ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

IN THE MATTER OF THE PETITION OF KINGSBURY UTILITY CORPORATION FOR A NEW SCHEDULE OF RATES AND CHARGES FOR WASTEWATER SERVICE	))))	**CAUSE NO. 44590 U** **APPROVED:** MAR 02 2016

ORDER OF THE COMMISSION
PHASE 1 ORDER

Presiding Officers:
James F. Huston, Commissioner
Jeffery A. Earl, Administrative Law Judge

On February 9, 2015, Kingsbury Utility Corporation ("KUC") filed a Small Utility Rate Application under Ind. Code § 8-1-2-61.5 and 170 IAC 14-1. On February 19, 2015, KUC filed a copy of its customer notice letter as required by 170 IAC 14-1-2(b). Also on February 19, 2015, KUC filed its proof of publication.

On February 26, 2015, the Commission's Water and Sewer Division issued a Memorandum finding that the application was complete.

On March 12, 2015, the Indiana Office of Utility Consumer Counselor ("OUCC") filed a Notice of Request for Field Hearing, indicating that the OUCC had received requests for a public hearing from a group of ratepayers and from R&R Plastics, Inc. The Commission held a public field hearing at 6:00 p.m. (local time) on April 21, 2015, at Kelsing Middle School, 306 East 18th Street, LaPorte, Indiana. At the hearing, the Commission accepted written and oral testimony from members of the general public.

On May 1, 2015, the Kingsbury Customer Group, which comprises Deerfield Estates, Midwest Warehousing, and R&R Plastics, filed a Petition to Intervene and Motion for Prehearing Conference. On May 8, 2015, LaPorte County, Indiana, filed a Petition to Intervene. KUC objected to both petitions to intervene and to the Motion for Prehearing Conference. Also on May 8, 2015, the Kingsbury Customer Group filed a Request for Formal Public Hearing, accompanied by the signatures of 14 KUC customers, including the Kingsbury Customer Group. On May 26, 2015, the presiding officers denied both petitions to intervene, the Motion for Prehearing Conference, and the Request for Formal Public Hearing, for the reasons explained in the May 26, 2015 docket entry. But the presiding officers allowed the Kingsbury Customer Group, LaPorte County, and any other interested parties to submit written comments to the OUCC, to be included in the OUCC's report.

On June 9, 2015, as required by 170 IAC 14-1-4(a), the OUCC filed its report, and additional written comments from the Kingsbury Customer Group and the general public.

On August 31, 2015, KUC filed its reply to the OUCC report.

On November 11, 2015, KUC filed a Request for Emergency Relief because it had experienced the failures of a secondary treatment pump and its trickling filter system. On December 9, 2015, the Commission issued an emergency interim order, granting KUC authority to immediately address the failures.

Based on the applicable law and the evidence presented, the Commission finds:

1. Notice and Jurisdiction. KUC is a *public utility* as that term is defined in Ind. Code § 8-1-2-1(a) and qualifies for treatment as a small utility under Ind. Code § 8-1-2-61.5. KUC published legal notice of the filing of this small utility rate case as required by 170 IAC 14-1-2(b). Therefore, we find that notice of this Cause was given and published as required by law. We further find that the application satisfies all of the requirements of Ind. Code § 8-1-2-61.5 and 170 IAC 14-1.

Under Ind. Code § 8-1-2-61.5, the Commission has discretion to conduct a formal public hearing if one is requested by a public or municipal corporation or ten individuals, firms, limited liability companies, corporations, or associations. Although the Commission received a request for a formal public hearing, the presiding officers chose not to conduct a formal public hearing for the reasons set forth in the May 26, 2015 docket entry, and because the Commission had already accepted public comments at a public field hearing. We find that there is no need for a formal public hearing in this Cause. However, all comments submitted by interested parties and members of the general public, whether made at the public field hearing or submitted by the OUCC in its report, are incorporated into the record of this Cause.

We find that the Commission has jurisdiction over KUC and the subject matter of this proceeding, and may issue an order in this Cause based on the information filed as authorized by 170 IAC 14-1-6.

2. KUC's Characteristics. KUC is a for-profit, combined water and wastewater utility that serves approximately 77 residential, commercial, and small-industrial wastewater customers in LaPorte County. KUC's water and wastewater infrastructure is over sixty years old and was originally installed to serve a United States Army munitions plant covering an area of approximately 3,000 acres.

