and revenues needed during 2021 and thereafter including increased payment in lieu of property taxes, increased debt service to the average annual pro forma amount for the five bond years ended January 1, 2026, and approximately \$9.6 million in annual CIP requirement for E&R.

Mr. Baldessari concluded by stating that in his opinion, the rates proposed in the Accounting Report are fair, just, non-discriminatory, and reasonable and necessary to meet the utility's projected revenue requirements.

B. OUCC's Case-in-Chief. Jennifer L. Sisson, an OUCC Utility Analyst II, testified regarding the OUCC's proposed adjustments and revenue requirement offsets. She stated the OUCC recommended an overall across-the-board rate increase of 24.21% to produce an increase in water revenues of \$8,182,223 based on a pro forma net revenue requirement of \$41,839,420. Ms. Sisson also recommended a three-phase increase. For Phase 1, the OUCC proposed an across-the-board 2.70% increase for a \$913,245 increase in operating revenues. For Phase 2, the OUCC proposed an additional 12.08% increase to provide \$4,191,142 of additional operating revenues. Finally, for Phase 3, the OUCC proposed an additional 7.91% increase to provide \$3,077,836 of additional operating revenues.

Margaret A. Stull, Chief Technical Advisor in the OUCC's Water/Wastewater Division, addressed the OUCC's recommended \$34,316,686 pro forma present rate operating revenues and recommended adjustments to Petitioner's Public Employee Retirement Fund ("PERF") expenses, periodic maintenance expense, bad debt expense, and utility receipts tax expense. She also testified regarding the OUCC's recommended revenue requirement for E&R.

With respect to Petitioner's proposed operating revenue adjustments, Ms. Stull indicated agreement with the adjustment to reflect the Cause No. 44760 Phase 1 rate increase as well as the growth normalization adjustment for public fire protection (inside city limits) and private fire protection revenues. She also accepted Evansville's calculations of growth normalization for its commercial customer class. Ms. Stull disagreed with Petitioner's proposed declining use adjustment because the calculation relies solely on revenue dollars without any consideration given to the impact of customer growth or actual consumption. She also disagreed with Petitioner's proposed operating revenue adjustment to reflect the Phase 2 rate increase approved in Cause No. 44760 because Petitioner applied the declining use adjustment in its calculation. Finally, Ms. Stull also disagreed with Petitioner's proposed growth normalization adjustment for public fire protection for customers located outside city limits because it included a surcharge being eliminated in this case.

With respect to Petitioner's proposed operating expense adjustments, Ms. Stull proposed a \$200,111 decrease to test year PERF expense because she disagreed with Evansville's inclusion of additional book pension expense based on Governmental Accounting Standards Board ("GASB") 68 requirements. In addition, she noted that the OUCC accepted some of Evansville's proposed periodic maintenance expense adjustments, but disagreed with the proposed adjustments for high and low service pumps, booster station pumps, and filter media as discussed by Mr. Seals. Finally, Ms. Stull recommended an E&R revenue requirement of \$6,442,862 (Phase 1), \$5,960,944 (Phase 2), and \$6,154,201 (Phase 3) for a total of \$18,558,007, or \$6,412,700 lower than Evansville's proposal. She stated the difference between the OUCC's proposed E&R revenue requirement and Evansville's related to the following four differences: (1) the elimination of two distribution system projects included in Evansville's SRF debt application; (2) the elimination of funds proposed for new service connections; (3) the elimination of annual on-call construction engineering services/resident project representative ("CES/RPR") costs; and (4) the amortization of the remaining distribution project costs ratably over a three-year period to levelize the phased rate increase.

James T. Parks, an OUCC Utility Analyst II, addressed Petitioner's CIP and the OUCC's specific recommendations for estimating water main replacement costs. Mr. Parks described Petitioner's water system and the progress Petitioner has made in completing the 2017–2020 capital projects identified in its last rate case, noting that Petitioner is delayed in completing many of the projects slated for 2017 and 2018.

Mr. Parks explained why Petitioner's submission of project and cost information in its case-in-chief lack sufficient detail but stated that the OUCC was able to obtain additional information and generally considers the projects appropriate as they will upgrade existing assets and replace aging infrastructure. However, based on the cost information that he was able to obtain, Mr. Parks stated the OUCC believes Evansville's main extension costs appear to be overstated by approximately 45% above actual total project costs. Mr. Parks recommended Evansville use actual costs from prior bids to estimate and budget for projects.

While Mr. Parks agreed Petitioner should accelerate replacement of aging mains, he expressed doubt regarding Petitioner's ability to achieve its stated goal of a 1.5% replacement rate. He noted that Petitioner's proposed rate of replacement is significantly higher than Evansville's historical rate of replacement. He also testified Evansville's replacement program should be ramped up consistent with contractor capacity to avoid escalated bid prices resulting from insufficient contractors available to do the work.

With regard to the clearwell and high service pump station project, Mr. Parks testified the project should not be approved because Evansville has not supported the need for the project, as the only justification for the project is the need for redundancy. Mr. Parks testified the needed repairs on the existing 6.5 MG clearwell could be performed during non-peak hours where Evansville's other two clearwells could be kept in service.

Finally, Mr. Parks recommended that Evansville be restricted to using funds approved for specific projects identified in this Cause only or for additional water main replacement projects identified in its 2016 Water Master Plan. He also recommended Evansville be required to annually submit a capital improvements reconciliation.

Carl N. Seals, an OUCC Utility Analyst, addressed Evansville's proposed periodic maintenance expense. Mr. Seals indicated his acceptance of Petitioner's pro forma expense for tank maintenance, leak detection, dredging in front of intake structure, and traveling screens. However, he expressed disagreement with the proposed expenditures for filter media, booster stations, and pump maintenance, noting the proposed expense for these maintenance items was much higher than the estimates provided in Evansville's last rate case. Mr. Seals also disagreed with Evansville's six-year replacement cycle of filter media and inclusion of capital costs in its maintenance expense.

Mr. Edward R. Kaufman, Assistant Director of the OUCC's Water/Wastewater Division, testified regarding Evansville's request for authority to issue \$147,355,000 of long-term debt. Mr. Kaufman testified that because Petitioner has not determined the amount and timing of its open market and SRF loans, it is difficult to assess the reasonableness of Petitioner's request. He stated it is important to know and understand the number, timing, and amount of debt issuances to accurately estimate annual debt service costs because such an estimate balances the needs of the utility with the interests of ratepayers. He said a utility needs revenues sufficient to meet its real debt service requirements, while ratepayers are entitled to rates that do not exceed actual debt service.

Mr. Kaufman generally agreed that Evansville's plan to issue long-term debt to fund its capital projects is reasonable, but recommended its proposed financing authority be reduced by \$30,000,000 to \$117,355,000. He stated that this reduction is intended to reflect the totality of the OUCC's concerns, including Petitioner's overstated project cost estimates, an unsupported inflation adjustment, and Petitioner's ability (or inability) to complete all of the projects included in its CIP. He stated the proposed reduction also recognizes that Evansville will issue debt from both the SRF and through the open market and will be able to earn interest on its unspent open market debt. Mr. Kaufman recommended that Petitioner provide as soon as practicable amortization schedules that reflect amounts, timing, and lender of its anticipated debt issuance. He further recommended that absent revised amortization schedules, the Commission authorize Petitioner to issue no more than \$117,355,000 in long-term bonds at a maximum interest rate of 5.0%.

