ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF INDIANA-AMERICAN WATER COMPANY, INC. FOR APPROVAL OF NEW DEPRECIATION ACCRUAL RATES TO BE APPLICABLE TO ITS WATER AND WASTEWATER UTILITY PLANT IN SERVICE.	))))))	**CAUSE NO. 44992** **APPROVED:** MAY 30 2018

ORDER OF THE COMMISSION

Presiding Officers:
James F. Huston, Chairman
Lora L. Manion, Administrative Law Judge

On October 6, 2017, Indiana-American Water Company, Inc. ("Indiana-American" or "Petitioner" or "Company") filed with the Indiana Utility Regulatory Commission ("Commission") its Petition for approval of new depreciation accrual rates to be applicable to its water and wastewater utility plant in service ("UPIS"). On October 6, 2017, Petitioner also prefiled its case-in-chief, which consisted of the testimony and attachments of John J. Spanos, Senior Vice President of Gannett Fleming Valuation and Rate Consultants, LLC, and Gary M. VerDouw, Director Rates and Regulatory of American Water Works Service Company, a related company to Petitioner. On January 12, 2018, Petitioner submitted the supplemental testimony of Mr. Spanos.

On January 19, 2018, the Indiana Office of the Utility Consumer Counselor ("OUCC") filed its case-in-chief, including the prefiled testimony of William Dunkel, the principal of William Dunkel and Associates.

On February 2, 2018, Petitioner filed the rebuttal testimony and attachments of Mr. Spanos. On February 19, 2018, Petitioner filed a correction to the rebuttal testimony of Mr. Spanos. On February 26, 2018, Petitioner filed corrections to direct testimony and attachment of Mr. VerDouw.

On February 26, 2018, the Presiding Officers through a docket entry asked Petitioner and OUCC questions regarding this Cause. Petitioner and OUCC responded in filings. To the extent necessary for our Order in this Cause, we take administrative notice of Petitioner's and OUCC's responses.

The Commission conducted a public hearing in this Cause on February 27, 2018, at 10:30 a.m., in Room 224 of the PNC Center, 101 West Washington Street, Indianapolis, Indiana. Petitioner and OUCC offered prefiled testimony and attachments that were admitted into evidence without objection.

On March 26, 2018, the Commission granted administrative notice of an Oklahoma Corporation Commission Order dated January 31, 2018, as requested by the OUCC, and the Commission admitted the Oklahoma Order into the record of this Cause.[1]

Based upon the applicable law and the evidence of record, the Commission now finds:

1. **Notice and Jurisdiction.** Notice of the hearing in this Cause was given as required by law. Petitioner is a "public utility" within the meaning of Ind. Code § 8-1-2-1(a) and is subject to the jurisdiction of the Commission. The Commission has jurisdiction over rates and charges for utility service, including the determination of proper and adequate rates of depreciation of the several classes of property of each utility under Ind. Code § 8-1-2-19. Thus, the Commission has jurisdiction over Petitioner and the subject matter of this Cause.

2. **Petitioner's Characteristics.** Petitioner is an Indiana corporation engaged in the business of rendering water utility service to customers in numerous municipalities and counties throughout the State of Indiana for residential, commercial, industrial, public authority, sale for resale, and public and private fire protection purposes. Petitioner also provides wastewater utility service in Wabash and Delaware Counties.

3. **Background and Relief Requested.** In this proceeding, Petitioner seeks approval of a change in depreciation accrual rates made effective upon the Commission's approval of general rates in a case Petitioner testified that it plans to file in mid-2018. The current depreciation rates were approved in Cause No. 43081 and made effective upon the Commission's October 10, 2007 Order in Cause No. 43187, regarding general rates. *Indiana-American Water Co.,* Cause No. 43081, 2006 WL 3877352 (IURC Nov. 21, 2006). *Indiana-American Water Co.,* Cause No. 43187, 2007 WL 2990124 (IURC Oct. 10, 2007).

