ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF INDIANA UTILITIES CORPORATION FOR AUTHORITY TO CHANGE ITS RATES, CHARGES, TARIFFS, RULES, AND REGULATIONS; AUTHORIZATION OF THE ISSUANCE OF LONG-TERM DEBT; AND APPROVAL OF AN ALTERNATIVE REGULATORY PLANS PURSUANT TO INDIANA CODE § 8-1-2.5-6 FOR PURPOSES OF IMPLEMENTING AN ENERGY EFFICIENCY PROGRAM, ASSOCIATED FUNDING AND DECOUPLING MECHANISMS, AND CHANGES TO PETITIONER'S CALCULATION OF COSTS FOR EXTENSION OF DISTRIBUTION MAINS	)	CAUSE NO. 44062 APPROVED: SEP 05 2012

ORDER OF THE COMMISSION

Presiding Officers:
Kari A.E. Bennett, Commissioner
Aaron A. Schmoll, Senior Administrative Law Judge

On August 22, 2011, Indiana Utilities Corporation ("Petitioner" or "Indiana Utilities") filed its Petition with the Indiana Utility Regulatory Commission ("Commission") seeking authority to increase its existing rates and charges; issue long term debt; implement an alternative regulatory plan for purposes of initiating an energy efficiency program and accompanying funding and decoupling mechanisms; and approval of an alternative regulatory plan to change its method of calculating the cost for extension of distribution mains.

Pursuant to notice, a pre-hearing conference in this cause was held on October 3, 2011, in Room 224 at the PNC Center, 101 West Washington Street, Indianapolis, Indiana. Proofs of publication of the notice of such pre-hearing conference were incorporated by reference into the record and placed in the official files of the Commission. The Petitioner and the Indiana Office of Utility Consumer Counselor ("OUCC") appeared and participated at the pre-hearing conference. No members of the general rate paying public appeared or participated therein. The Commission issued its Prehearing Conference Order on October 12, 2011.

On March 13, 2012, and continuing through March 14, 2012, a public hearing was held in Room 222 of the PNC Center, 101 West Washington Street, Indianapolis, Indiana. At such hearing, representatives of the Petitioner and the OUCC were present and participated. No members of the general rate paying public appeared or sought to testify on either day of the public evidentiary hearing.

On March 30, 2012, Petitioner filed its Late-Filed Exhibits 1, 2, 3, 4, 5, and 6. On April 9, 2012, the OUCC filed its Statement Regarding Petitioner's Late-Filed Exhibits, expressing its position and/or concerns relative to such Late-Filed Exhibits. On April 12, 2012, the Commission

convened an attorneys' conference for representatives of the parties to discuss the issues raised by the OUCC in its Statement. On April 23, 2012, the OUCC filed its Second Statement Regarding Petitioner's Late-Filed Exhibits, indicating that most of its questions and concerns regarding Petitioner's Late-Filed Exhibits had been answered or resolved, while also confirming that any matters remaining in dispute could be adequately addressed in post-hearing filings, without the need to present additional evidence. On April 26, 2012 at 1:00 p.m., the Commission held a further hearing for purposes of admitting Petitioner's Late-Filed Exhibits into the record. Such Late-Filed Exhibits were admitted without objection. No members of the rate paying public appeared or sought to be heard at this hearing.

The Commission, having considered the evidence in this cause; and having considered the laws of Indiana, and being duly advised; now finds as follows:

1. **Notice and Jurisdiction.** Due, legal, and timely notice of these proceedings was given and published as required by law. Petitioner provided notice of the proposed rate increase to its residential customers and published notice in the *Corydon Democrat*. Petitioner is a public utility as defined in Ind. Code § 8-1-2-1. Petitioner is also an energy utility as defined by Ind. Code § 8-1-2.5-4. The Petitioner seeks authority to increase its existing rates and charges, issue long term debt, implement an energy efficiency program as an alternative regulatory plan, and change the methodology for calculating the cost of extension and distribution mains, also as an alternative regulatory plan. Based on the jurisdictional authority provided to this Commission, pursuant to Ind. Code ch. 8-1-2 and Ind. Code ch. 8-1-2.5, the Commission has jurisdiction over Petitioner and the subject matter of this Cause.

2. **Petitioner's Characteristics.** Indiana Utilities Corporation is a public utility as defined by Ind. Code § 8-1-2-1 and is also an energy utility as defined by Ind. Code § 8-1-2.5-2. Petitioner has elected to be subject to the Commission's jurisdiction for purposes of its alternative regulatory plans pursuant to Ind. Code § 8-1-2.5-4. The Petitioner currently provides pipelines, distribution systems, land, land rights, equipment, materials, supplies, working capital, and other property for purposes of rendering natural gas service to its customers in Harrison and Floyd Counties, Indiana.

3. **Existing Rates, Test Year, and Relief Requested.** Indiana Utilities' current base rates are those established by this Commission on January 21, 2009, in Cause No. 43520. The test year for this proceeding is the twelve months ending March 31, 2011, adjusted for changes that are fixed, known, and measurable and occurring within 12 months following the end of the test year. Petitioner's cut-off date for determining the used and useful nature of its utility plant in service is June 30, 2011. Based on its Petition and the evidence of record, Petitioner seeks to increase its rates and charges by 12.68%, or $523,847[1]; issue long term debt in an amount up to $500,000; implement the energy efficiency program with accompanying funding and decoupling mechanisms previously authorized by this Commission in Cause No. 43995; and implement a change in the method of calculating the costs associated with main extensions to one focused on Petitioner's decoupled margins rather than Petitioner's gross revenue.

[1] The 12.68% increase is the projected increase in the total monthly bill, inclusive of the cost of gas at an average usage level. Excluding gas costs, Petitioner's proposal would increase rates and charges by 27.15%.

4. **Evidence of the Parties.**

A. **Petitioner's Case-in-Chief.** Petitioner offered in its direct case the testimony and exhibits of its financial and accounting witnesses from London Witte Group, including Duane C. Mercer, Bonnie J. Mann, and Earl L. Ridlen, III; as well as Petitioner's President, Frank Czeschin, economist John A. Boquist Ph.D., and rate design consultant, Kerry Heid.

(i) Duane C. Mercer

Mr. Mercer testified that the Petitioner is not earning the authorized return approved by this Commission in Petitioner's last base rate case, Cause No. 43520. Mr. Mercer indicated Petitioner's rates and charges should be increased to permit Petitioner to earn a reasonable return on its investment and allow Petitioner to cover all current operating expenses reasonably incurred to provide service to its customers. Mr. Mercer described Petitioner's current capital structure and noted that he had included the proposed long term debt requested in this proceeding in that capital structure. In order to properly cover Petitioner's current operating expenses and provide a reasonable return to Petitioner's investors, Mr. Mercer proposed that Petitioner be authorized to increase its rates and charges by $523,847.

Mr. Mercer also offered testimony in support of Petitioner's proposed implementation of an energy efficiency program with accompanying funding and decoupling mechanisms pursuant to an alternative regulatory plan ("ARP"). As Mr. Mercer noted, this Petitioner was one of eight small gas utilities that participated in a proceeding before the Commission in Cause No. 43995 seeking approval of the elements of this ARP. The Commission required Petitioner to obtain approval of new base rates before implementing the ARP. Additionally, Mr. Mercer supported Petitioner's proposed change in the ARP regarding calculation of cost recovery permitted for main extensions. Mr. Mercer noted gross revenues currently used by this Petitioner include the commodity cost of gas. Such commodity cost of gas provides no funds to the Petitioner for purposes of covering costs incurred in extending mains. Mr. Mercer proposed a calculation based on operating margins approved in this proceeding, estimating revenue from new customers seeking a distribution main extension. He noted a six year margin recovery calculation would be appropriate and would be similar to methodology currently being used by other Indiana gas utilities.

(ii) Bonnie J. Mann

Petitioner's witness Mann offered testimony describing and supporting Petitioner's pro forma adjustments to test year operating results to establish an appropriate revenue requirement. Ms. Mann specifically proposed pro forma operating revenue and expense adjustments, including the following: (i) a decreased adjustment to operating revenue of $(3,301,986) to eliminate net Gas Cost Adjustment ("GCA") revenues recorded during the test year ended March 31, 2011; (ii) a decreased adjustment to natural gas purchased of $(3,280,493) to eliminate the cost of gas from Petitioner's base rates; (iii) an increased adjustment for payroll of $22,583 to recognize an increase in Petitioner's payroll that occurred within the 12 month adjustment period following the end of the test year; (iv) an increased adjustment of $5,704 associated with Petitioner's pro forma pension contribution; (v) an increased adjustment of $59,862 to recognize rate case expense; (vi) a decreased adjustment of $(2,869) to reflect the IURC fee applicable to pro forma present rate revenue; (vii) an increased adjustment of $1,093 to recognize bad debt expense, representing a three-year average of write-offs; (viii) a decrease of $(22,073) to recognize the reduced cost

Petitioner anticipates for property, casualty, life, and medical insurance; (ix) a decreased adjustment of $(4,375) to remove charitable contributions included in Petitioner's test year operating expenses; (x) an increased adjustment of $7,100 to represent the cost of Petitioner's participation in the energy efficiency ARP proceedings in Cause No. 43995; (xi) a decreased adjustment of $(7,600) for a reduction in energy efficiency rebates previously offered pursuant to the normal temperature adjustment, which will be included in the energy efficiency program once that program is implemented; (xii) an increased adjustment of $4,468 to cover Petitioner's ongoing costs involved in reporting and other regulatory requirements involved in implementing the energy efficiency program; (xiii) an increase of $360 for the increase in postage which the United States Postal Service has announced; and (xiv) an increased adjustment of $600 for the additional electric, water, and sewer utility costs associated with Petitioner's new building.