Mr. Kaufman made three other recommendations concerning Evansville's proposed debt issuance. First, he recommended that if Evansville did not issue its proposed debt within two months of filing its revised tariff with the Commission, it should temporarily reserve the funds collected in rates for its 2017 debt and use those funds to offset the amount it borrows. Second, within 30 days of closing on its long-term debt issuance, Evansville should file a report explaining the terms of the loan, including an amortization schedule, the amount of debt service reserve, and issuance costs, a revised tariff, and the calculated rate impact. He said that Evansville's rates should be trued-up if necessary to match its actual cost of debt service. And, third, Mr. Kaufman recommended that if Evansville spends any of the funds from its debt service reserve for any reason other than to make its last payment on the proposed 2018 debt issuance, Evansville be required to provide a report to the Commission and OUCC within five business days.

C. Evansville's Rebuttal Case. Mr. Allen Mounts, Director of the Evansville Water and Sewer Utility, responded to the OUCC's position that Evansville should not receive the level of funding or borrowing authority it requested, especially for its water main extension program, otherwise known as Refresh Evansville.

Mr. Mounts testified that Refresh Evansville is a program that sets forth a long-term strategy to replace aging water mains and supporting infrastructure. He noted that the OUCC did not question the need for the program and agreed main replacement should be accelerated. Mr. Mounts testified that the Refresh Evansville program is an entirely new program for Petitioner, which requires it to deploy resources and manage capital projects on a scale not historically seen. He testified that any program of this magnitude would take time to ramp up and perform efficiently.

Mr. Mounts further testified that Evansville's decision to prioritize and plan for the long-term replacement of aging infrastructure through its Refresh Evansville program aligns with the policy objectives in Ind. Code § 8-1-2-0.5. He stated that if Evansville does not address the problem proactively and aggressively today, it will create higher costs to address it for future generations. Mr. Mounts testified the OUCC's approach hinders long-term planning for infrastructure improvements because it essentially forces a utility to request funding for a specific list of pre-approved capital projects, as opposed to a long-term capital improvement program and budget.

Mr. Mounts also responded to public comments received regarding Evansville's request in this Cause. He again explained why the Refresh Evansville program was needed and how it was managing the program. With regard to the impact the rate increase will have on low-income customers, Mr. Mounts reiterated that a less aggressive replacement strategy will force future rates for tomorrow's customers higher and noted that Evansville has also developed a low-income customer assistance program. He also noted that even with recent rate increases, Evansville's rates are still lower than the state average.

Mr. Mounts also addressed customer demand. He explained that Evansville did not forecast increased operating revenues to reflect an increase in water sales to Gibson Water because such increase is speculative and premature when Gibson Water has not agreed to any additional capacity or usage. He further testified that water usage is declining across the United States due to conservation efforts and more-efficient fixtures. He also disagreed with Ms. Stull that three years of data showing declining use is insufficient to establish a trend but prepared a forecast of total water sold for the next three years based on the trend for the period 2008–2017, which suggests 2021 water volume sold will be 6.3% less than 2018 projected volumes.

Michael Labitzke, Deputy Director of the Program Management Office for the Evansville Water and Sewer Utility, responded to the OUCC's concerns with the project costs included in the CIP and Evansville's pace for completing projects. He disagreed with Mr. Parks' contention that Evansville's estimated project costs are overstated. He stated that comparison of estimated project costs from a selection of projects in Petitioner's prior rate case is not appropriate because many of those costs were found to be underestimated and inaccurate. He sponsored Attachment ML-1R, which is a table comparing the estimated and actual composite costs per foot for all of the projects Evansville completed from Cause No. 44760. He also explained that contrary to Mr. Parks' assertion, the project cost estimates included in this Cause were developed based on actual bids received in 2017, not engineering estimates. Mr. Labitzke also explained that no contingency was added for main replacements since the estimates were based on 2017 bid amounts. However, inflation of 3% per year to the date construction is planned was added.

Mr. Labitzke explained why Evansville included engineering costs for design and construction oversight in its project estimates. He also addressed Mr. Parks' concern with the lack of sufficient contractors, noting that Evansville has taken action to address this issue by notifying contractors of the Refresh Evansville program and setting forth a planning schedule of projects. While expressing his belief

that Evansville's method of developing cost estimates will produce accurate estimates when compare to actual costs, he said that even if the costs come in lower than estimated, Evansville can use the additional monies to fund one of the \$132.5 million projects that are currently unfunded.

Finally, Mr. Labitzke explained how Evansville has developed a program to deploy resources that can predictably and consistently complete water main projects, which resulted in Evansville's stated goal to plan for and complete two or three water main replacement projects every quarter. He expressed his belief that a main replacement rate of 1.5% is achievable and stated the only thing holding Evansville back is a lack of funding.

Mr. Keepes addressed the OUCC's concerns with Petitioner's CIP and periodic maintenance expense. With regard to the timing for completing water main projects, Mr. Keepes stated the only potential delay is funding. He explained Evansville is out of money to fund these projects and needs additional funds to complete the projects at its current rate of replacement. He noted that Evansville constructed approximately eight miles of water line in 2017 and an additional 12 miles will be constructed, under construction, or in design by the end of 2018.

With regard to the clearwell and high pump stations, Mr. Keepes disagreed with Mr. Parks' assertion that repairs can be performed during non-peak periods with the other two tanks in service. He testified that contrary to the OUCC's suggestion, the need for the clearwell is not tied to any pending decision related to the new water treatment plant, and that the maintenance and repairs need to be made whether a new treatment plant is built or not. Mr. Keepes also explained that attempting to make the necessary repairs as Mr. Parks suggests during a non-peak period with the other two tanks in service would require shutting down three of the seven existing high service pumps, which would present a possibility that the required pumping capacity to the service area could not be met. Further, he noted that reliance on the two remaining clearwells, which total only two MG, could put Petitioner at risk of not meeting regulatory water quality compliance standards.

With regard to the OUCC's adjustments to Evansville's proposed periodic maintenance expense, Mr. Keepes testified that Evansville is not proposing a six-year replacement cycle but is instead proposing to rehabilitate four beds in each of the three phases of this rate case to achieve the rehabilitation cycle discussed in Cause No. 44760. He also disagreed with Mr. Seals' contention that media replacement costs included capital costs for underdrain replacement and provided a calculation showing such capital costs were not included. Mr. Keepes also responded to the OUCC's recommendation to use budgetary estimates from Evansville's last rate case to estimate periodic maintenance costs for filter media replacement, pump maintenance, and booster station maintenance in this case. He testified stale budgetary estimates are not the best indicator of cost, and actual bids received from competitive bidding should be used because actual bids represent the costs Evansville will actually incur for this work.

Mr. Baldessari responded to the OUCC's proposed reductions to Evansville's debt financing and E&R. Mr. Baldessari explained the Commission has for many years approved financing programs for public utilities so that they can fund ongoing capital requirements over a period of years without incurring the delay and cost of approval of individual issues. He stated this allows utilities to quickly enter the capital markets at opportune times to meet their capital needs. Mr. Baldessari testified that a large municipality like Evansville needs the same flexibility.