4. **Petitioner's Evidence.** Mr. Spanos, Senior Vice President of Gannett Fleming Valuation and Rate Consultants, LLC, testified regarding his depreciation studies and his recommended depreciation rates. Mr. Spanos quoted the definition of depreciation as follows:

> "Depreciation," as applied to depreciable utility plant, means the loss in service value not restored by current maintenance, incurred in connection with the consumption or prospective retirement of utility plant in the course of service from causes which are known to be in current operation and against which the utility is not protected by insurance. Among the causes to be given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand and requirements of public authorities.

National Association of Regulatory Utility Commissioners, Uniform System of Accounts for Class A Water Utilities (1996) (definition reflects Mr. Spanos's rebuttal testimony).

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[1] The OUCC represented to the Presiding Officers in the evidentiary hearing and in a subsequently filed motion that they were offering the Oklahoma Order because it involves the same witnesses and provides some support and evidence behind the positions presented in this Cause. However, in the OUCC's proposed order, they did not use the Oklahoma Order for the purpose they represented. We urge the OUCC to be circumspect in all representations to the Presiding Officers.

Mr. Spanos testified that he used the straight-line remaining-life method of depreciation with average-service life to develop recommended depreciation accrual rates. He testified that total annual depreciation is based on a system of depreciation accounting that aims to distribute the cost of fixed capital assets over the estimated useful life of the unit or group of assets in a systematic and rational matter. Mr. Spanos testified that his determination of annual depreciation accrual rates consists of two phases. In the first phase, he used service life and net salvage characteristics, which he estimated for each depreciable group. In the second phase, he calculated annual depreciation accrual rates for each group, using the straight-line remaining-life method and average-service life procedure.

Mr. Spanos explained that his calculations of service life and net salvage factor used compiled historical data from Petitioner's plant records. Mr. Spanos explained that he analyzed the data to obtain historical trends of survivor and salvage characteristics. He obtained supplementary information from management and operating personnel about Petitioner's practices and plans related to plant operations. He interpreted all of this data, and he formed judgments regarding average-service life and net salvage characteristics. Mr. Spanos testified that he used the straight-line method of amortization to develop proposed depreciation rates for the following UPIS accounts: General Plant Accounts 340.1, 340.21, 340.22, 340.23, 340.3, 340.31, 340.32, 340.33, 340.35, 340.5, 342, 343, 344, 346, and 347 for water assets; and Accounts 394, 396, and 397 for wastewater assets.

To illustrate how he conducted his evaluation, Mr. Spanos used the analysis for Account No. 331.01 Water Mains ("Mains"). It is the largest depreciable mass (group) account and represents approximately 42% of depreciable plant. Mr. Spanos used the retirement method to analyze the survivor characteristics of Mains and found based on life tables, the survivor curve was 105-R2. Thus, when determining the depreciation rate, Mr. Spanos used 105 years. Mr. Spanos looked at the annual gross salvage minus the cost to remove plant assets as compared to the original cost of plant during 1975 through 2016. Based on the data provided by Petitioner for the 42-year period, the net salvage factor was -79%. The formula for the calculation of "net salvage factor" follows: [2]

$$\text{Net Salvage Factor} = \frac{\text{Annual Gross Salvage} - \text{Cost to Remove Assets}}{\text{Original Cost of Plant Retired}}$$

$$-79\% = \frac{\$1,493,141 - \$12,599,235}{\$14,014,469}$$

However, Mr. Spanos testified that recent trends indicate a net salvage factor of -75%, and Mr. Spanos determined that based on industry ranges, historical indications, and Petitioner's expectations, the appropriate net salvage factor for Mains is -75%.