Ms. Mann also provided testimony and supported the Petitioner's exhibits relative to the utility plant in service as of June 30, 2011. She noted a change in Petitioner's depreciation amount based on 3% depreciation for distribution plant; and 5% depreciation for general plant other than transportation and computer equipment, which have a 20% depreciation rate. Ms. Mann noted the above depreciation rates result in a decrease of $(20,816) to the depreciation in Petitioner's test year depreciation expense. With respect to Petitioner's utility plant in service used and useful in serving its customers as of the cut-off date of June 30, 2011, Ms. Mann suggested an original cost book value net of depreciation of $5,556,502. Using the FERC 45-day method for calculating working capital, Ms. Mann added $134,819 to the depreciated book value of Petitioner's utility plant in service, and included $32,693, representing a 13-month average of Petitioner's materials and supplies. The total original cost rate base for determining Petitioner's investment is $5,724,014.

(iii) Earl L. Ridlen, III

Petitioner's witness Ridlen explained adjustments made to Petitioner's test year operating results related to taxes. Mr. Ridlen described an increased adjustment of $1,728 for the increase in payroll taxes and an increased adjustment of $3,535 for property taxes on the value of utility plant in service as of June 30, 2011. He described a decrease in utility receipts taxes of $(46,648) to reflect the pro forma present rate adjustments multiplied by the utility receipts tax rate of 1.4%. Mr. Ridlen also identified a decreased adjustment of $(29,070) representing a decrease in state and federal income taxes based on pro forma present rate adjustments.

Both Ms. Mann and Mr. Ridlen offered testimony proposing adjustments to the pro forma revenue requirement in order to collect sufficient funds to cover the IURC fee, bad debt expense, and taxes once Petitioner is authorized to increase its rates and charges.

(iv) Frank Czeschin

Petitioner's President, Frank Czeschin, presented direct testimony in support of Petitioner's request. Mr. Czeschin's testimony focused on discussions between Petitioner and its rate case consultants prior to filing its Petition in this Cause and the accuracy of the Petition as presented. Mr. Czeschin described the long term debt authority of up to $500,000 for a period of up to five years at a variable interest rate of 4.5%. He named the anticipated lender for such debt and described how the variable rate might change. He explained why the variable interest rate was established at 4.5% and why a five year period would be sufficient. Mr. Czeschin also described his

discussions with other lenders and indicated the lender chosen had the lowest interest rate and was Petitioner's primary bank.

Mr. Czeschin addressed the proposed implementation of energy efficiency programs and accompanying funding and decoupling mechanisms. He noted Petitioner had participated with other small gas utilities in Cause No. 43995, which sought and obtained this Commission's authority to initiate such programs and mechanisms, subject only to the setting of new base rates and charges. He confirmed Petitioner's intent to begin the energy efficiency programs as soon as possible in collaboration with the other participating utilities.

Mr. Czeschin also discussed why it is appropriate to change the calculation methodology on main extensions from one based on gross revenue to one based on margin. He indicated gross revenue, based on this Commission's current rules, includes the commodity cost of gas. Since Petitioner has proposed to decouple the commodity cost of gas from Petitioner's operating margins, he believes it is appropriate to use operating margins for future calculations regarding main extensions. As to the period of time used for estimating margin-based revenue recovery from new customers, he suggested an initial six year period as a reasonable period of time, as of this rate case. Mr. Czeschin noted that using margins and considering the ability to earn a return could require a greater period of time; but indicated a proposed change to six years would be reasonable and consistent with what other gas utilities have used.

(v) John A. Boquist

Petitioner offered the direct testimony of John A. Boquist, Professor Emeritus at the Indiana University Kelley Graduate School of Business. Dr. Boquist described his review of Petitioner; his analysis of a proxy group of regulated natural gas utilities; and his opinion as to the current economic condition. He ultimately opined as to Petitioner's cost of capital and a reasonable return on equity investment made in Petitioner's rate base. Dr. Boquist testified the cost of common equity should be set by the Commission at a return sufficient to attract capital; maintain the company's financial integrity; allow Petitioner to render continuous and reliable service to its customers; and provide the company with a return commensurate with that available on investments in other enterprises of corresponding risk. Dr. Boquist discussed the risks faced by this Petitioner, including financial risk, liquidity risk, business risk, and regulatory risk. He claimed that Indiana Utilities, in addition to the above general risks, has unique risk factors, including its small size, lack of marketability, and competition from alternative energy sources which provide alternative energy supplies in and around a given service territory.

Dr. Boquist described the discounted cash flow ("DCF") analysis and a capital asset pricing model ("CAPM") analysis he performed for Petitioner. He was required to apply his analysis to a proxy group since Indiana Utilities is not publicly traded. Dr. Boquist described in detail the analysis he performed and concluded an average unadjusted DCF analysis for the proxy group would result in a DCF of 9.38% based on the market value of the proxy group's equity investment and an unadjusted average of 12.37% based upon the book value (original cost) of the proxy group's equity investment. Dr. Boquist indicated it is necessary to analyze the DCF on both market value and book value to avoid the problem created by applying a market derived common equity cost to an original cost rate base. Such a direct application would cause the establishment of a lower cost of common equity than the DCF analysis would suggest. Dr. Boquist believed an additional adjustment was required due to Petitioner's small size, limited marketability, and limited

service territory. He testified that after adjusting for those additional risk factors, Dr. Boquist's DCF results ranged from 10.38% to 13.37%.

Dr. Boquist's CAPM analysis of the proxy group resulted in an unadjusted CAPM of 7.33%. After making an additional adjustment for Petitioner's unique risk factors, including its small size, Dr. Boquist's CAPM analysis for this Petitioner resulted in an 11.40% cost of equity ("COE") capital. In concluding his direct testimony, Dr. Boquist recommended this Commission authorize a 10.89% return on equity capital as a fair and reasonable return. In Dr. Boquist's opinion, such a return would recognize both the mathematical results of the various DCF and CAPM analyses performed and would provide an appropriate adjustment in recognition of Petitioner's unique risks.

(vi) Kerry Heid

Petitioner's witness Kerry Heid offered testimony reflecting the allocation of Petitioner's proposed revenue requirement across the board to all customer classes. Mr. Heid described the application of an Energy Efficiency Rider made up of the energy efficiency funding component ("EEFC") and sales reconciliation component ("SRC") for purposes of funding energy efficiency programs and decoupling Petitioner's margins. As Mr. Heid noted, the use of both an EEFC and SRC were previously approved by this Commission for this Petitioner and other small gas utilities in Cause No. 43995. Mr. Heid explained Petitioner is proposing to split its current general sales rate class into two separate classes to allow Petitioner to apply the Energy Efficiency Rider to only residential customers. Finally, Mr. Heid described future annual filings Petitioner would make with the Commission related to the SRC.

B. OUCC's Case-In-Chief. The OUCC's case-in-chief included the prefiled testimony and exhibits of Sherry L. Beaumont, Heather R. Poole, Bradley E. Lorton and Jon Dahlstrom, along with the revised and amended schedules and attachments of Ms. Beaumont and Ms. Poole.

(i) Sherry L. Beaumont

OUCC Utility Analyst Sherry L. Beaumont presented the OUCC's accounting schedules, showing amounts included in Petitioner's proposed revenue requirement and the OUCC's proposed adjustments to those amounts and to other values impacting the ultimate size of the approved rate increase, e.g., return on equity ("ROE"), fair value of Petitioner's used and useful utility plant in service, Petitioner's capital structure, weighted cost of capital, etc. The OUCC did not contest Petitioner's proposed long term debt issuance; its proposed ARP for calculating main extensions; or a number of Petitioner's proposed accounting adjustments. Ms. Beaumont also sponsored a customer comment ("Public's Exhibit 1") that was submitted to the OUCC to oppose the proposed rate increase. That customer comment was sent in response to Petitioner's notice of a possible 12.7% residential rate increase.

(ii) Heather R. Poole

The adjustments documented in Ms. Beaumont's accounting schedules were presented and explained by OUCC Utility Analyst Heather R. Poole, the OUCC's primary accounting witness in this case. Ms. Poole agreed with Petitioner's proposed accounting adjustments to the following items included in Petitioner's Test Year expenses: the cost of property, casualty, life and medical

insurance; charitable contributions; removal of energy efficiency costs from the NTA; postage; and the cost of utility service for Petitioner's new office. Ms. Poole's prefiled testimony addressed additional disputed issues. However, after completing her analysis and reviewing Petitioner's rebuttal testimony, Ms. Poole withdrew two of her original objections in supplemental testimony filed on March 12, 2012. Ms. Poole indicated Petitioner's original positions on the following issues were adequately explained in its rebuttal testimony: (i) Petitioner's inclusion of its Vice President's, Charles Czeschin, salary in payroll as a part-time employee; and (ii) Petitioner's calculation of deferred taxes included in its capital structure,

Ms. Poole recommended further adjustments to Petitioner's operating expenses, including adjustments to purchased natural gas; payroll; pension; rate case expense; IURC fee; bad debt expense; costs associated with the energy efficiency proceeding in Cause No. 43995; the estimated cost of future participation in filings for the energy efficiency program; and other miscellaneous expenses. The OUCC also presented proposed adjustments to Petitioner's pro forma taxes, capital structure and rate base.

Starting with OUCC adjustments to Petitioner's proposed operating expenses, Petitioner's 3.71% gas loss rate experienced during the test year was unusually high, compared to Petitioner's unaccounted for gas rates in 2009 (2.87%) and 2010 (2.80%). Ms. Poole proposed using a three-year average of 3.13% to calculate unaccounted for gas purchased during that adjustment period. Ms. Poole explained that use of a three-year average would provide a more accurate projection of the cost of future unaccounted for gas.