Mr. Baldessari testified that Evansville and its consulting engineers had now identified the projects to be included in the SRF financing and those projects to be included in open market financing. He sponsored Attachment DLB-2R, which detailed the estimated project costs and bond issues to be included in the financing plan. He testified the financing plan resulted in the same total aggregate par amount of proposed bonds totaling \$147,355,000 included in Evansville's original filing, and is comprised of \$111,175,000 par amount of proposed SRF bonds through a combined SRF subsidized interest rate and pooled SRF bond issue. The subsidized interest rate portion totals \$7,500,000 with the balance to be funded with SRF's pooled program. The remaining \$36,180,000 par amount of bonds will be issued with a competitively bid open market bond issue. He testified that minor modifications to the financing plan have produced a slight modification to the overall rate request.

Mr. Baldessari also responded to Mr. Kaufman's proposed amortization schedule and inclusion of interest earnings on bond proceeds as being inconsistent with the bond resolutions. He also disagreed with Mr. Kaufman's proposal for a maximum interest rate for the proposed bonds, noting that interest rates change frequently and Evansville has proposed to file a true-up report after the bonds are issued. With respect to any gap of time between when Evansville receives its order and the bonds are issued, Mr. Baldessari stated that Evansville disagrees with Mr. Kaufman and proposes to instead use any debt service funds resulting from the delay in issuing the bonds to pay for the Refresh Evansville projects that are unfunded.

Mr. Baldessari explained why he disagreed with Ms. Stull's four adjustments to reduce Evansville's proposed annual E&R adjustment. In response to Ms. Stull's opposition to Petitioner's proposed declining use adjustment, Mr. Baldessari stated that when additional years are included, the trend shows that Petitioner's adjustment is conservative. He also noted that Petitioner's adjustment for customer growth normalization is consistent with its last three rate proceedings before this Commission. He also explained his disagreement with Ms. Stull's recommendations related to the method for normalizing the phased increase from Cause No. 44760 and the outside city fire protection rates.

Regarding the OUCC's adjustments for periodic maintenance, Mr. Baldessari testified that Schedule I included with Ms. Sisson's testimony showed a periodic maintenance adjustment total of \$973,561. However, Table 9 in Ms. Stull's testimony shows a periodic maintenance adjustment of \$950,671. He said this results in an unidentified difference of \$22,890, which appears to be related to Mr. Seals' proposed adjustment for booster stations and results in incorrectly calculated revenue requirements.

7. **Commission Discussion and Findings.** As an initial matter, we must express our agreement with the OUCC that the information provided by Evansville in its case-in-chief to support its requested rate relief was less than what should be considered acceptable in several areas, particularly with respect to explanations for adjustments and supporting documentation for proposed capital projects (both in its CIP and Refresh Evansville program) and associated costs. Evansville is reminded that it bears the burden of proof in demonstrating it is entitled to its requested relief. The OUCC should not have to request or otherwise seek basic supporting documentation that should have been provided with Petitioner's case-in-chief to support its requested relief. Further, even if the OUCC is able to ascertain through discovery the information necessary to support Petitioner's requested relief, the Commission, which is the entity that must ultimately render a decision on the matter, would still lack the necessary information to make its determination because it is not privy to the parties' discovery. The Commission strongly encourages Evansville to consider ways to improve the presentation of its requested relief, including meeting with the

OUC and Commission staff prior to the filing of its next rate case to discuss the type of information that should be included with its case-in-chief filing.

Ind. Code § 8-1.5-3-8(a) and (b) requires that a municipally owned water utility furnish reasonably adequate services and facilities and that the utility's rates and charges be nondiscriminatory, reasonable, and just. Section 8(c) further identifies the revenue requirements to be considered in establishing reasonable and just rates and charges, including: (1) all legal and other expenses incident to the utility's operation; (2) a sinking fund for the liquidation of bonds or other obligations; (3) debt service reserve; (4) working capital; (5) extensions and replacements to the extent not provided for through depreciation; and (6) taxes. A municipal utility's rates and charges for water service is subject to Commission approval. Ind. Code § 8-1.5-3-8(f).

Based on its rebuttal filing, Evansville requests approval for a 47.87% increase, or a \$16,039,138 increase in revenue, to be implemented in three phases. Evansville also seeks approval for financing authority in an amount not to exceed \$147,355,000. The OUC recommended the Commission approve a 24.21% increase, or an \$8,182,223 increase in revenue, to be implemented in three phases. The OUC took issue with certain aspects of Evansville's CIP, which resulted in a recommendation that Evansville's financing authority be reduced by \$30,000,000 to \$117,355,000. The OUC also challenged several of Evansville's pro forma revenue and expense adjustments and proposed revenue requirement offset for interest income. The following table summarizes the parties' positions and we address each of the issues presented further below.

	Phase I		Phase II		Phase III	
	OUC	Rebuttal	OUC	Rebuttal	OUC	Rebuttal
Operating Expenses	\$ 23,415,103	\$ 24,779,946	\$ 23,430,172	\$ 24,857,471	\$ 23,499,329	\$ 24,958,383
Extensions and Replacements	6,442,862	7,082,200	5,960,944	8,344,400	6,154,201	9,544,100
Payment in Lieu of Taxes	1,882,300	1,882,300	2,509,100	2,509,100	3,112,900	3,112,900
Debt Service						
Existing Debt	10,133,900	10,133,900	10,132,501	10,132,501	10,134,195	10,134,195
New Debt	1,667,736	4,201,248	5,403,575	8,547,211	7,691,575	10,408,128
Total Revenue Requirements	43,541,901	48,079,594	47,436,292	54,390,683	50,592,200	58,157,706
Less Revenue Requirement Offsets:						
Interest Income	577,525	201,999	334,862	201,999	203,420	201,999
Other Operating Revenues	524,476	524,476	524,476	524,476	524,476	524,476
Other Non-Operating Income	377,928	377,928	377,928	377,928	377,928	377,928
Sewer Portion of General Expenses	7,371,586	7,371,586	7,371,586	7,371,586	7,371,586	7,371,586
Fixed Capacity Payments from Wholesaler	-	-	-	-	191,144	191,144
Net Revenue Requirements	34,690,386	39,603,605	38,827,440	45,914,694	41,923,646	49,490,573
Less: Revenues at Current Rates Subject to Increase	33,792,210	33,505,765	34,705,455	39,681,130	38,896,597	46,015,606
Net Revenue Increase Required	898,176	6,097,840	4,121,985	6,233,564	3,027,049	3,474,967
Gross Revenue Conversion Factor	101.6778%	101.2714%	101.6778%	101.6188%	101.6778%	101.5635%
Recommended Increase	\$ 913,245	\$ 6,175,365	\$ 4,191,142	\$ 6,334,476	\$ 3,077,835	\$ 3,529,297
Recommended Percentage Increase	2.70%	18.43%	12.08%	15.96%	7.91%	7.67%
Overall Rate Increase			15.11%	37.34%	24.21%	47.87%

A. Revenue Adjustments.

1. **Declining Use Adjustment.** Evansville proposed an adjustment to revenues to address declining use. Mr. Baldessari analyzed baseline revenues from 2014 through 2017 and calculated a 4.0% decrease in residential sales, a 2.7% increase in commercial sales, a 0.7% decrease in industrial sales, and a 1.8% decrease in public authority sales. He ultimately calculated an overall decrease in base sales of \$437,165.

The OUCC opposed Petitioner's proposed declining use adjustment because it relied only on revenue dollars over a three-year period without consideration given to the impact of customer growth or actual consumption. Ms. Stull explained that most utilities support a declining use adjustment by evaluating actual customer usage on a monthly basis over at least a 10-year period. She noted that some utilities further refine their analysis by using only winter water consumption to eliminate variations driven by seasonal factors.