Mr. VerDouw, Director Rates and Regulatory of American Water Works Service, testified that it has been more than 10 years since Petitioner had a depreciation study performed. The current depreciation rates became effective on October 10, 2007. The current study is based

[2] Several similar phrases were used interchangeably by the parties to mean "net salvage factor." To avoid confusion, the Commission uniformly uses "net salvage factor" throughout this Order to refer to the term defined herein.

on Petitioner's UPIS as of December 31, 2016. Mr.VerDouw testified that Petitioner proposes a five-year unrecovered reserve for amortization of certain assets in the following National Association of Regulatory Utility Commissioners ("NARUC") plant accounts: water Account No. 340.0 and certain assets in wastewater Account No. 390.0. He testified that the recommended amortization for each year of a five-year period lowers depreciation expense $1,957,117 for water and increases depreciation expense $722 for wastewater.

Mr. VerDouw, in his corrected direct testimony, stated that the proposed rates will decrease depreciation expense for water UPIS $6,582,486 annually for the first five years the rates are in effect, as compared to the current rates and water UPIS as of December 31, 2016. After the five-year period, depreciation expense for water UPIS will decrease $4,625,369 annually. This variation is due to the completion of the five-year unrecovered reserve amortization.

Mr. VerDouw testified that the proposed rates will increase depreciation expense for wastewater UPIS $34,570 annually for the first five years the rates are in effect, as compared to the current rates and wastewater UPIS as of December 31, 2016. After the five-year period, depreciation expense for wastewater UPIS will increase $33,848 annually. This variation is due to the completion of the five-year unrecovered reserve amortization.

Mr. VerDouw testified regarding Petitioner's request that the proposed depreciation accrual rates become effective to coincide with the Commission's Order in Petitioner's next rate case that approves new rates and charges. Mr. VerDouw testified that Petitioner plans to file its next general rate case in mid-2018. He testified that assuming a 300-day approval process for the rate case, the depreciation accrual rates approved in this Cause would become effective during the second quarter of 2019.

5. OUCC's Evidence. Mr. William Dunkel, Principal of William Dunkel and Associates, testified on behalf of OUCC. Mr. Dunkel testified that he agrees with Mr. Spanos's proposed depreciation rates for nearly all water and wastewater accounts; however, he does not agree with Mr. Spanos's proposed net salvage factor, embedded in the depreciation rate, for Mains. Mr. Dunkel also testified that he does not agree with Petitioner's characterization of "unrecovered reserve," preferring to call it "over-recovered reserve." Mr. Dunkel testified that he agrees with Mr. Spanos's revised recommendation of a 40-year average service life for Account 334.30 Meter Vaults.

For Mains, Mr. Dunkel testified that he recommends that the Commission approve the continuation of the current -35% for net salvage factor. He said that Petitioner actually incurs a net salvage of $897,010 per year based on the most current three-year average, but the Mains net salvage annual accrual Mr. Spanos proposes is $4,688,343. Mr. Dunkel said that his proposed net salvage factor will produce an accrual of $2,080,263. Mr. Dunkel divided the accrual of $2,080,263 by the average net salvage of $897,010 per year to find a ratio (or multiplier) of 2.3. Mr. Dunkel divided Mr. Spanos's accrual of $4,688,343 by the average net salvage of $897,010 per year to find a ratio of 5.2. Mr. Dunkel indicates Indiana-American should not be allowed to charge ratepayers $4.6 million per year for net salvage when the actual net salvage averages less than $0.9 million. He also considers that $2,080,263 is generous when comparing it to $897,010.

In comparison, Mr. Dunkel states that the second largest account, Account No. 333.00 Services, yields a ratio of 1.9 using Mr. Spanos's results.