Ms. Poole also proposed several adjustments to payroll. First, she reduced Petitioner's pro forma payroll expense for two part-time employees working fewer hours per week. Ms. Poole also reduced Petitioner's pro forma payroll expense by removing all bonuses paid during the test year. Ms. Poole based that recommendation on the Commission's rejection of unsupported proposed bonuses for utilities in Cause No. 43520 and on Petitioner's failure to provide written documentation or otherwise explain bonus criteria for its employees to qualify for bonus payments. Petitioner did not include that level of detail in its case-in-chief and failed to provide it to the OUCC during the course of informal discovery. Ms. Poole indicated the utility also failed to provide any evidence that the proposed bonuses were essential to Petitioner's day-to-day operations. Given the lack of appropriate documentation or other confirmation of extra hours worked, time spent on-call, longevity of employment, performance quality or compliance with other possible bonus criteria, Ms. Poole recommended denying recovery through rates of any paid bonuses.

Ms. Poole recommended a $6,000 reduction to the utility president and owner's proposed salary, which included an 8.2% salary increase for 2012. Petitioner proposed no more than a 3% increase in payroll for the utility's other employees. If that recommendation is not acceptable to Petitioner, Ms. Poole recommended the Commission deny recovery from ratepayers of any payroll increases that exceed 3%, or the actual percentage increase awarded if less than 3%.

Ms. Poole proposed adjustments to Petitioner's test year pension expense, which flowed from the above payroll adjustments. She also eliminated the pension expense for Petitioner's Vice President, Charles Czeschin, since he no longer participates in Petitioner's pension plan.

Ms. Poole stated Petitioner's estimated rate case expense is more than double the amount in Petitioner's last rate case, Cause No. 43520. Ms. Poole pointed out that Petitioner has no written

contracts or engagement letters with its rate consultants for work performed on this rate case. Ms. Poole added that invoices received from Petitioner's accountants do not list which employees performed the work, the number of hours worked per employee, the employee's hourly rate, or the total cost of the work performed. Neither the Petitioner nor the OUCC can accurately judge the reasonableness of these charges without more detailed invoices or contracts.

Ms. Poole testified the number of OUCC staff assigned to a particular case should not impact Petitioner's projected rate case expense. The assignment of more OUCC staff to a particular case could be due to a number of different reasons. To project Petitioner's pro forma rate case expense from this base rate case, Ms. Poole proposed increasing Petitioner's last rate case expense approved in Cause No. 43520 by 10%, and then adding an estimate of Dr. Boquist's total rate consulting fee (since Dr. Boquist did not participate in Petitioner's previous rate case and no other COE witness was used). Although Petitioner has averaged approximately 3.84 years between rate cases, Ms. Poole noted with Petitioner's upcoming implementation of rate decoupling approved in Cause No. 43995, Petitioner should be able to reduce the frequency of its future rate case filings. Ms. Poole doubled Petitioner's historic average number of years between rate cases (3.84 x 2 = 7.68 years) and rounded that figure down to the next lower whole number. Accordingly, Ms. Poole recommended amortizing Petitioner's current rate case expense over a period of seven years, as opposed to the three-year amortization period proposed by Petitioner.

Ms. Poole adjusted Petitioner's proposed IURC fee, using the IURC's currently approved rate.

Regarding bad debt expense, which fluctuates from year to year, Ms. Poole recommended the rolling use of an updated three-year average. This yielded a slightly different adjustment than Petitioner's proposal. Ms. Poole's proposed three-year average also included up-to-date information on Petitioner's bad debt expense, providing a more representative projection of that future expense.

As to consulting fees related to Petitioner's energy efficiency program, Ms. Poole recommended a different adjustment than Petitioner made to its test year expense, based on Mr. Mercer's estimated allocation of consulting fees for the energy efficiency program and rate decoupling approved in Cause No. 43995. Ms. Poole used a seven-year amortization period, the same amortization period she proposed for rate case expense.

On the adjustment for funding future regulatory filings with the Commission under Cause No. 43995 (referenced as "decoupling expense"), Ms. Poole recommended the eight small gas utilities which shared in the cost of proceedings before the Commission in Cause No. 43995, should also share the cost of required future reports to the Commission associated with Cause No. 43995. Ms. Poole recommended the cost of preparing future reports be allocated based on the same factors used in the underlying proceeding.

Ms. Poole proposed three other miscellaneous expense adjustments. She recommended removing $250 in unrecoverable lobbying expenses paid to the U.S. Chamber of Commerce. She also proposed removing a $25 voluntary contribution for information technology paid to the Harrison County Chamber of Commerce during the test year. Ms. Poole also recommended a $600 reduction to a February 2011 London Witte Group invoice totaling $1,200, which referenced a visit with client to discuss: (i) a potential rate case; and (ii) anticipated annual impacts of decoupling.

Ms. Poole recommended that half of the invoice be deferred for amortized recovery as part of Petitioner's total rate case expense, instead of expensing the entire amount during the test year.

Ms. Poole proposed a change in depreciation expense to reflect actual updates to utility plant in service as of the agreed cut-off date of June 30, 2011. Ms. Poole also removed non-depreciable property from Petitioner's depreciation calculation.

Ms. Poole proposed adjustments to various taxes, including payroll taxes, utility receipts tax, and federal and state income taxes based on Ms. Poole's other accounting adjustments. She adjusted the weighted cost of new long-term debt in her synchronized interest calculation, which in turn impacted projected federal and state income taxes.

Ms. Poole also recommended an adjustment to Petitioner's utility plant in service to recognize the actual original cost of additional utility plant placed in service after the end of the test year, but before the agreed cut-off date for additions to rate base (i.e., between March 31 and June 30, 2011). Ms. Poole recommended an increase to accumulated depreciation for the 3-months between April 1, 2011 and June 30, 2011, due to the above increase to Petitioner's utility plant in service. Based on her other accounting adjustments, Ms. Poole also recommended additional changes to working capital, which is included in base rates.

Finally, Ms. Poole changed the cost of existing long-term debt, noting that the long-term debt balances decreased from September 30, 2010, to the end of the test year on March 31, 2011, reducing the cost of Petitioner's existing long-term debt.[2]

(iii) Bradley E. Lorton

OUCC Utility Analyst Bradley E. Lorton opposed Petitioner's requested 10.89% COE, representing a 0.59% increase to the 10.3% ROE authorized in its last rate case, Cause No. 43520, in January of 2009. Given the change in economic conditions since Petitioner's last rate case, Mr. Lorton testified that it was more reasonable to expect a reduction, rather than an increase, in Petitioner's ROE. Neither Mr. Lorton's DCF results nor his CAPM analysis yielded an ROE anywhere near Petitioner's current authorized level. Based on his analysis, using the same proxy group and the same cost models as Dr. Boquist, Mr. Lorton recommended the Commission approve an ROE of 9.0% for Petitioner at this time. Mr. Lorton testified his recommended ROE was as generous as it could be, based on the results of his DCF and CAPM analyses.

Mr. Lorton observed that the main difference between his recommendation and Petitioner's proposed ROE was Dr. Boquist's use of questionable size-based adjustments. Dr. Boquist added 100 basis points to his DCF analysis and added 407 basis points to his CAPM analysis due to additional risk Dr. Boquist attributed to Petitioner's small size. Mr. Lorton disputed the magnitude

[2] Although Ms. Poole originally stated that deferred tax should be calculated as of June 30, 2011 (the cut-off date for adjustments to rate base), Ms. Mann's rebuttal testimony explained why she believed deferred taxes should be calculated as of March 31, 2011 (the end of the test year), instead of the later date the OUCC originally proposed. After reviewing Petitioner's rebuttal position, Ms. Poole agreed to withdraw the OUCC's proposed adjustment to deferred taxes.

of Dr. Boquist's two small utility adjustments. Mr. Lorton also challenged the applicability of such adjustments for a regulated public utility, especially one about to implement a new rate decoupling mechanism already approved in Cause No. 43995.

Mr. Lorton testified the "DCF model holds that the price of an asset today should equal the sum of all the cash flows that the asset will generate, discounted by the appropriate rate back to the present." (Pub. Exh. BEL, pp. 5-6.) He described the underlying principle of the Constant Growth DCF model he used as follows: "[T]he price of a firm's stock reflects the expected cash flows (i.e., dividends) associated with that stock, discounted at a rate to the cost of equity capital." (Pub. Exh. BEL, p.6.) Mr. Lorton testified that, using the Constant Growth DCF model, the estimated COE equals the forward dividend yield plus a constant long-run growth rate. Mr. Lorton testified the Constant Growth DCF model is considered reliable when estimating COE for public utilities. Using that model, he calculated a forward dividend yield of 3.5% using the "half year method." That result was consistent with the average Value Line forward yield for the proxy group, which was also 3.5%. Mr. Lorton calculated a growth rate of 5.5% as reasonable for the proxy group based on historic and projected growth in Earnings Per Share, Dividends Per Share and Book Value Per Share.

Mr. Lorton observed that the first stage of Dr. Boquist's "two-stage quarterly growth" DCF model was 10 years long, yet Dr. Boquist assumed a 3 to 5 year forecasted growth in cash flow. The underlying time periods used in his analysis did not match. Mr. Lorton also challenged Dr. Boquist's assumption that publicly traded companies regularly increase dividends every quarter. Mr. Lorton presented evidence from his own growth calculations and from the Congressional Budget Office and the Social Security Administration that did not support the high growth rate of 5.8% Dr. Boquist used. Mr. Lorton also criticized Dr. Boquist's failure to provide any explanation of how he calculated the proposed additional 100 basis point risk adjustment made due to Petitioner's small size.

Mr. Lorton also explained the CAPM analysis he performed. Using Value Line adjusted betas for the proxy group, Mr. Lorton calculated an average beta of 0.66. He then averaged the yield on twenty-year treasury bonds since January 2007 to arrive at a 4.2% risk free rate for his CAPM analysis. Mr. Lorton testified the rate he calculated under the CAPM is fair and reasonable, since it takes into account both recent economic trends and prior data. He calculated a Market Risk Premium of 5.2% based on data from Morningstar (formerly Ibbotson). Mr. Lorton's risk premium included both (i) the geometric mean for average compound annual rate of return over a period of more than one year, and (ii) the arithmetic mean for the average of one-year holding period returns. Mr. Lorton noted the Commission gives substantial weight to both the geometric mean and the arithmetic mean in estimating ROE under the CAPM, as demonstrated in the Commission's rate order in Cause No. 42520. Mr. Lorton estimated Petitioner's ROE at 7.63% using the CAPM.