In rebuttal, Mr. Mounts argued that water usage is declining across the United States and cannot be ignored. He also provided a forecast of total water volume sold for 2019 through 2021 based on the trend of annual water volume sold from 2008 through 2017.

Based on the evidence presented, we decline to accept Petitioner's declining use adjustment. While water usage may be declining across the United States, it does not necessarily follow that water usage in Petitioner's service area is also declining. In addition, although Petitioner provided the total water volume sold over a longer period of time (i.e., a 10-year period), it failed to offer any analysis or explanation concerning the impact of customer growth or actual consumption on the total water volume sold. In the future, if Petitioner seeks to make a declining use adjustment, it must file in its case-in-chief, a detailed analysis, preferably based on winter usage, evaluating the utility's water production, sales, and customer growth.

2. **Cause No. 44760 Phase 2 Rate Increase Adjustment.** Petitioner proposed adjustments of \$886,488 and \$3,534,926, respectively, to test year operating revenues to reflect the 29.37% and 14.03% rate increases approved in Phase 1 and Phase 2 of Cause No. 44760, respectively. Ms. Stull disagreed with Petitioner's proposed operating revenue adjustment to reflect the Phase 2 rate increase because she did not accept Petitioner's proposed declining use adjustment. Consequently, Ms. Stull proposed an adjustment of \$3,596,260 to reflect the Phase 2 rate increase. As set forth above, we lack sufficient evidence to accept Petitioner's proposed declining use adjustment. Therefore, we approve Petitioner's proposed adjustment of \$866,488 for the Phase 1 rate increase and the OUCC's proposed adjustment of \$3,596,260 for the Phase 2 rate increase.

3. **Customer Growth Normalization.** Petitioner proposed a test year customer growth normalization adjustment for its residential, commercial, and public authority customer classes as well as its inside and outside city fire protection and private fire protection customers. OUCC witness Stull accepted Petitioner's adjustments for commercial customers, inside city fire protection customers, and private fire protection customers. She disagreed, however, with Evansville's calculated adjustment for its residential, public authority, and outside city fire protection customers.

Evansville and the OUCC used same methodology in calculating their residential customer growth normalization adjustment. However, Evansville's adjustment reflects 3,117 additional monthly bills based

on the estimated financial effects of approximately 292 users added to the system from the beginning of the test year, whereas the OUCC's adjustment reflects 7,343 additional monthly residential bills. Pet.'s Ex. 1, Att. DLB-1 at 23 and Pub.'s Ex. 1, Sch. 5. On rebuttal, Mr. Baldessari explained that Evansville modified its test year residential billing data for irrigation meters and temporary shut-offs. He explained that when irrigation meters are shut off (usually during the winter season), the account is deactivated, and the reverse happens when the account is turned on again. Based on this explanation, we agree with Evansville's estimated additional monthly bills of 3,117 for its residential customers.

The parties' calculations for the residential and public authority adjustments also differed with respect to the average monthly bill amounts. Both Evansville and the OUCC agreed on the test year average residential monthly consumption. However, Evansville used the actual tariff rates in effect in the month during which the customer count increased or decreased whereas the OUCC used the current Phase 2 rates. Evansville argues that the OUCC's calculation essentially double counts, or imputes more, revenues than would be collected. If Evansville had normalized its test year customer growth before adjusting for its Phase 1 and Phase 2 rate increases, we would agree with Evansville; however, because Evansville did not do so, there is no double counting of revenues. Evansville's Phase 2 rate increase went into effect on January 1, 2018. Therefore, we find the OUCC's position to use Evansville's current rates when determining the amount of increased revenues associated with the additional bills to be appropriate and reasonable. Although Evansville argues that it calculated its customer normalization adjustments in the same manner that it has in its last three rates cases, we note that both Cause Nos. 43190 and 44760 involved settlements and the issue was not presented to, or considered by, the Commission in Cause No. 44137. Accordingly, using Evansville's estimated additional monthly bills and the OUCC's average monthly bill amounts, we find the residential customer adjustment to be \$71,504.¹

Similarly, the parties agreed on the number of additional bills for the public authority customer adjustment, but disagreed on the rates to be used in the calculation. For the same reasons above, we find the use of Petitioner's current rates appropriate to calculate the average bill for the public authority customers and the OUCC's adjustment of \$42,406 to increase test year public authority revenues to be reasonable.

With regard to the outside city fire protection adjustment, the OUCC disagreed with the tariff rates used by Evansville to calculate its adjustment because it included the surcharge Evansville plans to eliminate in this Cause. On rebuttal, Mr. Baldessari explained that his calculation is revenue-neutral because the fire protection charges were adjusted to be the same for inside and outside city customers. Thus, while Evansville applied its across-the-board percentage increase to both its inside and outside fire protection revenues, the actual public fire protection rates were not calculated "across-the-board" as the other tariff rates were calculated in this case because the final one-third of the territorial rate differential is phased-out. The OUCC's proposed adjustment, however, would improperly shift revenues to other customer classes, which should not occur without conducting a cost of service study. Therefore, we find Evansville's proposed outside city fire protection adjustment of \$188,233 to be reasonable.

4. Conclusion. Based on the foregoing, we find Evansville's pro forma present rate revenue to be \$34,542,938, as shown on the next page:

¹ This amount was calculated by multiplying the 3,117 customers by \$22.94 (the volumetric rate of \$4.48 per 1,000 gallons times the average monthly consumption of 3.676 plus the monthly service charge for a 5/8" meter at \$6.47).

		Year Ended		Pro Forma
		September 30		Present
		2017	Adjustments	Rates
Operating Revenues				
	Residential Water Sales	\$ 13,696,042	\$ 2,528,099	\$ 16,224,141
	Commercial Water Sales	6,197,076	1,167,851	7,364,927
	Industrial Water Sales	2,120,285	380,346	2,500,631
	Public Authorities Water Sales	929,528	202,618	1,132,146
	Sales for Resale	1,655,288	305,633	1,960,921
Fire Protection				
	Public Fire Protection - Inside	2,189,308	415,052	2,604,360
	Public Fire Protection - Outside	1,239,611	188,233	1,427,844
	Private Fire Protection	526,780	82,807	609,587
	Split Services and Fire Plugs	18,980		18,980
	Late Fees	147,946	26,979	174,925
Other Operating Revenues				
		457,282	67,194	524,476
	Total Operating Revenues	\$ 29,178,126	\$ 5,364,812	\$ 34,542,938

B. Revenue Requirement.

1. Operating Expenses.

a. PERF Pension Expense. Petitioner proposed a \$201,371 increase to its test year PERF expense of \$1,285,601 for total pro forma PERF expense of \$1,486,972. Petitioner's proposed adjustment consisted of two amounts—Petitioner's PERF cash contribution and accrued PERF pension expense based on GASB 68 requirements. Ms. Stull testified she accepted Petitioner's calculation of its pro forma PERF cash contribution but disagreed with its inclusion of accrued PERF pension expense, because while Petitioner is required to reflect pension liability on its balance sheet, no additional cash payment to PERF is required.