Mr. Dunkel also testified that he disagrees with how Mr. Spanos calculated net salvage factor for Mains. He testified that Mr. Spanos's net salvage calculation uses different units in the numerator and denominator. He testified that Mr. Spanos should have converted both the numerator and denominator to constant dollars. But Mr. Spanos did not do that. Mr. Dunkel referenced a page from Wolf and Fitch's text *Depreciation Systems*. He testified that Wolf and Fitch write that the first step in salvage analysis is to convert the observed dollars to constant dollars.[3]

Mr. Dunkel testified that he disagrees with Mr. Spanos's and Mr. Verdouw's characterizations of "unrecovered reserve." Mr. Dunkel stated that there is a $9,785,585 reserve surplus for certain accounts, and he considers that an "over-recovered reserve." Mr. Dunkel testified that Petitioner proposes to use this credit to return $9.8 million in over-collection to its ratepayers over five years, and he does not object to this credit. Mr. Dunkel concluded that this surplus shows that the past depreciation rates in retrospect were too high and created a reserve surplus.

Finally, Mr. Dunkel concluded that he supports Petitioner's recommendations for nearly all water and wastewater accounts, except he recommends that the Commission approve his proposed net salvage factor of -35% for Mains and reject Petitioner's proposed -75%.

6. **Petitioner's Rebuttal.** Mr. Spanos testified that the remaining issue in dispute with the OUCC is the net salvage factor component of the depreciation rate for Mains. Mr. Spanos testified that net salvage (amount) in depreciation is gross salvage less cost of removal. Gross salvage is the scrap or reuse value of a retired asset. There is also a cost to retire the asset, such as the cost to cut, remove, and retire pipe from the ground. Mr. Spanos explained that most types of utility property typically experience negative net salvage, meaning the cost of removal exceeds gross salvage.

Mr. Spanos indicated the relationship between actual net salvage costs and annual accrual for net salvage is complex and dependent on a number of factors, including the age of assets in an account, the account's survivor characteristics, and past and future levels of changes in unit costs. Mr. Spanos stated that annual accrual for net salvage should not be expected to be the same as or similar to recent actual net salvage costs or some arbitrary multiple higher than recent actual net salvage costs.

Mr. Spanos testified that Mr. Dunkel's methodology for calculating net salvage factor for Mains is not systematic and rational, as required by the Uniform System of Accounts. Mr. Spanos testified that Mr. Dunkel arbitrarily determined net salvage factor by multiplying recent net salvage costs by 2.3. Mr. Spanos testified that Mr. Dunkel did not provide support or justification for the multiplier. Mr. Spanos testified that Mr. Dunkel uses different arbitrary multipliers in other cases, thus the approach is not a systematic or rational approach to determine

[3] Frank K. Wolf & W. Chester Fitch, *Depreciation Systems*, 61, Iowa State Univ. Press (1994).

net salvage factor. Mr. Spanos theorized that Mr. Dunkel appears to have based his selection of the multiplier to achieve a desired result and not based on an effort to accrue properly for future net salvage.

Mr. Spanos contended that Mr. Dunkel's proposal is based on the incorrect premise that future annual depreciation accruals for net salvage will be the same as recent past net salvage costs. Mr. Spanos testified that real world net salvage accruals are mostly higher than recent net salvage costs. Mr. Spanos testified that Mr. Dunkel's approach is not a reasonable basis for estimating future net salvage because it does not consider the number of assets that were retired over the same period. Mr. Spanos testified that basing the net salvage factor on amounts of net salvage recorded in recent years is not a reasonable basis to establish an estimate of future net salvage.

Mr. Spanos further explained that net salvage factor is intended to recover future net salvage, not what has been recorded in recent years. Mr. Spanos testified that his methodology determines the correct future net salvage and properly allocates the net salvage over the lives of the assets. By properly recognizing the relationship of net salvage to retirements, Mr. Spanos said his method recognizes that retirements do not occur at the same level each year. Mr. Spanos said that his method provides a reasonable basis for the estimation of future net salvage and Mr. Dunkel's method fails to recognize that in the future the amount of plant retired in a given historical year will change over time.