Mr. Lorton observed that Dr. Boquist's addition of a 407 basis point small business size adjustment was the main difference between their respective estimates of Petitioner's ROE using the CAPM. Mr. Lorton cited Commission Orders in Cause Nos. 40398 and 43680 and several scholarly resources to establish that a small business adjustment is not needed to estimate ROE for Indiana's small rate-regulated monopoly public utilities. Mr. Lorton acknowledged the Commission had allowed a small business size adjustment in the Boonville Natural Gas rate case decided in 2008 (Cause No. 43342). However, Mr. Lorton noted the additional risk adjustment Dr. Boquist recommended in this case to compensate for the small size of this utility, is almost three

times larger than the small utility risk adjustment the Commission approved in 2008 in the Boonville Natural Gas rate case. Mr. Lorton observed that, unlike that earlier Boonville rate case, Petitioner is seeking approval of a rate increase and an increase in ROE at the same time it is implementing its first rate decoupling mechanism, which will further reduce Petitioner's business risk. Mr. Lorton emphasized that the Commission Order in the Boonville case, Cause No. 43342, was issued before the 2008 economic downturn (i.e., before the collapse of Lehman Brothers and other major financial institutions). Mr. Lorton also indicated the spot yield on 20-year U.S. Treasury bonds was 170 basis points higher at that time, despite low economic expectations after the severe decline in U.S. financial markets in 2008.

Mr. Lorton testified macroeconomic trends support the reasonableness of his recommended ROE of 9.0%. He cited a December 2011 CFO Magazine Business Outlook Survey, indicating that Chief Financial Officers from S&P 500 companies expected only a 6.3% average annual rate of return. Mr. Lorton observed that companies in the S&P 500 are more risky than regulated utilities, such as the Petitioner in this case. He also testified that interest rates have been in a long-term decline, making recent years a period of low-cost capital. He testified that 10-year U.S. Treasury yields had fallen below 2%, while 20-year Treasury yields were under 3%. Mr. Lorton observed that current sluggish economic growth indicates the U.S. economy is still struggling to achieve a robust growth rate. Mr. Lorton quoted Federal Reserve Chairman Ben S. Bernanke for the proposition that long-term inflation forecasts and expectations have remained fairly stable. Mr. Lorton cited data from the Bureau of Labor Statistics showing the Consumer Price Index has remained stable and low by historic comparison. Mr. Lorton observed these trends do not reveal an over-heating economy that would fuel a significant increase in capital costs. He indicated interest rates remain low; economic growth remains lower than what we experienced in the 1990s; and inflation remains relatively low, after removing the impacts of energy and food price volatility. Mr. Lorton recommended a 9.0% ROE for Petitioner, the highest of his two analytical model results. Mr. Lorton concluded the OUCC's proposed 9.0% ROE is more in line with current economic conditions than Petitioner's proposed 10.89% ROE.

(iv) OUCC Witness Jon Dahlstrom

OUCC witness Jon Dahlstrom recommended the Commission deny Petitioner's proposed energy efficiency rider because Petitioner failed to provide required information regarding Petitioner's potential order granted margins and order granted margins per customer, which form the basis of the SRC element of the proposed energy efficiency rider. Mr. Dahlstrom observed that without knowing the number of customers in each rate class, total projected sales by customer class, and the actual order granted margins or order granted margins per customer, there was insufficient information to determine the true impact of Petitioner's planned use of an SRC approved in Cause No. 43995.

Petitioner's counsel cross-examined Mr. Dahlstrom regarding Petitioner's revised rate design proposal provided to the OUCC after Petitioner's rebuttal testimony was filed. Petitioner's revised rate design proposal was provided to the OUCC in Petitioner's response to OUCC data requests. Mr. Dahlstrom indicated Petitioner's stated reason for introducing a new rate design at that point in the proceeding. He said Petitioner reportedly was advised by a large industrial customer that the customer would move its operations out of Petitioner's service territory if the pending proposed rate increase were approved and implemented in the manner originally proposed by the Petitioner. Mr. Dahlstrom testified that, in an effort to avoid losing a major customer, which

in turn could drive rates higher for Petitioner's other customers, Petitioner informally presented its proposed revised rate design. Petitioner's proposed revised rate design represents an effort to lessen the impact of the requested rate increase on Petitioner's industrial customers, and to prevent the customer from relocating its operations and the accompanying jobs outside of Petitioner's service territory. If an industrial customer relocated operations, not only would Petitioner lose a major customer, the community would lose local jobs. (Petitioner's revised rate design proposal was marked as "Public's Redirect Exhibit 1" when offered and admitted into evidence at the hearing.) If approved, the revised rate design will shift some cost recovery away from Petitioner's commercial and industrial customers and onto Petitioner's residential customers, increasing residential rates.

Mr. Dahlstrom indicated the OUCC understood and appreciated the reasons for Petitioner's proposed rate design changes. However, he said an almost identical result could be achieved if the Commission approved the OUCC's proposed adjustments, which would not randomly shift cost recovery between different customer classes to keep one industrial user's rates low enough to prevent relocation. If, on the other hand, the Commission does not accept the OUCC's proposed adjustments, or does not accept enough of them to keep rates low enough to retain the industrial customer, Mr. Dahlstrom confirmed the OUCC would support use of Petitioner's revised rate design, if necessary to retain local jobs, especially in light of current economic conditions and unemployment rates across the United States.

Mr. Dahlstrom testified the OUCC reviewed Petitioner's proposed change to the method used to calculate the costs associated with future main extensions. He said the OUCC agrees with Petitioner that, after decoupling is implemented, main extension cost recovery should be based on Petitioner's margins, instead of gross revenue, for six years, instead of three. Mr. Dahlstrom did not oppose Petitioner's proposed main extension ARP.

C. Petitioner's Rebuttal Case. In its rebuttal case, Petitioner offered additional testimony from each of its original witnesses.

(i) John A. Boquist

Dr. Boquist's rebuttal focused on the OUCC's analysis and recommendations on an appropriate rate of return for Petitioner's equity capital. He indicated Mr. Lorton's estimate of a 9.0% cost of common equity is not supported by an appropriate application of the DCF or CAPM models. Regarding Mr. Lorton's DCF analysis, Dr. Boquist questioned the attempt to find an annual dividend result by applying one-half of the dividend growth per year. He also questioned why the OUCC used a half year method when all of the companies included in the proxy groups paid dividends on a quarterly basis. Dr. Boquist questioned the averaging of projected earnings per share, dividends per share and book value per share, pointing out that the companies in the proxy group experienced different growth rates for those inputs. Dr. Boquist rationalized his use of a two-stage quarterly dividend growth model to alleviate what he considered an averaging problem.

With respect to the OUCC's CAPM analysis, Dr. Boquist questioned the decision by Mr. Lorton to average the arithmetic mean and the geometric mean to determine the appropriate market risk premium to use in this analysis. Dr. Boquist went on to question Mr. Lorton's use of large company equity risk premiums over long term bonds, noting the interest on bonds should be subtracted from the total bond return in order to establish the true difference between risky stocks and the generally risk-free return on long term bonds. As Dr. Boquist noted, investors can only

expect interest from treasury bond investments to be truly risk-free. Dr. Boquist considered using the total return on treasury bonds to be problematic. He claimed Mr. Lorton's analysis also confused the CAPM with Ibbottson's "build up method" to estimate Petitioner's COE capital. Dr. Boquist recalculated the OUCC's analysis under Ibbottson's "build up method," as outlined in the SBBI Valuation Edition 2011 Yearbook. His computation resulted in a COE of 12.3%. Finally, Dr. Boquist discussed Mr. Lorton's ultimate recommendation on a rate of return by noting that Mr. Lorton did not add any size or marketability adjustments to his mathematically calculated DCF and CAPM results. Dr. Boquist claimed that if the 140 basis point small size adjustment found appropriate by the Commission in *Boonville Natural Gas*, Cause No. 43342, was added to the results of Mr. Lorton's DCF or CAPM analysis, the result would be a 10.4% ROE.

(ii) Duane C. Mercer

In addition to offering rebuttal testimony to various OUCC proposed accounting adjustments, Petitioner's witness Mercer offered testimony responding to Mr. Lorton's proposed 9% ROE. Mr. Mercer cited, among other matters, Mr. Lorton's recent testimony in the *Westfield Gas* case, Cause No. 43624, where Mr. Lorton proposed a 9.75% ROE for Westfield, but the Commission found a 10.1% ROE would be appropriate. Mr. Mercer said that in the *Westfield Gas* case, Petitioner had no debt and was owned by Citizens Energy, a much more creditworthy entity. Mr. Mercer indicated that Indiana Utilities has debt, is not owned by a larger creditworthy entity, and was not involved in any acquisition adjustment issues reflected in the *Westfield Gas* order. Mr. Mercer next discussed his opinion as to macro-economic trends, noting that he had reviewed numerous recent articles in the *Indianapolis Business Journal* which suggest that home sales are increasing, and bank failures are decreasing. He pointed to a recent speech by the Indiana Governor indicating that unemployment in Indiana has decreased. He described recent meetings with various business leaders in Indiana where those leaders suggested the economy was improving, and noted the equity markets reflected in the Dow Jones Industrial Averages since Mr. Lorton's testimony in the *Westfield Gas* case reflect significantly higher stock prices. Mr. Mercer stated that in his opinion, the economy in Indiana is clearly improving and has improved since Mr. Lorton testified in the *Westfield Gas* case. According to Mr. Mercer, the *Westfield Gas* Order confirms an appropriate return on equity for Indiana Utilities in the instant rate case would be higher than the return previously approved for Westfield Gas.