3. Test Period. The test period selected for determining KUC's revenues and expenses reasonably incurred in providing wastewater utility service to its customers is the 12 months ending June 30, 2014. With adjustments for changes that are fixed, known, and measurable, we find that this test period sufficiently represents KUC's normal operations to provide reliable data for ratemaking purposes.

4. Background and Relief Requested. The Commission approved KUC's current rates on January 16, 2008. *Kingsbury Util. Corp.*, Cause No. 43296U, 2008 WL 294516 (IURC Jan. 16, 2008). In that case, the Commission authorized KUC to increase its rates by 101.02% across the board to produce additional revenue of $169,454. On September 11, 2013, the Commission authorized KUC to implement an excessive strength surcharge, establish a system development charge, and make changes to limited, identified non-recurring charges. *Kingsbury Util. Corp.*, Cause No. 44327, Phase I Order, 2013 WL 5276001 (IURC Sept. 11, 2013). On April 9, 2014, the Commission denied KUC's request for authority to issue long-term debt to make needed treatment plant replacements and upgrades, pay off short-term debts, and provide funds and a reserve fund for an interconnection and main relocation project. *Kingsbury Util. Corp.*, Cause No. 44327, Phase II Order, 2014 WL 1477993 (IURC Apr. 9, 2014).

In this Cause, KUC proposed a two-phase rate increase—a 54.55% increase across the board to produce additional revenues of $93,896 (Phase 1) and a 21.31% increase to the Phase 1 rates to generate additional revenues of $56,703 (Phase 2). The two proposed increases would result in a total rate increase of 87.9% to generate additional revenues of $150,599. KUC also requested authority to finance up to $480,000 for wastewater facility refurbishments and improvements through maturities not to exceed 30 years at market interest rates.

5. OUCC Report. The OUCC proposed a two-phase rate increase—a 2.18% increase across the board to produce additional revenues of $3,773 (Phase 1) and a 27.05% increase to the Phase 1 rates to generate additional revenues of $47,929 (Phase 2). The specific issues raised by the OUCC Report are addressed below.

6. Rate Base.

A. Utility Plant in Service. KUC proposed a Phase 1 utility plant in service ("UPIS") amount of $1,143,903 as of June 30, 2014. The OUCC recommended an amount of $1,234,493, which it calculated by taking KUC's UPIS from its last rate case and adding in the plant additions from KUC's annual reports from 2007 through 2013. In reply, KUC did not dispute the OUCC's additions, but included more up-to-date information in its revised UPIS calculation. KUC's revised amount for Phase 1 is $1,183,412.

KUC proposed a Phase 2 UPIS amount of $1,623,903, which is the Phase 1 amount plus $480,000 in additions. The OUCC recommended an amount of $1,574,493, which it calculated by adding $340,000 in additions to its Phase 1 amount of $1,234,493. In reply, KUC submitted updated figures for its proposed additions, which raised the total amount of additions to $610,000.

We must consider several disputed projects must be considered before we can calculate KUC's UPIS.

1. Pump Replacement. In its application, KUC included the cost to replace its two primary treatment pumps and two secondary treatment pumps for $40,000 per pump. The original pumps are rated for 1.22 million gallons per day ("mgd") (850 gallons per minute ("gpm")). KUC originally proposed replacing the pumps with pumps rated for 2.5 mgd. The OUCC challenged the proposal for two reasons.

First, the OUCC asserted that the 2.5 mgd capacity of the pumps exceeds the utility's demand and the operational limitations of the plant. The OUCC proposed that KUC replace the pumps with pumps rated at 850 gpm. Second, the OUCC pointed out that while three of the pumps are 40 years old, one of the primary pumps is less than 20 years old and replacement parts are readily available for it. As a result, the OUCC proposed to include $72,000 to replace three pumps and $9,000 for rebuilding and maintenance of the fourth pump.

In reply, KUC asserted that the 2.5 mgd are consistent with the facility's design, and would be more efficient. KUC supplied an updated cost proposal of $241,650 for the replacement of the four pumps. On November 23, 2015, one of the secondary treatment pumps failed and could not be repaired. On November 30, 2015, KUC filed a request for emergency relief for authority to obtain financing to replace the failed pump. On December 9, 2015, the Commission issued an Interim Emergency Order authorizing KUC to obtain and install a new secondary pump with an 850 gpm capacity.