Mr. Spanos testified that he incorporates in his calculations the analysis of historical net salvage expressed as a percentage of the original cost of historical retirements. Mr. Spanos testified that he uses this data according to the industry standard method to estimate net salvage. Mr. Spanos testified that the industry standard method of estimating net salvage, the traditional method, properly recognizes that net salvage in a given year is a function of how many assets are actually retired. Mr. Spanos also testified that the industry standard method is to incorporate the analysis of historical net salvage expressed as a percentage of the original cost of historical retirements, not to analyze the absolute dollar amounts as Mr. Dunkel does. The traditional method expresses historical net salvage as a percentage of historical retirements. However, Mr. Dunkel's method is not a widely accepted practice, and it fails to account for the fact that net salvage will vary from year-to-year as a result of the number of assets retired in a given year. Mr. Spanos testified that Mr. Dunkel's proposal is a variation of what is referred to as a normalized expense method. Mr. Spanos said that method was previously rejected by the Commission in Cause No. 43259. *PSI Energy, Inc.*, 2004 WL 1493966, at 71-72 (IURC May 18, 2004).

Mr. Spanos responded to Mr. Dunkel's testimony regarding Petitioner's practice of retiring the vast majority of Mains in place. Mr. Spanos testified that there is a cost to retire an asset. For example, the retirement of a water main typically requires a multiple person crew and heavy equipment to remove and retire the pipe from the ground and cut the pipe for disposal. Mr. Spanos testified that there may be disposal costs for the pipe also. Mr. Spanos explained that all of the costs associated with retirement are costs of removal. Mr. Spanos testified that most types of utility property typically experience negative net salvage, meaning that the cost of removal exceeds gross salvage. Mr. Spanos testified that this is true of many of Petitioner's assets.

Mr. Spanos testified that two widely cited preeminent depreciation texts support his calculation methodology and not Mr. Dunkel's calculation methodology. The texts are NARUC's *Public Utility Depreciation Practices* and *Depreciation Systems* by Wolf and Fitch.[4] Mr. Spanos explained that Mr. Dunkel presented quotes from *Public Utility Depreciation Practices* on pages 16 and 18 of his testimony, and Mr. Dunkel stated that he followed NARUC's guidance. However, Mr. Spanos testified that Mr. Dunkel did not actually perform the analysis described by NARUC, which is the traditional method of analysis Mr. Spanos used. Mr. Spanos further testified that NARUC explains that net salvage factor is expressed as a percentage of plant retired by dividing the dollars of net salvage by the dollars of original cost of plant retired. Mr. Spanos explained that he used that NARUC method, but Mr. Dunkel did not use that method. Mr. Spanos testified that the traditional method is a longstanding, widely-accepted practice, and it is supported by depreciation textbooks.

Mr. Spanos responded to Mr. Dunkel's testimony that Mr. Spanos should have converted both the numerator and denominator to constant dollars on Mains. Mr. Spanos said that Mr. Dunkel's representation of Wolf and Fitch in *Depreciation Systems* is fundamentally incorrect. Mr. Spanos provided the following quote from Wolf and Fitch: "A first step in salvage analysis is to convert the observed dollars to constant dollars. Then the constant dollar salvage curves can be examined and fit to a model."[5] Mr. Spanos testified that it should be obvious from that text that the conversion to constant dollars is only the first step in the analysis, and not the end result, as Mr. Dunkel implies. Mr. Spanos said that Mr. Dunkel used that passage to imply that the authors also require inflation to be removed from net salvage estimates. Mr. Spanos testified that Mr. Dunkel's statement is incorrect, and the authors support the opposite. Mr. Spanos testified that it should be clear that additional steps are required as the authors wrote that constant dollar salvage curves can be examined and fit to a model. Mr. Spanos testified that Wolf and Fitch recommend using an inflation index to develop future net salvage at the price level at the anticipated time of retirement.[6]

In response to Mr. Dunkel's criticism of characterizations regarding "unrecovered reserve," Mr. Spanos testified that his intent was not to imply whether the reserve for these specific accounts was over or under recovered, but to state that there are amounts to be recovered. These amounts could be positive or negative values. Further, Mr. Spanos testified that the unrecovered reserve adjustment applies only to the general plant accounts, which are a small percentage of UPIS. Mr. Spanos testified that Mr. Dunkel seems to draw a conclusion from the amounts for these specific accounts as to the book reserve position of the entire Company. Mr. Spanos testified that Mr. Dunkel's conclusion on this matter would not necessarily be accurate.