Next, Mr. Mercer discussed the OUCC's downward adjustment to payroll, focusing initially on the proposed reduction of the President's salary in the revenue requirement. Mr. Mercer pointed out that the President's salary is fixed, known and measurable, and has been reviewed and approved by its Board of Directors. He compared the salary proposed for Petitioner's President to the officer salaries paid by other small utilities. He testified that two REMCs that are contiguous to the Petitioner's service territory and arguably draw from the same population pay their officers more than Petitioner proposed for its President. Second, Mr. Mercer referred to recent, fully litigated small gas utility proceedings, noting that in the case of *Boonville Natural Gas* (Cause No. 43342) and *Lawrenceburg Gas*, (Cause No. 43090), each paid their officers more than Petitioner is proposing to pay here. Since those cases were litigated approximately four years ago, Mr. Mercer concluded the OUCC's downward adjustment to the President's salary lacked reasonable support.

Next, Mr. Mercer discussed the downward payroll adjustment recommended by the OUCC to eliminate bonuses paid during the test year. Mr. Mercer noted that while this Commission reduced bonus pay in Petitioner's last rate case, it also offset such reduction by an increase in base

salaries. Here the OUCC has not offered to offset its proposed reduction by any increase. Mr. Mercer said the test year payroll for Petitioner's employees, used to establish pro forma payroll, was the actual payroll expense Petitioner incurred during the test year. Finally, Mr. Mercer testified Petitioner has now eliminated bonus pay and will only be compensating its employees through base pay, using the total 2011 test year pay plus the 3% increase for 2012. Mr. Mercer expressed his belief that concerns raised by the OUCC were eliminated by Petitioner's actions occurring within the 12 month period following the end of the test year.

Finally, Mr. Mercer turned to the rate case expense adjustment proposed by the OUCC. He testified that an appropriate estimate of rate case expense would include the cost actually incurred from recently litigated natural gas rate cases, not from settled cases. He noted that in *Boonville Natural Gas*, (Cause No. 43342), the company actually incurred rate case expense of $267,961 in a proceeding which was concluded in 2008. He then opined that it is unreasonable to expect the Petitioner in this case to be able to litigate this proceeding utilizing less rate case expense than the cost actually incurred four years ago. As to the amortization of the rate case expense, Mr. Mercer pointed out that this Petitioner has regularly filed rate cases every three or four years. If Petitioner wants to continue offering energy efficiency programs on the terms approved in Cause No. 43995, it will be required to seek further approval from the Commission because of the pilot program nature of approval granted for a limited three-year term in Cause No. 43995. Mr. Mercer concluded that Petitioner will be back before this Commission in three to four years.

(iii) Bonnie J. Mann

The testimony of Petitioner's rebuttal witness Ms. Mann, and Petitioner's Late-Filed Exhibits 1 and 2 confirmed Petitioner accepted a number of the OUCC's operating expense adjustments impacting the pro forma revenue requirement in this case. Ms. Mann testified Petitioner agreed with the OUCC's (i) adjustment for natural gas purchases, (ii) reduction in payroll for two part-time employees; (iii) elimination of the Vice President's cost from the pension costs; (iv) use of the most current IURC fee available at the time of the order; (v) appropriate bad debt expense adjustment; (vi) a miscellaneous expense adjustment; (vii) changes in depreciation based on the updated plant in service; (viii) the methodology for computing various taxes impacted by the final revenue requirement; (ix) the updated plant in service; (x) the methodology for calculating working capital; and (xi) an adjustment to existing long term debt in Petitioner's capital structure.

Ms. Mann's rebuttal testimony also addressed several continuing areas of disagreement between the OUCC and Petitioner concerning adjustments proposed by the OUCC. Regarding the adjustment to the President's salary, Ms. Mann referenced an exhibit prepared by the OUCC (Exhibit GAF-2) and filed in the *Boonville Natural Gas Corporation* rate case, Cause No. 43342. She noted the President's salary in this case is lower than four of the CEOs' salaries for 2006 presented in that exhibit. She noted that since 2006, the President's responsibilities have increased due to pipeline safety requirements, the application of normal temperature adjustment, and various energy efficiency programs. She concluded that the OUCC's downward adjustment of $6,000 is inconsistent with either the duties the President performs or the compensation received by other small gas utility owners.

Ms. Mann testified the OUCC's proposed removal of bonuses from pro forma payroll expense failed to recognize Petitioner paid bonuses to its employees in the test year. Ms. Mann indicated Petitioner decided to increase affected employees' base pay to include amounts previously

paid to them as bonuses. Ms. Mann stated the total compensation Petitioner currently pays its employees is necessary to find and retain employees.

Ms. Mann noted the OUCC and Petitioner used the same methodology to calculate pension expense. She also agreed any amount still shown as a contribution to the pension program for the benefit of Vice President Charles Czeschin should be removed from test year payroll since Charles Czeschin no longer participates in the pension program. According to Ms. Mann, after that agreed adjustment is made, the remaining difference between the OUCC and Petitioner's pension expense adjustments are due to differences in the total payroll expense used to calculate Petitioner's pension contribution. Ms. Mann also agreed with Ms. Poole that the total payroll originally proposed by Petitioner should be adjusted downward due to reductions in hours worked by two part-time employees, with corresponding downward adjustments to pension expense. (*See* Petitioner's Late-Filed Exhibit 2, which provided that calculation.)

Ms. Mann disagreed with the OUCC's reduction of rate case expense and the amortization period the OUCC used. She referred to a fully litigated rate case in Cause No. 43342, which she described as another small gas utility rate case litigated in 2008, with total rate case expense greater than what Petitioner requested in this case. She pointed to another fully litigated small gas utility rate case, Cause No. 43090, in 2007. In that case, the cost of the outside consultants was also higher than proposed for Indiana Utilities and did not include the additional expense of a cost of capital expert, which Petitioner retained for this rate case. Ms. Mann testified it would be unreasonable to assume a current, fully litigated case would now cost less than a case that was fully litigated four or five years ago. In questions from the Bench, as to Petitioner's most current estimate of rate case expense for this particular case, Ms. Mann indicated Petitioner's estimate now exceeds the amount included in its pro forma revenue requirement.

Regarding the correct amortization period, Ms. Mann observed the OUCC's calculations revealed that Petitioner's recent base rate cases have been filed on average every 3.84 years. After describing her participation in Cause No. 43995, Ms. Mann testified she saw nothing to suggest that approval of a decoupling mechanism would double the number of years between Petitioner's future rate cases. In light of the pilot nature of the energy efficiency program approved in Cause No. 43995 and Petitioner's rate case filing history, Ms. Mann expects Petitioner to file its next base rate case within three to four years.

On the issue of Petitioner's consulting fees related to Cause No. 43995, Ms. Mann said Petitioner's revenue requirement request is based on the actual amount invoiced to and paid by Petitioner. Ms. Mann said the OUCC did not question whether Petitioner was billed for and actually paid the amount included in Petitioner's proposed revenue requirement in this rate case. With respect to the issue of amortization, Ms. Mann indicated that her objection to the amortization period for recovery of these expenses is the same as her objection to the amortization period the OUCC proposed for recovery of rate case expense. For the reasons discussed above, Ms. Mann expects Petitioner to file its next base rate case in three to four years, rather than seven.

For purposes of recovering funds for future participation in the energy efficiency program approved in Cause No. 43995 (referred to as "decoupling expense"), Ms. Mann pointed out the OUCC assumed all gas utilities participating in that case would do joint reporting on the results of the approved energy efficiency program; without filing separate company-specific reports. Ms. Mann testified that while some costs will be shared, a number of costs will be individually incurred

by one or more of the small gas utilities. She noted that during the gas energy efficiency proceedings, it was made clear that there should be no cross-subsidization by any one utility's customers for the costs of another utility. Thus Ms. Mann maintained that her original proposal, described as the expected cost for this Petitioner of future information gathering and reports to be filed with the Commission, was correct.

On the issue of deferred taxes, Ms. Mann agreed Petitioner previously proposed a calculation based on the September 30, 2010 audit. The OUCC suggested updating deferred taxes to June 30, 2011, the cut-off date of Petitioner's utility plant in service. While Ms. Mann did not argue against an update, she indicated the update should be through March 31, 2011, the cut-off date for Petitioner's accounting adjustments and capital structure. Ms. Mann also noted any update to deferred taxes should include all components of deferred taxes, including any impacts by unrealized gains on marketable equity securities that were more than the book/tax depreciation differences after September 30, 2010. She testified this, in turn, would mean updating the common equity component of the capital structure. Ms. Mann recalculated the capital structure based on those updates and used that amount in her rebuttal testimony and in Petitioner's Late-Filed Exhibit 2.

(iv) Earl L. Ridlen, III

Petitioner's witness Ridlen offered rebuttal testimony and exhibits concerning London Witte Group's use of engagement letters, and Petitioner's ability to review and request additional information on any invoice. Finally, he described the method used to calculate the updated deferred income tax component of the capital structure. He provided the updated calculation as a late-filed exhibit. He also indicated his colleague, Ms. Mann, used his updated deferred income tax component in her recalculation of Petitioner's capital structure.

(v) Frank Czeschin

In rebuttal, Petitioner's President, Frank Czeschin, opposed the OUCC's payroll adjustments, both as to compensation for utility officers (including his $6,000 annual increase in salary) and bonuses originally budgeted for other employees. Mr. Czeschin said Petitioner's officers' salaries appear to be reasonable when compared to those of other natural gas utilities and other area employers described by witness Mercer. With respect to the issue of bonus compensation, Mr. Czeschin testified that due to the OUCC's opposition to Petitioner's continued inclusion of bonuses in pro forma payroll expense, Petitioner moved all bonus payments into base pay. He confirmed Petitioner will not be paying bonuses on a going forward basis.