GASB 68 requires government entities to recognize accrued pension expense and net pension liability. Pension expense is accrued because accrual creates a better matching of the expense. Failure to reflect pension accrual pushes off the cost of the pension to tomorrow's customers, creating intergenerational inequities. Therefore, we agree with Evansville that unfunded pension liabilities can lead to significant financial issues in the future if the liability is not funded. Accordingly, we accept Petitioner's proposed \$201,371 increase to its test year PERF expense. We also agree with Evansville that the amount of the expense in excess of the required cash contribution should be placed in a restricted fund and require Evansville to do so.

b. Periodic Maintenance. The parties agreed on periodic maintenance associated with dredging, tank maintenance, traveling screens, and leak detection totaling \$1,305,452. However, the OUCC disagreed with Petitioner's proposed adjustments for periodic maintenance related to its filter media replacement, high and low service pumps, and booster stations.

Petitioner seeks to recover \$1,006,820 per year for filter media replacement. OUCC witness Seals recommended a \$738,020 reduction to this amount because he believed Evansville will be using a six-year replacement cycle and testified the proposed costs were incorrectly estimated and included capital costs for underdrain replacement that should not be included in periodic maintenance expense. Mr. Seals also recommended that the cost for filter media replacement be based on the budgetary estimates for the work submitted in the last rate case instead of the actual bid received by Dieg Brothers, which was part of a larger contract. On rebuttal, Mr. Keepes explained Evansville is not proposing a six-year replacement cycle but rather to rehabilitate four beds in each of the three phases of this rate case to achieve the 10- to 20-year rehabilitation cycle discussed in the Settlement Agreement approved in Cause No. 44760. He also testified the contractor that submitted the budgetary estimates in the last rate case communicated to Evansville it could not perform the work for the amount originally quoted and therefore Evansville decided to competitively bid the work, which resulted in the Dieg Brothers bid. Mr. Keepes testified the Dieg Brothers bid is the result of competitive bidding and the best indicator of cost. He also testified that the media replacement costs did not include capital costs for underdrain replacement and provided the calculation and supporting documents showing capital costs were not included.

Based on a review of the Settlement Agreement approved in Cause No. 44760 and Attachment PRK-2R of Petitioner's Exhibit 2-R, it appears that Evansville has not adopted a six-year replacement cycle, but is instead behind on the maintenance agreed upon in the Settlement Agreement. Therefore, we approve of Petitioner's proposed replacement of four filter media per year over the next three years. We further find that Petitioner shall provide in its next rate case an accounting of its filter media activity demonstrating the maintenance work has been completed. We also agree with Mr. Keepes that actual bids, not budgetary estimates from two years ago, are the best indicator of costs and that Mr. Keepes' calculation and supporting documents provided on rebuttal demonstrate that the filter media costs do not include capital costs for underdrain replacement. We therefore find that Petitioner's cost for periodic maintenance related to filter media replacement should be \$1,006,820 per year.

Evansville proposed periodic maintenance costs of \$90,240 for each of its seven high service pumps and \$100,140 for each of its six low service pumps over a four-year cycle. The OUCC did not oppose the four-year cycle, but did object to the estimated costs. Mr. Seals compared quotes for the same work included in Petitioner's last rate case with the Dieg Brothers bids provided in this case and noted that costs had increased 153%. Noting the cost estimates provided in Cause No. 44760 were more detailed, he recommended those estimates be used in this case. On rebuttal, Mr. Keepes testified the actual bids reflect the market price for the pump maintenance work and the actual cost Evansville will pay for the work, and therefore it did not make sense to base costs off stale budgetary estimates.

Based on the evidence presented, we agree that actual bids should be used in place of stale budgetary estimates to reflect periodic maintenance costs. Actual bids reflect the costs Evansville will actually incur for this work and should therefore be used to calculate periodic maintenance expense. Accordingly, we find that Petitioner's periodic maintenance expense related to pump maintenance should be \$308,130 per year.

Mr. Seals also recommended a reduction to Evansville's proposed booster station periodic maintenance expense of \$61,911² for the same reason, and recommended the prior maintenance cost of \$7,630 per pump be used to calculate booster pump maintenance. Because we find it reasonable that

² \$20,637 times three pumps.

Petitioner's estimated costs be based on actual bids received as opposed to quotes received two years ago, we approve Petitioner's proposed booster station periodic maintenance expense of \$61,911 per year.

Therefore, we reject all of the OUCC's proposed adjustments to Evansville's periodic maintenance expense and find Petitioner's total pro forma periodic maintenance expense to be \$2,682,313.

c. Other Expense Issues. The parties generally agreed about the use of a gross revenue conversion factor ("GRCF") to calculate the amount of certain operating expenses and taxes associated with a proposed revenue increase and the methodologies to compute bad debt expense and the utility receipts tax ("URT"). However, the parties disagreed as to the appropriate factors to use in the accepted methodologies.

First, Evansville disagreed with the amount of normalized sales for resale customer revenues used by the OUCC in its URT calculation. A comparison of Public's Exhibit 1, Schedule 4 at 1 to Petitioner's Exhibit 1, Attachment DLB-1 at 19 reveals that the OUCC transposed Evansville's sales for resale revenue with the public authority revenue. Therefore, we find that the amount of pro forma sale for resale revenue, which is exempt from URT, is understated.

Second, the parties both calculated a 0.6857% bad debt expense. However, Petitioner disagreed with the OUCC including a reduction for bad debt expense in its URT calculation. Ind. Code § 6-2.3-5-2 authorizes a utility to deduct bad debt expense from revenues subject to URT. Because we find it unreasonable for a utility to pay more in URT than is required by law, we accept the OUCC's inclusion of a reduction for bad debt expense in the URT calculation.

2. Petitioner's CIP and Proposed Funding. Evansville's proposed CIP is estimated to cost \$157,332,531. Pet.'s Ex. 2, Att. PRK-2. Evansville proposes to finance the projects in its CIP with \$132,361,824 in debt and \$24,970,707 through E&R. The OUCC raised several issues relative to Petitioner's CIP and its proposed funding.

a. CIP. Petitioner witness Keepes sponsored Evansville's CIP, which consists of five different categories of projects and includes a list of project names, estimated total amounts, and years. Pet.'s Ex. 2, Att. PRK-2 through PRK-6. The OUCC raised four general concerns with Petitioner's proposed CIP: (1) the documentation provided by Petitioner in its case-in-chief to support its CIP was insufficient to determine the reasonableness of projects and estimated costs; (2) capital projects included in Evansville's prior rate case have not been completed; (3) the projected pace for completing projects appears to be unattainable; and (4) the estimated costs of the projects are overstated.

OUCC witness Parks testified that the OUCC could not determine from Petitioner's case-in-chief whether the proposed projects in the CIP were reasonable because Petitioner did not include engineering studies, a master plan, preliminary engineering reports, or detailed cost estimates for the projects. However, Mr. Parks explained that he was able to obtain additional information through discovery and from staff at the Indiana Finance Authority to review the proposed projects. Pub.'s Ex. 3. We agree with Mr. Parks and find that Evansville must improve the information it provides in its case-in-chief filing when requesting approval for funding of proposed capital projects. At a minimum, Evansville must include for each project that exceeds \$500,000 the following: project name, a description of the project, the purpose of the project, a detail of estimated cost for the project, and the project's current phase of development. Evansville should also include such information for any unfunded projects for which it may wish to include as support for its

requested financing. In addition, Evansville shall begin assigning project numbers when the project is added to its CIP as opposed to waiting until project design in order to better track progress and completion of projects.