7. **Commission Discussion and Findings.** Depreciation allows utilities to recover the original cost of assets that are used and useful in providing service at a level that spreads recovery of the cost over the estimated lives of the assets. Generally, depreciation expense is determined by multiplying the original cost of specific utility plant or a plant group by a depreciation rate. The depreciation rate is determined using the service life and application of a

[4] NARUC, *Public Utility Depreciation Practices*, The Association (1996).

[5] *Depreciation Systems,* at 61.

[6] *Id.* at 267.

net salvage factor to a specific utility plant or a plant group.

The Commission has the responsibility pursuant to Ind. Code § 8-1-2-19 to ascertain and determine the proper and adequate rates of depreciation of the several classes of property of each public utility. Petitioner seeks a change in its depreciation accrual rates, and Petitioner submitted a depreciation study performed for the utility that serves as the basis for the requested change in depreciation accrual rates.

The Commission is presented with two options to determine the appropriate depreciation expense for Petitioner's water and wastewater plant: (1) Accept nearly all of Petitioner's proposed depreciation rates, and accept the OUCC's proposed net salvage factor of -35% for Mains, rejecting Petitioner's proposed net salvage factor of -75%; or (2) Accept Petitioner's proposed depreciation rates. The key issues are whether the underlying assumptions and methodology in Petitioner's depreciation study and OUCC's recommendation are reasonable to produce depreciation expense rates that are proper and adequate. In considering the underlying assumptions, we will consider historical retirements for Mains, the use of a multiplier by the OUCC, the ultimately proposed net salvage factors, inflation assumptions, and use of constant dollars. Finally, while not disputed, the Commission also addresses whether Petitioner's proposed credit to customers is appropriate.

Mr. Dunkel did not perform a robust depreciation study on behalf of the OUCC; Mr. Dunkel recommends approval of Mr. Spanos's study, except as it concerns the net salvage factor for Mains. Mr. Dunkel selected the net salvage factor of -35% from Cause No. 43081 as the appropriate net salvage factor for Mains in this Cause. *Indiana-American Water Co.,* 2006 WL 3877352. To justify the -35%, he performed several calculations. Using -35% in the formula, he obtained a total accrual amount of $8,023,872. Then he used -35% to perform another calculation to obtain an accrual for net salvage of $2,080,263. Finally, he divided the accrual for net salvage by the three-year average actual net salvage value of $897,010 to obtain a multiplier of 2.3. Mr. Dunkel indicated that his 2.3 multiplier is more reasonable than the 5.2 multiplier that Mr. Dunkel imputed from Mr. Spanos's data.

The basis offered by Mr. Dunkel in his case-in-chief for rejecting Mr. Spanos's calculation of net salvage factor for Mains was his comparison of accrued net salvage to historical actual costs for removal. Mr. Dunkel testified that Mr. Spanos's net salvage factor is too high and does not take into consideration that the vast majority of mains are retired in place. Mr. Dunkel implied that his use of average historical retirements is a more accurate approach. However, in response to the Commission's docket entry, Petitioner explained that costs are still incurred when a main is retired in place. Petitioner indicated that even when a retired main is not removed, the retired main is still physically cut and disconnected from the active main. The disconnected main is also capped and plugged to prevent soil and backfill from subsequently filling it. Petitioner indicated to complete these tasks, a multi-person crew is required to use heavy equipment, and Petitioner incurs costs associated with these tasks.