Mr. Czeschin addressed the OUCC's concern about not requiring detailed cost estimates or invoices from rate consultants. Mr. Czeschin reported that he regularly reviews invoices and, if he has any questions, he can request additional data from the consultants. He noted this is the same process used for other vendors, including contractors, equipment vendors and even the interstate pipelines that transport Petitioner's natural gas. Mr. Czeschin confirmed Petitioner was aware of the estimated rate case expense before initiating this rate case. He noted the last base rate case for this Petitioner was settled and thus does not provide a reasonable basis to estimate rate case expense in this fully litigated proceeding. Finally, he noted the proposed rate case expense here is less than the actual rate case expense incurred by other similar utilities in litigated rate cases. Based on all

information previously provided, Mr. Czeschin concluded Petitioner's proposed rate case expense is reasonable.

In response to questions from the Bench, Mr. Czeschin acknowledged Petitioner supported an alternative rate design proposal as a way for Petitioner to attempt to avoid losing one of its major customers. He acknowledged the alternative rate design was presented to the OUCC in the document identified in the record as OUCC Redirect Exhibit 1. Mr. Czeschin confirmed Petitioner's plan to include the alternate rate design in compliance filings if approved by the Commission.

(vi) Kerry Heid

Mr. Heid's rebuttal testimony supported the above alternative rate design. However, he disagreed with concerns expressed by OUCC witness Dahlstrom as to the Energy Efficiency Rider and, in particular, the concerns expressed regarding the order granted margins and the order granted margins per customer. Mr. Heid noted the order granted margin and the order granted margin per customer will change as the Commission modifies Petitioner's original proposed revenue requirement. Any future review of those margins will not occur until the SRC has actually been in place for one year. Finally, Mr. Heid testified the SRC for this proceeding would only apply to residential customers and would follow the Commission's Order in Cause No. 43995. In response to questions from the Bench, Mr. Heid prepared and caused to be filed Petitioner's Late-Filed Exhibits 3 and 4. Late-Filed Exhibit 3 reflects the revised revenue requirement after Petitioner accepted a number of the OUCC's adjustments listed above and after the OUCC accepted several of Petitioner's adjustments, allocated as proposed in Petitioner's alternative rate design, marked as OUCC Redirect Exhibit 1. Late-Filed Exhibit 4 provided a hypothetical example of the SRC using the revised revenue requirement for residential customers only, reflecting the results in the event of growth or decline in Petitioner's residential customer base. Finally, in response to questions from the Bench, witness Heid prepared and caused to be filed Late-Filed Exhibit 5, a revised sample tariff intended to resolve any ambiguity in tariff language used in the SRC tariff in Petitioner's case-in-chief.

5. Discussion and Findings.

A. Pro Forma Operating Expenses. Through the pre-filed evidence of record, both direct and rebuttal, evidence developed during the evidentiary hearing, and documents late-filed at our request, the Parties have presented us with a number of disputed issues related to Petitioner's pro forma operating expenses. These issues relate to payroll; pension; rate case expense; recovery of costs associated with Petitioner's participation in Cause No. 43995, which Petitioner referred to as ARP expenses; future costs associated with regulatory filings required under Cause No. 43995, which Petitioner called "decoupling expenses"; and various flow through taxes. We will address each of these disputed issues separately below.

(i) Payroll

Petitioner, through its witnesses Mr. Mercer, Ms. Mann, and Mr. Czeschin, originally requested a $22,583 increase to test year payroll. Petitioner agreed with some of the OUCC's recommended reductions to payroll, and its final requested amount of $17,444 reflects the payroll amount after adjustments.

The OUCC has opposed the request for a $6,000 salary increase for Petitioner's President, Frank Czeschin. The OUCC also objected to Petitioner's request for bonuses to reward employees for future performance. The objection was rooted in the fact that Petitioner has not provided eligibility criteria or employment policies setting standards for when Petitioner might make such bonus payments. After the OUCC filed its testimony in opposition to Petitioner's request for ratepayer-funded bonuses, Petitioner modified its position on rebuttal and removed the request for bonuses, choosing instead to increase the payroll by the same amount.

We find Petitioner's payroll expenses to be reasonable. With respect to the salary of Petitioner's president, we note that the overall salary requested is reasonable in comparison with the salaries of other small gas executive officers. We also agree with Petitioner's treatment of what was initially defined as bonuses. The historical evidence shows that bonuses are in essence part of the overall compensation for employees, and not necessarily a performance incentive. Accordingly, we find that the adjustment to payroll is $17,444.

(ii) Payroll Taxes

The parties disagreed about the appropriate payroll tax adjustment for Petitioner's pro forma payroll expense, but only as a result of their differing positions on the total underlying payroll expense. There is no difference of opinion as to the methodology to be used to calculate payroll taxes. As witness Mann noted, payroll tax adjustments are a flow-through adjustment based on the underlying pro forma payroll. In light of our findings on payroll expense, discussed above, we find that the payroll tax adjustment is $1,334.

(iii) Pension Expense

Petitioner agreed to reduce its pension expense to reflect the removal of Charles Czeschin from its pension program. Petitioner reduced its pro forma pension expense accordingly in Petitioner's Late-Filed Exhibit 1, which included our accepted payroll adjustment. As pension expense is calculated based on payroll expense, we accept Petitioner's proposed $10,819 adjustment to pension expense.

(iv) Rate Case Expense

The OUCC disagreed with Petitioner's proposed rate case expenses, and suggested approval of an amount based on Petitioner's total rate case expense in its last rate case, adjusted for inflation and including an additional allowance for a COE consultant not retained in Petitioner's last rate case. OUCC witness Ms. Heather Poole explained the OUCC's calculation of total rate case expense and the OUCC's decision to use a seven-year amortization period to recover Petitioner's total rate case expense. Petitioner argued that its requested rate case expense is based on its retention of certain experts with whom it had a long-standing relationship.

The Commission recognizes the OUCC's concern regarding rising rate case expenses. However, the contested nature of this proceeding contributed to the high rate case expense. Overall, Petitioner's proposed rate case expenses represent amounts in line with what has been incurred previously for litigated rate cases. We note that some portions of Petitioner's rate case expense,

such as the expert witness fees, should have been better negotiated when the same witnesses are preparing similar or identical testimony for other pending rate cases, which would have lowered the overall rate case expense. However, while we are critical of Petitioner with respect to some aspects of its proposed expenses, we also note that the evidence indicated that Petitioner's actual rate case expense will equal what is in the revenue requirement and may even exceed its initial proposed amount. Accordingly, we accept Petitioner's proposed rate case expense of $251,350.

Under the circumstances, we believe a four-year amortization period balances ratepayer and utility interests. Accordingly, the amortized rate case expense is $62,838, which results in an adjustment increase of $38,917.

(v) ARP Proceedings

Petitioner proposed recovery of consulting costs associated with Cause No. 43995[3], which involved seven other small gas utilities as additional joint petitioners. In the instant case, Petitioner proposed to recover its payments for consultants in Cause No. 43995 over a three-year amortization period. The OUCC's testimony indicates that it does not object to recovery of those costs, but objects to the amortization period used to establish the pro forma annual revenue requirement and to the percentage used to allocate these costs among the Joint Petitioners in Cause No. 43995. The OUCC went on to propose a seven-year amortization period based on its belief that Petitioner should be able to reduce the frequency of future rate cases from one every 3.84 years to one every seven years with full rate decoupling.

With respect to the expenses incurred under Cause No. 43995, we find that Petitioner shall recover the actual costs incurred, as presented in this Cause. As to the amortization period, our Order in Cause No. 43995 authorized a pilot program for three years. Accordingly, we find that a three-year amortization for the costs incurred under Cause No. 43995 to be appropriate, and find Petitioner's ARP expense of $21,300 amortized over three years results in an annual expense of $7,100.

(vi) Decoupling Expense

Petitioner has also proposed to increase its administrative and general expenses by $4,468 annually for future reporting and other regulatory requirements associated with the energy efficiency program approved in Cause No. 43995. The OUCC has recommended reducing that amount by recalculating the potential estimated cost for professional assistance, relying on responses by Petitioner to data requests served on the Petitioner. In rebuttal, Petitioner's witness Ms. Mann stated that while Petitioner will be participating jointly with seven other small gas utilities in reporting to the Commission, that joint participation will not extend to gathering and preparing the information regarding Petitioner's individual participation in the energy efficiency program. As a consequence, there will be both shared and individual costs for program participants. Thus, Petitioner has estimated what its future costs will be and included that amount in its requested revenue requirement.

[3] That proceeding was filed as an alternative regulatory plan; hence the reference to "ARP Proceedings" for this adjustment.

We authorize Petitioner to recover $4,468 in its revenue requirement related to costs associated with the energy efficiency program approved in Cause No. 43995.

(vii) OUCC Accounting Adjustments Accepted by Petitioner

The Petitioner and OUCC have each proposed various adjustments relating to operating revenues and expenses, including natural gas purchased; miscellaneous expenses; bad debts; charitable contributions; insurance expenses; energy efficiency costs currently included in the normal temperature adjustment calculations; postage; depreciation; and the costs of electric, water, and sewer utilities necessary to serve the new storage building included in Petitioner's rate base. Through the direct testimony of OUCC witness Poole and the rebuttal testimony of Petitioner's witness Ms. Mann, along with Ms. Mann's Late-Filed Exhibit 1, Petitioner agreed to accept the OUCC's adjustments to those amounts. We find the OUCC and Petitioner's explanation reasonable and will include the adjustments in Petitioner's revenue requirement in this Cause.

(viii) Taxes

Both the Petitioner and OUCC have proposed adjustments to payroll taxes, property taxes, utility receipts taxes, and federal and state income taxes. The witnesses for both Parties acknowledge the methodology used was the same for all of these taxes. The differences in their respective adjustments relate to the differences in the underlying payroll, property, receipts, or income to which these taxes apply. Since we have made findings concerning payroll and other adjustments above, and will below note our approval of updates to Petitioner's utility plant in service, anticipated receipts, and Petitioner's projected income will be dictated by our final decisions below, we will apply the same methodology that both the OUCC and Petitioner used in the final approved revenue requirement.