OUCG witness Parks expressed concern with Evansville's ability to complete its CIP projects within its estimated time frame, noting that only 24% of the 34 projects in Evansville's 2017–2020 CIP have been completed and 18% were under construction. However, Evansville witness Mounts explained that costs for the projects in its 2017–2020 CIP were higher than estimated and Petitioner has run out of money to fund the projects. In addition, while Evansville's proposed main replacement pace of 1.5% is significantly higher than its historical replacement level, both Mr. Labitzke and Mr. Mounts explained that in 2017 Petitioner made substantial changes to how it was managing capital projects and needs. Mr. Mounts testified that Evansville has created a team-based approach to managing capital projects and restructured its engineering group to create a Project Management Office to manage all aspects of the water main replacement projects. Mr. Labitzke testified that Evansville has developed a program to ensure a constant stream of main replacement projects are in design and out to bid. Evansville has also developed contractor outreach programs to promote contractor availability and competitive bidding.

While we share the OUCG's concerns that Evansville's proposed pace for completion of infrastructure investment may be unattainable in the short term based on Evansville's historical performance of its 2017–2020 CIP, we recognize that Evansville has embarked on an aggressive infrastructure replacement program—one which the OUCG has generally agreed is reasonably necessary. We also recognize that the construction market will not make further investment in construction capacity unless it sees a sustained increase in consistent work being bid by Evansville. We agree with Mr. Mounts and Mr. Labitzke that the prospect of deferring needed investments will only lead to greater investments in the future and that Evansville has demonstrated a commitment to developing and implementing a program that should allow for better management and administration of its water main replacement program and proposed level of replacement.

OUCG witness Parks also testified that the project costs included in Evansville's CIP are overstated based on a comparison and analysis of engineering estimates with historical bid results. He conducted a similar comparison with respect to per foot main costs. Evansville witness Labitzke disagreed with Mr. Parks, noting that many of the estimated project costs included in Evansville's last rate case were underestimated and not accurate. Mr. Labitzke also explained that Evansville has included conservative project estimates in this Cause to ensure Evansville will have adequate funding to achieve its proposed 1.5% replacement rate.

We understand that cost estimates at the planning level typically have larger contingencies built in because they are based on concept rather than actual design. When the design is complete, the engineer should be able to provide an opinion of probable cost within plus or minus 10%. While we generally agree with Mr. Park's methodology, we also recognize that Evansville's CIP contains projects based on conceptual designs with large contingencies and it is not unusual or unreasonable for a utility to base its CIP budgetary need on planning level construction estimates. However, we do expect Evansville to have an established practice (or to create one in the immediate near future if it does not) whereby it periodically updates its CIP as more accurate estimates become available. Such updates should take into consideration not only the phase of planning or design of the project but should also adjust for inflation and other variables in the local construction market.

Further, as noted by Mr. Labitzke, Evansville does have approximately \$132 million of unfunded water main projects contained in its Refresh Evansville program that could be funded if estimated costs exceed the actual cost of the projects. As indicated above, Petitioner should have included its Refresh Evansville program and supporting documentation for the projects identified therein in its case-in-chief—particularly given the fact that it was seeking to use any savings identified by the OUCC to fund the unfunded projects. Mr. Parks, however, testified that he reviewed Petitioner’s 2016 Water Master Plan and the Refresh Evansville program projects and provided information concerning the additional unfunded water main projects that he reviewed in Public’s Exhibit 3, Attachment JTP-9. He further testified that to the extent the CIP projects are completed for less than the estimated costs, then use of such funds should be used only for other needed water main replacement projects identified in Petitioner’s 2016 Water Master Plan.

b. Specific CIP Projects. OUCC witness Parks recommended that Petitioner not receive funding for the clearwell and high service pump station at this time because the only justification Petitioner provided for the project is operational redundancy. Mr. Parks suggested that the existing clearwell could be taken off line for inspection and needed repairs during non-peak periods. On rebuttal and in response to questions from the Presiding Officers, Mr. Keepes explained that the OUCC’s proposal involves risks the utility believes is unreasonable, such as possible noncompliance with water quality standards. He stated that to repair the clearwell, it must be taken off line, which could last for up to eight weeks, and explained the possible operational issues and risks that may occur during that time. Mr. Keepes also testified that the new clearwell and high service pump station is needed for overall redundancy and resiliency in the system for the future.

Based on the evidence presented, we find that Petitioner has failed to demonstrate the reasonableness of, or need for, this project. It appears that Evansville believes it needs an additional clearwell and high service pump station for the estimated eight-week maintenance on the existing 6.5 MG clearwell and for redundancy should issues with the existing clearwell capacity arise. The existing 6.5 MG clearwell was last inspected in 2011 and no evidence was offered as to when any maintenance was last performed. In addition, when asked whether Evansville had considered any alternatives for ensuring sufficient clearwell capacity during maintenance for reducing its perceived risks, Petitioner stated that it did not. Pet.’s Ex. 5 at 2. The additional clearwell and high service pump station, at an estimated cost of \$18 million, is a significant capital expense.³ We find Petitioner’s failure to explore other possible options for ensuring sufficient clearwell capacity during the apparently limited times that maintenance is necessary to be unreasonable. Further, we find that Petitioner has failed to sufficiently explain why complete duplication of clearwell capacity is necessary for redundancy and resiliency in the system. The evidence presented indicates there may be possible incremental levels of duplicative clearwell capacity that could have been considered but were never analyzed, which may have lowered risk to the utility and expense to the customer. Accordingly, we decline to approve funding for this project. Our decision today, however, does not preclude Petitioner from seeking approval for the project at some future date. But, we encourage Petitioner to first explore other options to the installation of duplicative clearwell and high service pump station capacity and be prepared to address the reasonableness of its chosen option. Accordingly, the Commission finds that Evansville’s proposed funding for its CIP should be reduced by \$18.096 million.

³ We note that Petitioner’s Exhibit 2, Attachment PRK-4 reflects a cost of \$18,096,000 for a “New 6.0 MG Clear well and HSP #4,” and Public’s Exhibit 5, Attachment ERK-4, p.8, which is a list of projects for the SRF application, reflects a cost of \$4,250,000 for the “HSPS 4, Clearwell and Transmission Mains.” It is unclear whether the cost reflected on the OUCC’s exhibit are in addition to or a subset of the cost reflected on Petitioner’s exhibit.

OUCC witness Stull recommended elimination of funding for new service connections and on-call CES/RPR as well as two distribution system projects identified by OUCC witness Kaufman that were included in Petitioner's SRF application.⁴ With regard to new service connections, Ms. Stull recommended elimination of \$1,152,000 in funding because the costs are funded through Petitioner's tap fees. Petitioner witness Baldessari agreed with Ms. Stull that new service connections should not be paid from operating revenues and should be paid from connection fees. Pet. Ex. 1-R at 19. However, he disagreed that Petitioner's funding should be reduced because Evansville has over \$132 million in unfunded Refresh Evansville projects for which the additional funds could be used. Based on the evidence presented, we agree with the OUCC that new service connections should be paid from connection fees and not funded from operating revenues. Accordingly, we find that Evansville's proposed funding for its CIP should be further reduced by \$1,152,000.