Regarding Mr. Dunkel's use of actual net salvage expense for the past three years in his calculations, Mr. Spanos contended that Mr. Dunkel assumes that future annual depreciation accruals for net salvage will be the same as recent net salvage expenses. We note that Mr. Dunkel did not provide evidence to show that future retirements are expected to be similar to

recent retirements to indicate that this is a rational assumption. Additionally, Mr. Dunkel did not offer testimony to show that three years is a reasonable number of years to use. Mr. Dunkel's use of actual net salvage expense for the past three years is not supported by the evidence. Mr. Spanos concluded that Mr. Dunkel's methodology to calculate net salvage factor is not systematic and rational as required by NARUC's Uniform System of Accounts, and we agree.

Although Mr. Dunkel expressed concern regarding the actual costs of retirements, Mr. Spanos indicated that Mr. Dunkel's approach does not actually take proper consideration of historical retirements. By using -35%, we would ignore the past eleven years of data, and that would create intergenerational inequities. Mr. Spanos's study takes into consideration the retirements that have occurred since the last depreciation study and the projected remaining lives of the plant. However, by arbitrarily selecting a net salvage factor for Mains, Mr. Dunkel does not take into consideration this historical data. Based on our consideration of the evidence presented, the Commission also finds that Mr. Dunkel's use of actual net salvage expense for the past three years is not reasonable because it would tend to create intergenerational inequities.

Regarding Mr. Dunkel's use of the multiplier of 2.3 in his formula, Mr. Dunkel did not provide detailed testimony explaining why he chose a multiplier of 2.3 and not a different multiplier. Mr. Dunkel did not provide testimony that 2.3 is the result of a statistical study or some other analysis. Mr. Spanos concluded that Mr. Dunkel set his net salvage depreciation accrual amounts to be an arbitrary multiple of 2.3 times higher than recent net salvage costs. We find that the evidence fails to provide a reasonable basis for Mr. Dunkel's use of the multiplier of 2.3.

Regarding Mr. Dunkel's ultimately proposed net salvage factor of -35%, Mr. Dunkel provided minimal justification. He said that -35% was the same net salvage factor approved in 2006 in previous Cause No. 43081. *Indiana-American Water Co.*, 2006 WL 3877352. We find this explanation is insufficient to demonstrate why it is a proper and adequate net salvage factor for the Commission to approve in this Cause. Net salvage factor for Mains was one of the issues in dispute in that Cause, and the ultimate net salvage factor of -35% was a product of compromise as noted in the Settlement and Stipulation Agreement. Pet. Admin. Notice Ex. 1. To argue that we should continue to use the agreed upon net salvage factor from that Cause because the OUCC's witness is dissatisfied with the analysis presented in this Cause does not provide a rational basis for determining the appropriate net salvage factor.

In summary, upon review of the evidence in this Cause, including passages from the NARUC's *Public Utility Depreciation Practices* and *Depreciation Systems* by Wolf and Fitch, the Commission finds inadequate support for Mr. Dunkel's proposed net salvage factor. Therefore, the Commission rejects Mr. Dunkel's proposed -35% net salvage factor for Mains.

Mr. Spanos performed and submitted a robust depreciation study on behalf of Petitioner, and he proposed a net salvage factor of -75% for Mains. Mr. Spanos testified that he used the method for computing net salvage factor that is accepted in the industry and by the Commission. Mr. Spanos also testified that his method is consistent with the instruction of NARUC.

Mr. Dunkel disagrees with Mr. Spanos's assumption in his depreciation study regarding inflation. Mr. Dunkel testified that Mr. Spanos's calculation is wrong because he effectively

assumes future inflation will be the same as past inflation. However, Mr. Spanos's calculation includes inflation that occurred during the lifetime of the asset, including periods of high and low inflation. Mr. Spanos testified that Wolf and Fitch recommend using an inflation index to develop future net salvage at the price level at the anticipated time of retirement. We have repeatedly rejected attempts to eliminate or curtail the effects of future inflation when calculating net salvage. We find that Mr. Spanos's approach regarding inflation is reasonable and consistent with our past discussion. *PSI Energy Inc.,* 2004 WL 1493966, at 71.