B. Rate Base. The Parties have each presented us with evidence on Petitioner's rate base used and useful to provide service to Petitioner's customers. We note that there is no dispute among the Parties as to the used and useful nature of such rate base. Their only difference relates to the original cost of Petitioner's utility plant in service. The OUCC, through its witness Ms. Poole, testified the utility plant in service requires additional updating through the cut-off date of June 30, 2011. The Petitioner, through its witness Ms. Mann, agreed. Based upon the evidence of the Parties, including Petitioner's Late-Filed Exhibit 1, we find that Petitioner's utility plant in service as of June 30, 2011, net of depreciation, is $5,559,124.

Although the Petitioner's President testified to the potential for a higher fair value, based on replacement cost new less depreciated value ("RCNLD") of at least $8,650,000, Petitioner is not requesting approval of any amount other than the depreciated book value, nor did Petitioner present evidence supporting its RCNLD valuation. We note that Petitioner proposed to recover a return based on the depreciated book value of its rate base. For purposes of establishing the revenue requirement for the Petitioner and in keeping with the evidence of both the Petitioner and the OUCC, we will use the depreciated book value of Petitioner's utility plant in service in calculating its rate base in this cause.

The Petitioner and the OUCC disagreed as to the amount of working capital to include in rate base. The disagreement was not related to methodology, but rather the mathematical results

flowing from differences in the parties' pro forma operating expenses. In light of our decisions above as to Petitioner's operating expenses, we find $131,953 in working capital is reasonable. Petitioner also proposed inclusion of materials and supplies in rate base. The OUCC did not oppose that request. We therefore find that $32,693 in materials and supplies should be included in rate base.

Based on the above, we find the rate base of this Petitioner, calculated using its original cost as of June 30, 2011, net of accumulated depreciation, is $5,723,770. We now turn to the calculation of an appropriate return on rate base.

C. Capital Structure. The Petitioner has, through its direct evidence, presented a capital structure of its audited financial information as of September 30, 2010. The OUCC proposed to update Petitioner's capital structure through June 30, 2011, the cut-off date for plant. The update recognizes a reduction in interest cost for existing long term debt and changes to deferred taxes. In rebuttal, Petitioner indicated if the capital structure elements are updated, all elements impacting the capital structure, including all elements impacting deferred taxes, should also be restated, but as of the end of the test year, March 31, 2011. At the hearing, the OUCC modified its testimony to reflect a March 31, 2011 capital structure. We agree that March 31, 2011 should be used as the cut-off date for updating Petitioner's capital structure, and that all elements of Petitioner's capital structure should be updated through the end of the test year.

Based on our findings above, we find that Petitioner's capital structure will include deferred taxes in the amount of $1,028,576 at a zero (0%) cost of capital. Petitioner's existing long term debt balances in the amount of $165,000 should also be included in the capital structure, at a cost of 4.54%. The Parties are in agreement that Petitioner should be authorized to issue new long term debt in the amount of $500,000 and that the cost of such debt is 4.50%. Based upon the evidence, we will include this new long term debt in Petitioner's capital structure. The parties are in agreement as to the amount of customer deposits to be included in the capital structure. Thus we find the evidence supports the inclusion of $66,142 in customer deposits in Petitioner's capital structure at a cost of 6%.

Based on those updates to Petitioner's capital structure, a total of $7,864,531 in common equity should be included in Petitioner's capital structure as of March 31, 2011. We now consider the cost of such equity capital and an appropriate authorized return on equity based on current market conditions.

D. Cost of Capital. Petitioner, through its witness Dr. Boquist, offered evidence both as to the cost of Petitioner's equity capital and the appropriate weighted return. Dr. Boquist first calculated the COE using the mathematical results of his DCF and CAPM analyses. He then made further small utility adjustments to both cost model results to reflect that Petitioner's stock is not publicly traded.

Dr. Boquist's unadjusted DCF analysis reflected costs ranging from 9.38% to 12.37%. His unadjusted CAPM analysis reflected a cost of 7.33%. However, after adjusting his DCF test results for Petitioner's small size, limited marketability, and limited service territory, Dr. Boquist added 100 basis points to the results of his DCF analysis, increasing his estimated DCF COE range to an adjusted range of 10.38% to 13.37%. Dr. Boquist made a 407 basis point adjustment to the results of his CAPM analysis, thereby, increasing his CAPM COE from 7.33% to 11.40%.

Dr. Boquist stated that the basis point difference in the size adjustments to his DCF and CAPM results was based on his knowledge and experience, calculated in a manner he believed to be consistent with recommendations by Ibbotson and Associates. Based on his knowledge and experience, Dr. Boquist recommended a 10.89% return on equity for the Petitioner, in contrast with the 9.0% return recommended by the OUCC.

OUCC witness Mr. Lorton offered evidence as to the cost of Petitioner's equity capital and the appropriate level of return to be authorized for this utility. Mr. Lorton used similar DCF and CAPM analyses, resulting in a DCF result of 9.00% and a CAPM result of 7.63%. Mr. Lorton recommended the higher amount, resulting in a 9.00% COE. Mr. Lorton did not propose any further separate adjustment based on Petitioner's size. His choice of the higher of the two model results already included a 140 basis point increase in his calculated DCF COE. Mr. Lorton did not consider any further small utility adjustment to be necessary.

We agree with Mr. Lorton that Petitioner's proposed 10.89% COE fails to give proper weight to current market conditions or the increased income protection from the combination of Petitioner's NTA[4] and SRC mechanisms. In Cause No. 43180, we investigated natural gas utility rate design alternatives and energy efficiency measures. *In re Investigation on the Commission's Own Motion Into Rate Design Alternatives and Energy Efficiency Measures for Natural Gas Utilities* ("*Commission Investigation*"), Cause No. 43180 (Oct. 21, 2009). In the Order concluding our investigation, we recognized "that decoupling mechanisms clearly shift risk from the utility to ratepayers, and that reduction of risk should be considered in determining the appropriate return on equity of for-profit gas utilities." *Id.* at 10. We acknowledge that the utilities in Dr. Boquist's proxy group utilizied some form of decoupling; but, we also believe that the addition of the SRC mechanism warrants a reduction to Petitioner's current COE. However, we do not believe that Mr. Lorton's recommended 9.00% adequately covers any size-based differential. Accordingly, we find that a 10.10% COE is appropriate for Petitioner at this time.

The following table reflects our findings with respect to the Petitioner's capital structure and the cost of each element of its capital structure:

[4] In 2006, Petitioner and a number of other small gas utilities filed cases requesting the implementation of a normalized temperature adjustment ("NTA") mechanism, to reduce the potential for under-recovery due to warmer than usual weather. The Commission granted the companies' requests. *Indiana Utilities Corp.*, Cause No. 43137 (IURC, Dec. 6, 2006).

Petitioner's Weighted Capital Structure
(as of March 31, 2011)

Description	Amount	Percent of Total	Cost	Weighted Cost
Common Equity	$7,864,531	81.72%	10.10%	8.25%
Customer Deposits	$66,142	0.69%	6.00%	0.04%
Long Term Debt – Existing	$165,000	1.71%	4.54%	0.08%
Long Term Debt – New	$500,000	5.20%	4.50%	0.23%
Deferred Tax	$1,028,576	10.69%	0.00%	0.00%
Total	$9,624,249	100.00%		8.60%

E. **Return on Rate Base.** The Parties have each presented evidence on Petitioner's rate base, used and useful to provide service to Petitioner's customers. Both the Petitioner and the OUCC provided evidence on the original cost of Petitioner's utility plant in service as part of such rate base. Both Parties agreed that Petitioner's depreciated original cost book value should be used as the value of Petitioner's used and useful utility plant in service for purposes of evaluating rate base, and we find that valuation reasonable. Although Petitioner also presented a statement as to what the fair value of Petitioner's utility plant should be based on reproduction cost, Petitioner did not file a RCNLD study and we make no finding as to the fair value based on that limited evidence.

As we noted in our Order in Cause No. 43526, we do not make a fair value determination as an academic pursuit. *Northern Ind. Pub. Serv. Co.*, Cause No. 43526, at 14 (Aug. 25, 2010). Although Ind. Code § 8-1-2-6 requires the Commission to make a fair value determination of a utility's used and useful property, it is incumbent on the utility to present evidence supporting its proposed fair value. In Cause No. 43526, NIPSCO did present fair value evidence, but did not request that we use the fair value for ratemaking purposes, requesting instead that we utilize its original cost evidence. Accordingly, we made a fair value finding, but indicated that the fair value was not being relied on for ratemaking and was explicitly given no weight. Here, Petitioner did not present adequate evidence for the Commission to make a fair value finding, and we decline to do so given that the parties have agreed to use original cost for ratemaking purposes.

We are required to provide rates sufficient to allow a regulated utility to earn a return on rate base, and the parties have proposed that we calculate the return using the weighted cost of capital. Based upon our previous findings as to Petitioner's rate base and weighted cost of capital, we find the Petitioner should be authorized to increase its rates to an amount that is sufficient to allow it an opportunity to earn $492,244 on its investment in rate base, for a 8.60% overall return on rate base.

F. Pro Forma Revenue Requirement. Having considered all evidence of record, the Commission now finds that, based on the foregoing discussion and findings, Petitioner's current rates and charges are insufficient to provide Petitioner appropriate funds to operate its utility and earn a reasonable return on its investment in utility rate base. A summary of our findings above, including revenue requirements that were not in dispute in this cause, are listed below:

Revenue Requirement Elements

Net Original Cost Rate Base	$ 5,723,770
Rate of Return	8.60%
Required Net Operating Income	$ 492,244
Pro Forma Net Operating Income at Present Rates	$ 245,248
Required Increase in Net Operating Income	$ 246,996
Required Revenue Increase	$ 416,895

G. Rate Design. Petitioner originally proposed an across-the-board allocation of the pro forma increase in Petitioner's annual revenue requirement to all of its customer classes. That approach utilized the cost of service allocation currently in effect at present rates. The OUCC disagreed with the proposed increase to customer charges, and expressed concerns about the inability to verify the proposed order granted margins ("OGM") and order granted margins per customer ("OGMPC") under the Petitioner's sales reconciliation component.