Ms. Stull also recommended, based on the testimony of OUCC witness Parks, elimination of the \$3.6 million annual on-call CES/RPR costs because these costs were already included in capital project costs. Petitioner witness Baldessari disagreed, stating that the CES/RPR costs are for the smaller line projects and are not included in the capital project costs. However, based on Petitioner's response to OUCC DR 7-1c., as reflected in OUCC's Exhibit 3, Attachment JTP-5, it appears that non-construction costs, including CES/RPR costs, were contained in the cost estimates. Therefore, we agree with the OUCC and find that Evansville's proposed funding for its CIP should be further reduced by \$3.6 million.

Finally, Ms. Stull recommended elimination of two distribution projects that were included in Petitioner's proposed E&R and its SRF application. Petitioner witness Baldessari explained that Evansville is requesting approval of a financing plan to fund its proposed CIP; a plan that includes both E&R and bond financing. He stated that if Evansville chooses to finance any project through debt that was previously slated for E&R, then there will be projects previously slated for funding through debt that will now be funded with E&R. And to the extent Evansville is able to save any money in the aggregate, then those funds will be applied to the \$132 million of unfunded projects. Because Petitioner is seeking to fund its CIP through a combination of debt and revenue funds, as long as Petitioner has not duplicated a project within its CIP, there is no potential for double recovery. Based on the evidence presented, we find that the two distribution system projects are not identified twice in Petitioner's CIP.

Accordingly, we find that the projects included in Petitioner's CIP, except for the clearwell and high service pump station (\$18.096 million), new service connections (\$1.152 million), and CES/RPR (\$3.6 million), totaling \$134,484,531 to be reasonable and should be considered in our determination of the appropriate level of debt service and E&R to be approved.

c. CIP Funding. Petitioner proposed to fund its CIP (inclusive of \$157,332,531 in capital projects) with \$132,361,824 being financed with debt and \$24,970,707 being allocated to E&R. Because we have determined only \$134,484,531 of Petitioner's CIP should be funded, we find that Petitioner's proposed E&R requirement of \$24,970,707 should be approved and its debt funding should be reduced to \$109,513,824 for the reasons discussed below.

⁴ Ms. Stull recommended the funding for these projects be eliminated from Petitioner's proposed E&R requirement, which we address further below in this Order.

1. **E&R.** Under Ind. Code § 8-1.5-3-8(c)(5), E&R is a component of a municipal utility's revenue requirement and represents cash-funded capital projects. Petitioner proposed an E&R revenue requirement of \$7,082,200 (Phase 1), \$8,344,400 (Phase 2), and \$9,544,100 (Phase 3) for a total of \$24,970,707 over a three-year period. OUCC witness Stull proposed four adjustments to Petitioner's proposed annual E&R allowance, three of which involved the elimination of funding for the new service connections, the CES/RPR costs, and the two distribution system projects included in Evansville's SRF application. Ms. Stull's fourth adjustment was a recommendation to spread the E&R costs ratably over the three-year phase-in of the rate increase.

As indicated above, we agree that the new service connections and CES/RPR costs should be eliminated from Petitioner's proposed funding plan. However, we find that those costs should be removed from the proposed amount of debt-funded capital projects, rather than from E&R. Additionally, we decline to accept the OUCC's recommendation to spread the E&R costs ratably over the three-year phase-in of the rate increase. Instead, we find Petitioner's proposed E&R budget reasonably balances the need for customers' direct funding of some capital projects without relying too heavily on debt. Evansville's proposed E&R amounts in each phase are set to ramp up to pay for the CIP projects and to reduce the reliance on bond-funded improvements. We agree with Evansville that its proposed E&R budget and how it is allocated among the three years achieves a balance of bond funding and E&R-funded capital improvements, while still keeping utility rates at an affordable level.

2. **Debt Service.** Evansville initially indicated that it intended to fund \$132,361,824 of its CIP through debt issuance of \$147,355,000 (which is inclusive of construction and non-construction costs) in the open market or through the SRF at various times. While actual interest rates would be determined when the bonds are sold or the SRF financing closes, Evansville anticipated the debt would be issued at interest rates ranging from 2.5% to 4.0% over 20 years.

OUCC witness Kaufman testified that the overall review of Petitioner's proposed financing was difficult to evaluate because the amounts and timing of the debt issuance were not certain. He argued that approval of debt issuances without specific terms could result in over- or under-recovery and would deprive the Commission and OUCC of the opportunity to evaluate Evansville's plan as it takes place. Based on these concerns as well as Mr. Parks' conclusions regarding Evansville's proposed CIP, he recommended Evansville's borrowing authority be reduced by approximately \$30 million to \$117,355,000.

On rebuttal, Mr. Baldessari testified that the OUCC's \$30 million reduction was arbitrary because the OUCC did not provide any detail as to how that amount was determined. He stated the Commission routinely approves financing programs where the specific time, number, and amounts of issues are not known at the time of approval to allow utilities the flexibility to quickly enter capital markets at opportune times. He also provided additional details related to Evansville's financing plan, including the amounts to be funded through the SRF and the associated interest rate. Mr. Baldessari also reiterated Evansville's intention to file a true-up report after the bonds are issued to address the OUCC's concerns and the true-up report will include an updated amortization schedule with actual interest rates, the amount borrowed, and the resulting true-up water rates and charges.

Having addressed above the OUCC's concerns with Petitioner's CIP to determine the total amount of funding required and the appropriate amount of E&R, we find that Evansville should be authorized to fund the remaining \$109,513,824 of its CIP through debt and approve total debt financing of \$116,985,000. This total amount of debt financing was determined based on Mr. Baldessari's rebuttal testimony indicating that, based on discussions with SRF, \$111,175,000 would be a SRF bond issuance with a blended interest

rate of 3.294% over 20 years and the remainder (i.e., \$5,810,000⁵) issued in the open market with interest ranging from 2.20% to 4.40% over 20 years. A comparison of the parties' positions and the Commission's determination is summarized in the table below:

<u>Estimated Project Costs</u>	<u>Petitioner's Direct</u>	<u>Petitioner's Rebuttal</u>	<u>Commission</u>
<i>Estimated Construction Costs and Engineering</i>			
Distribution System Improvements	\$ 99,970,000	\$ 93,198,300	\$ 99,970,000
Wholesale User Improvements	6,454,900		6,454,900
Water Treatment Plant Improvements	23,341,024		23,341,024
Less: 6.0 MG Clear Well and HSP #4			18,096,000
Subtotal: Water Treatment Plant Improvements		24,286,000	5,245,024
Booster Station Improvements	2,595,900	7,077,000	2,595,900
Engineering services (9.6%)		11,957,800	
Engineering services (CES/RPR)			(3,600,000)
Adjustment for Connection Fees			(1,152,000)
Total Estimated Construction Costs and Engineering	132,361,824	136,519,100	109,513,824
<i>Estimated Non-Construction Costs</i>			
Pre-Funded Debt Service Reserve	10,553,763	10,411,700	8,162,192
Capitalized Interest	825,000	1,371,800	220,294
Allowance for Underwriter's Discount (1.5%)	2,210,325	542,700	87,150
Allowance for Legal, Bound Counsel, Financial Advisory, Bond Issuance Costs, General Project Contingencies and Rounding	1,404,088	1,404,100	1,328,175
Total Estimated Non-Construction Costs	14,993,176	13,730,300	9,797,811
Allowance for IURC Estimation of Proposed Revenue Bonds - Open Market			8,265
Total Estimated Project Costs	147,355,000	150,249,400	119,319,900
<i>Estimated Project Funding</i>			
Proposed Revenue Bonds - SRF	147,355,000	111,175,000	111,175,000
Proposed Revenue Bonds - Open Market		36,180,000	5,810,000
Total Debt Issuance		147,355,000	116,985,000
Estimated Interest Earnings		2,894,400	2,334,900
Total Estimated Project Funding	\$ 147,355,000	\$ 150,249,400	\$ 119,319,900