Mr. Dunkel also disagrees with Mr. Spanos's use of constant dollars. Mr. Dunkel testified that according to Wolf and Fitch Mr. Spanos should have converted both the numerator and denominator to constant dollars on Mains. In response, Mr. Spanos testified that Mr. Dunkel's representation of his calculation is inaccurate and the conversion to constant dollars was only a first step in his analysis. We believe that Mr. Dunkel did not consider all of the steps in Mr. Spanos's calculation, and he seems to have misunderstood the calculation. Upon consideration of the evidence, we find that Mr. Spanos's treatment of constant dollars is reasonable and it is consistent with the industry standard approach.

Mr. Spanos proposes changes in depreciation rates in part due to past methodologies, approved rates, and past service life characteristics. Mr. Spanos explains that his service life estimates are based on judgment that considers the statistical analysis of data, Petitioner's policies, a field review of plant, discussions with management regarding acquisitions and retirements, and survivor curve estimates from previous studies of Petitioner and of other water utilities. As expected, the service lives of specific plant accounts can change as the factors upon which the final judgment change. Adjustments to depreciation rates were proposed based on the characteristics of UPIS as of December 31, 2016. The Commission understands that the determination of net salvage factor, while based on data, is also based on an expert's judgment. We note that Mr. Spanos has used a reasonable approach based on a thorough study and his judgment to develop recommended depreciation rates, including the embedded net salvage factor for Mains.

Upon consideration of the evidence, the Commission approves Petitioner's use of net salvage factor of -75% for Mains. We find that Mr. Spanos's proposed depreciation accrual rates for water as modified by his supplemental direct testimony are approved. Pet. Ex. 3, Attach. JJS-3. As there was no dispute, we find that Mr. Spanos's proposed rates for wastewater set forth in his direct testimony are approved. Pet. Ex. 2, Attach. JJS-2. Both of those sets of rates are further set forth in Pet. Ex. 1, Attach. GMV-1 (corrected by Petitioner on February 26, 2018).

Finally, Petitioner proposed a $9.875 million credit to customers over five years to account for what Petitioner has called "unrecovered reserve." The Commission notes that Mr. Dunkel criticized the labeling of the credit and preferred to call the credit "over-recovered reserve." Setting aside the label, there is no dispute regarding the appropriateness of Petitioner's proposed adjustment. In Petitioner's February 26, 2018 Docket Entry response, Petitioner provided support for their proposal to provide a credit to customers on a going-forward basis. Petitioner explained that the underlying change was due to an implementation of general plant amortization, allowing for more stable depreciation expense per asset. Petitioner included the over accrual in their general account groups of $9.786 million as an offset to Petitioner's accrual amount. Pet. Ex. 2, Attach. JJS-1, at 54. Petitioner proposes a reduction to its accrual amount of

$1.957 million over a five-year period. While Mr. Dunkel criticizes the term Mr. Spanos used to describe the credit to its proposed accrual amount, there is no dispute regarding the appropriateness of Petitioner's proposed adjustment. The Commission finds that the credit is appropriate. The Commission approves Petitioner's proposed $9.875 million credit to customers over five years.

The Commission's approval of depreciation schedules in this Cause will not change residential customer rates until the Commission approves an Order in Petitioner's next general rate case.

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

1. Coincident with the approval of new rates and charges for water and wastewater service as to be determined in Petitioner's next general rate cases for water and wastewater respectively, new depreciation accrual rates as set forth in Pet. Ex. 1, Attach. GMV-1 (corrected by Petitioner on February 26, 2018) are approved.

2. This Order shall be effective on the date of its approval.

HUSTON, KREVDA, OBER, AND ZIEGNER CONCUR; FREEMAN ABSENT:

APPROVED: MAY 30 2018

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

Mary M. Becerra

Mary M. Becerra
Secretary of the Commission