Testimony at the evidentiary hearing revealed that the OGM and the OGMPC will be determined by this Order, which will ultimately be used by Petitioner in future SRC filings. Because the parties continue to be actively involved in the gas energy efficiency proceeding in Cause No. 43995, the OUCC will be able to review annual filings by Petitioner and other small gas utilities to confirm the OGM and OGMPC calculations.

After filing its rebuttal testimony, the Petitioner changed its requested rate design and across-the-board rate increase. This change was prompted by one of Petitioner's large industrial customers potentially moving its operations to Kentucky unless the customer's future monthly gas utility bills could be reduced. Petitioner's rate design modification was designed to lessen the impact of the requested rate increase on Petitioner's industrial customer and to retain that customer at its current business location. The revised rate design proposal was provided to the OUCC in an informal discovery response, and entered into evidence at the evidentiary hearing as Public's Redirect Ex. 1. The OUCC indicated that in the absence of a better option, the OUCC could support the proposed rate design change to avoid losing a major customer, because a loss of that magnitude could drive rates even higher for Petitioner's remaining customers.

Petitioner did not offer a cost of service study into evidence, so we are unable to determine how Petitioner's revised proposal affects cost causation principles. The OUCC did indicate through witness Jon Dahlstrom that without a cost of service study there is no analytical support for an increase to the customer charge. However, the OUCC ultimately accepted an increase to Petitioner's customer charges (Public's Redirect Ex. 1). We are troubled by both parties' inconsistent treatment of rate design and cost of service in this proceeding. The basis of an across-the-board increase is to maintain the current relationships between all rate components. Thus we

believe that if an across-the-board increase is ultimately agreed upon, the customer charges should be increased by the same percent as all other rate components. If they were not, a greater proportion of Petitioner's fixed costs would be recovered through the variable distribution charges.

In its proposed order, the OUCC proposes to simply accept an across-the-board increase with the OUCC's lower proposed revenue requirement. However, since we have not adopted several of the OUCC's proposed adjustments, we believe that the best approach to address rate design is to adopt Petitioner's proposed rate design offered through Public's Redirect Ex. 1 and the revenue requirement as approved through this Order.

Although we are approving Petitioner's revised proposal, we note that it is Petitioner's obligation to present evidence to support its rate design. Petitioner did not present adequate justification for not presenting a cost of service study as part of its case. This circumstance is particularly concerning for three reasons. First, during questioning from the bench at the evidentiary hearing, Mr. Heid stated that the last cost of service study performed for Petitioner was in support of its rate case in Cause No. 42426, which Petitioner filed on April 23, 2003. The period of time that has passed since that last cost of service study calls into question whether it is still valid and relevant. Second, the only stated basis provided by Petitioner to support its decision not to perform a new cost of service study in support of this present rate case was its proposal for an across-the-board increase, which as previously discussed, is no longer Petitioner's request. Finally, as Petitioner requested a decoupling mechanism in this proceeding, we remind Petitioner of our discussion in our Order in Cause No. 43180 that "any proposed [decoupling] mechanism must be fair and equitable to all customers," and that the "impacts of decoupling on ratepayers should be analyzed through a rate case with protective measures and conservation alternatives recommended." *Commission Investigation*, at 10. We order that Petitioner must move towards straight-fixed variable rate pricing, consistent with our discussion in our Order in Cause No. 43180, in order to continue implementing a decoupled rate design. This will require Petitioner to file a cost of service study in its next rate proceeding in order to increase the amount of fixed costs recovered through Petitoner's customer charges. With the addition of the SRC to Petitioner's rates, which reduces Petitioner's risk in earning its authorized margins, we believe it is imperative for Petitioner to demonstrate that its rates are cost-based.

H. <u>Long Term Debt</u>. Petitioner has sought authority to increase its long term debt in an amount up to $500,000 for a period of up to five years at a variable interest rate of 4.5%. Petitioner explained its purpose for borrowing funds, the financing alternatives reviewed, basis for the projected interest rate, and how the interest rate will vary with changes in the lender's prime rate. Petitioner has agreed to file additional information concerning the final terms of the new loan within sixty (60) days after the closing date. Petitioner's explanation of the terms of the proposed debt, the purpose of the proposed debt, and its willingness to advise the Commission and the OUCC of any final terms following closing further support the Commission's decision to grant the financing authority requested. Petitioner is authorized to complete its financing transaction and ordered to file the final terms of its new long-term loan with the Commission, with a copy to the OUCC, within sixty (60) days after its loan closing date.

I. <u>Alternative Regulatory Plan - Energy Efficiency Program</u>. The Petitioner and seven other small gas utilities jointly sought and obtained authority from this Commission in Cause No. 43995 to implement an energy efficiency program, with an approved cost recovery mechanism for program costs and an approved rate decoupling mechanism. The Commission

granted this Petitioner and the other seven utilities the authority they requested in Cause No. 43995 on November 30, 2011, subject only to their subsequent filing of a base rate case and implementation of new base rates approved therein. With this Order, the Petitioner has now completed its base rate case. Accordingly, it is appropriate for the Petitioner to begin implementing the new, previously approved energy efficiency program, and the accompanying program funding and rate decoupling mechanisms. In this proceeding, Petitioner requested authority to establish an Energy Efficiency Rider which would include an energy efficiency funding component applied to all of Petitioner's residential customers, in the initial amount of $0.83 per residential customer per month. No energy efficiency funding component will be applied to any non-residential customers. Based on our findings in Cause No. 43995 and the evidence in this case, we find such a funding component for energy efficiency program cost recovery fair and reasonable for this Petitioner.

Petitioner seeks authority to implement the SRC decoupling mechanism approved in Cause No. 43995, which Petitioner plans to recover through the same Energy Efficiency Rider used to recover program costs. That Energy Efficiency Rider would only apply to Petitioner's residential customers. The purpose of the SRC is to allow the Petitioner to decouple its operating margins from usage to eliminate financial risks that might block the implementation and continued offering of effective gas energy efficiency programs. Petitioner's witness Mr. Heid indicated that Appendix F in Petitioner's rebuttal case and Petitioner's Exhibit KAH-R2, further described in Petitioner's Late-Filed Exhibit 5, introduce the appropriate method for Petitioner to implement the SRC by tariff. Based on the evidence of record, we agree that Petitioner should be authorized to implement its proposed SRC and that Petitioner's Appendix F, which includes both an appropriate energy efficiency funding component and an appropriate sales reconciliation component, should be approved, in accordance with the Commission's Order in Cause No. 43995 and other applicable law. As we noted in our investigation in Cause No. 43180, we encourage utilities to continue to move toward straight-fixed variable rate design, and the implantation of the SRC is a step in that direction.

J. <u>Alternative Regulatory Plan-Main Extension Calculation</u>. Petitioner's witnesses Mr. Czeschin and Mr. Mercer proposed an alternative regulatory plan to change the method of calculation for main extensions. Currently, Rule 10 in Petitioner's tariff provides for free main extensions if the cost of such extension is equal to or less than the total revenue expected to be recovered from Petitioner's new customers who hook into the new main extension over a three-year period. Petitioner has proposed a change that would use decoupled margins, or operating margins, over a six-year period for purposes of such calculation. Mr. Czeschin and Mr. Mercer testified that only the operating margin revenue provides Petitioner funds to cover the cost to build main extensions. The evidence reveals that the amount of time necessary to begin to recover its investment in such extensions is much longer than six years, but the six year time period is a reasonable change at this time. The OUCC witness Mr. Dahlstrom indicated that it had reviewed Petitioner's proposal and did not oppose this proposed change. In light of the evidence, we authorize Petitioner to implement its revised Rule 10 after a copy of the revised Rule has been filed with the Commission's Gas Division, and a copy served on the OUCC.

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

1. Petitioner is hereby authorized to increase its rates and charges in accordance with our findings in paragraph 5F above, in order to produce an additional $416,895 in annual revenue beyond that provided by its current rates and charges.

2. Petitioner is authorized to implement the Energy Efficiency Program we previously approved in Cause No. 43995, including the recovery of Petitioner's share of joint energy efficiency program costs and SRC recovery, subject to the terms of our final Order in Cause No. 43995 and in accordance with our findings in paragraph 5I of this Order. Petitioner shall file a cost of service study in its next base rate case.

3. Petitioner is authorized to implement the alternative regulatory plan for main extension cost recovery in accordance with our findings in paragraph 5J above.

4. Petitioner shall file with the Commission under this Cause, prior to placing into effect the rates and charges and Terms and Conditions for Gas Service authorized herein, tariff schedules set out in accordance with the Commission's rules for filing utility tariffs. Said tariffs, when filed by Petitioner and upon approval by the Commission's Natural Gas Division, shall cancel all present and prior rates and charges concurrently when said rates and charges herein are approved are placed into effect by Petitioner. Along with the tariff, Petitioner shall file a derivation of rates based on the approved revenue requirement in paragraph 5F which shall include an OGM and OGMPC calculation.

5. Petitioner is authorized to issue long term debt in the amount and on the terms found in paragraph 5H above. Following the closing on such debt issuance, the Petitioner shall make a compliance filing with the Commission, under this Cause, concerning the final terms of such loan within sixty (60) days after closing consistent with our findings in paragraph 5H above.

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

ATTERHOLT, BENNETT, LANDIS, MAYS AND ZIEGNER CONCUR:

APPROVED: SEP 05 2012

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

Brenda A. Howe

Brenda A. Howe
Secretary to the Commission