Based on the above, the Commission approves debt service of \$14,355,148 for Phase 1 (Year 2020), \$17,272,764 for Phase 2 (Year 2021), and \$18,294,287 for Phase 3 (Year 2022). These amounts were

⁵ The remainder amount of \$5,810,000 is based on the reduction of total estimated construction cost and engineering from Petitioner's proposed amount of \$132,361,824 to \$109,513,824. The revised estimated non-construction cost and estimated interest earnings were determined using the same methodology used by Mr. Baldessari.

determined using Attachment DLB-2R, page 4 of Petitioner's Exhibit 1-R and modifying the bond amortization for the open market bond⁶ to reflect the new amount of \$5,810,000. Because Petitioner structured the proposed revenue bonds – open market such that debt service payments do not begin until July 1, 2020, they are not counted in Year 2020 debt service.

Under Ind. Code § 8-1.5-2-19(b), when a municipality issues debt, it must show that the rates and charges will provide sufficient funds for the operation, maintenance, and depreciation of the utility, and to pay the principal and interest of the proposed bond issue, together with a surplus or margin of at least 10% in excess. Based on the schedule below, the Commission finds Evansville will meet the standard under Ind. Code § 8-1.5-2-19(b) and, therefore, certifies that Petitioner's authorized rates and charges provide sufficient funds for the utility's operation, maintenance, and depreciation, and to pay the principal and interest of the proposed bond issue, together with a surplus or margin of at least 10% in excess.

Finally, the OUCC recommended that if Petitioner spends any funds from its debt service reserve for any reason other than to make the last payment on its current or proposed debt issuances, Petitioner should be required to provide a report to the Commission and the OUCC within five business days of the transaction. The report should include: (1) how much Petitioner spent; (2) the reasons for spending the funds; (3) a cite to any applicable loan documents that allow the spending of funds from its debt service reserve; (4) its plans to replenish its debt service reserve; and (5) an explanation of any cost-cutting activities it has implemented to forestall spending funds from its debt service reserve. Petitioner did not object to the OUCC's recommendation and because we find it reasonable, we accept the OUCC's recommendation.

C. Rate Relief. Based on the evidence presented as discussed above, the Commission finds that Petitioner's current rates and charges are insufficient to satisfy Petitioner's annual pro forma net revenue requirements. As shown below, Petitioner's total annual operating revenues for Phase 1, Phase 2, and Phase 3 are \$34,542,938, \$39,689,322 and \$44,595,338, respectively. Accordingly, Petitioner's existing rates are insufficient to recover Petitioner's revenue requirement and should be increased to produce an additional \$5,146,384, \$4,906,016 and \$2,677,118 (each inclusive of the prior phase increase) in annual operating revenues for Phase 1, Phase 2, and Phase 3, respectively.

⁶ The 2018B – open market bond.

	Phase 1	Phase 2	Phase 3
Operating Expenses	\$ 24,782,497	\$ 24,865,701	\$ 24,945,019
Extensions and Replacements	7,082,162	8,344,444	9,544,101
Payment in Lieu of Taxes	1,882,300	2,509,100	3,112,900
Debt Service			
Existing Debt	10,133,900	10,132,501	10,134,195
New Debt	4,201,248	7,140,263	8,160,092
Total Revenue Requirements	48,082,107	52,992,009	55,896,307
Less Revenue Requirement Offsets:			
Interest Income	201,999	201,999	201,999
Other Operating Revenues	524,476	524,476	524,476
Other Non-Operating Income	377,928	377,928	377,928
Sewer Portion of General Expenses	7,371,586	7,371,586	7,371,586
Fixed Capacity Payments from Wholesaler	-	-	191,144
Net Revenue Requirements	39,606,118	44,516,020	47,229,174
Less: Revenues at Current Rates Subject to Increase	34,542,938	39,689,322	44,595,338
Net Revenue Increase Required	5,063,180	4,826,698	2,633,836
Gross Revenue Conversion Factor	101.643317%	101.643317%	101.643317%
Recommended Increase	\$ 5,146,384	\$ 4,906,016	\$ 2,677,118
Recommended Percentage Increase	14.90%	12.36%	6.00%

D. True-Up Report. Petitioner proposed and we find that Petitioner shall file a true-up report with the Commission under this Cause and serve a copy thereof on the parties of record within 30 days of closing on each issuance of long-term debt. The true-up report shall include an amortization schedule with the actual interest rates on the bonds, amount borrowed, and the resulting trued-up water rates and charges. If both parties determine in writing that the increase or decrease would be immaterial, the parties shall so inform the Commission as part of the true-up report or through a subsequent filing. If no such determination is made, Petitioner shall implement the revised rates within two weeks. If the parties disagree on the materiality of the increase or decrease, Petitioner shall notify the Commission with its true-up report and a procedural schedule will be established to address the dispute.

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

1. Petitioner is authorized to increase its rates and charges for water service, across-the-board, in three Phases with the increase for Phase 1 constituting a 14.90% increase in order to increase annual operating revenues by \$5,146,384, for Phase 2 constituting a further 12.36% increase in order to increase additional annual operating revenues by \$4,906,016 and for Phase 3 constituting a further 6.00% increase in order to increase additional annual operating revenues by \$2,677,118.

2. Petitioner is granted a Certificate of Authority to issue additional long-term debt in one or more issues to the SRF or pursuant to competitive sale or private placement at or below competitive market rates and in principle amount not to exceed \$116,985,000 as approved in this Order.

3. Prior to implementing the approved rates, Petitioner shall file the tariff and applicable rate schedules under this Cause for approval by the Commission's Water/Wastewater Division. For Phase I, such rates and charges shall be effective on or after the Order date subject to approval by the Water/Wastewater Division. The Phase 2 and Phase 3 schedules shall be effective on January 1, 2020 and January 1, 2021, respectively, subject to approval by the Water/Wastewater Division.

4. Petitioner shall file a true-up report as provided in Finding Paragraph 7.D.

5. In accordance with Ind. Code § 8-1-2-70, the Petitioner shall pay within 20 days from the date of this Order, and prior to placing into effect the rates approved herein, the following itemized charges, as well as any additional charges which were or may be incurred in connection with this Cause.

IURC Charges:	\$ 12,142.97
OUCG Charges:	\$ 48,534.69
Legal Advertising Charges	\$ 182.37
Total:	\$ 60,860.03

Petitioner shall pay all charges into the Commission public utility fund account described in Ind. Code § 8-1-6-2, through the Secretary of the Commission.

6. In accordance with Ind. Code § 8-1-2-85, Petitioner shall pay a fee equal to \$0.25 for each \$100 of water utility revenue bonds issued, to the Secretary of the Commission, within 30 days of the receipt of the financing proceeds authorized in this Order.

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

HUSTON, FREEMAN, KREVDA, OBER AND ZIEGNER CONCUR:

APPROVED: DEC 05 2018

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



Mary M. Becerra
Secretary of the Commission