KUC's plant was originally designed to treat up to 2.5 mgd of wastewater. But KUC does not treat anywhere near that amount of wastewater. Over the past ten years, KUC has experienced final effluent flow of between 173,000 and 289,000 gpd. In addition, plant components such as pumps, the ultraviolet ("UV") system, trickling filters, and imposed effluent limits create hydraulic bottlenecks within the system. Therefore, we find that 850 gpm pumps are adequate.

But we disagree with the OUCC that KUC should only replace three of the four pumps. Although the OUCC argued that replacement parts are readily available for the primary pump, it did not provide any evidence to support this claim, nor did it provide a comparison of the cost of replacement versus the costs of obtaining repair parts and the increased labor expense of conducting repairs on the pump. Because we are authorizing KUC to purchase 850 gpm pumps instead of 2.5 mgd pumps, the total cost of the replacement will be substantially less. In addition, we want wastewater utilities to invest prudently in maintaining their treatment systems, taking a long-term view of reliable utility operations. Therefore, we authorize KUC to replace its two primary and two secondary treatment pumps with 850 gpm pumps at $24,000 each ($96,000 total).

2. Travis Ditch Project. In its application, KUC included $70,000 for the replacement of an exposed force main crossing Travis Ditch. KUC proposed replacing 170 feet of pipe. The pipe is exposed to the running water. The OUCC did not dispute the need to replace the exposed main, but disagreed with the proposed cost. The OUCC created an estimated cost based on replacing 60 feet of pipe at a minimum of 3 inches below the creek bottom. Based on a conversation with an engineer, the OUCC estimated that the project should cost approximately $50 per foot or $3,000 for the line. The OUCC added $10,000 for one hydrostop unit and $3,000 for soil and rock replacement for a total cost of $16,000.

In reply, KUC submitted a quote from Woodruff & Sons, Inc. detailing replacement of both the water main and wastewater force main. The total quote is $390,434.34, with $106,313.04 attributable to the force main. The quote also includes $169,646.72 for Pumps & Piping and By-Pass Pumping. In light of the updated quote, KUC increased its proposed expense from $70,000 to $101,313. KUC argued that there are unique soil properties in Northwest Indiana and that the KUC area has special needs because it was formerly a munitions plant and has certain environmental contamination issues.

All parties agree that the force main replacement is necessary, but the parties vary vastly on the cost of the project. Neither party provided sufficient evidence to support their contention. While KUC supported its proposed amount with a quote from Woodruff & Sons, we agree with the OUCC that the quote is excessive for an open-cut installation. KUC argues that there are unique soil properties in Northwest Indiana and that the KUC area has special needs because it was formerly a munitions plant and has certain environmental contamination issues, but it did not provide any evidence to support this claim. KUC also did not explain why it is necessary to replace 170 feet of pipe to cross the 50-feet-wide ditch: the OUCC asserts that replacing 60 feet of pipe would be sufficient.

We have insufficient evidence to determine a reasonable amount of expense for the Travis Ditch project. As a result, for calculation purposes we will include $18,400 (the OUCC estimate plus a 15% contingency amount) in expense for the Travis Ditch project on a preliminary basis. KUC shall solicit competitive bids to perform the work and shall submit the results of the bids and evidence supporting its chosen bid to the OUCC and to the Commission under this Cause. Based on the evidence presented, including any responsive evidence from the OUCC and rebuttal evidence from KUC, the Commission will make a finding of the reasonable cost of the project and will adjust the authorized financing accordingly.

3. Influent Flow Meter. The OUCC recommended that KUC install an influent flow meter at its wastewater treatment plant at a cost of $15,000. The OUCC said that the meter would assist KUC in measuring the volume and pollutant load generated by KUC's collection system customers compared to the volume and pollutant load of hauled wastes from KUC's affiliated customers. This information would assist KUC in performing cost of service studies and influent loading studies. KUC agreed to install the influent flow meter if it has sufficient available funding available after its other projects, but KUC resisted the OUCC's inclusion of the $15,000 cost in the revenue requirement calculation. KUC asserts that the additional expense is not warranted in light of the already considerable rate case increase it is requesting.

We acknowledge the benefits of installing an influent flow meter that the OUCC identified, and we authorize KUC to install the meter as soon as practical. Therefore, we have included the $15,000 cost in KUC's borrowing authority and Phase 2 UPIS. Data from the meter should be used to support facility sizing requests in future cases.

4. UPIS Calculation. We accept KUC's calculation of $1,183,412 for Phase 1 UPIS. KUC provided the most up-to-date evidence to support the Phase 1 calculation. For Phase 2 UPIS, we calculated the amount of additions to UPIS based on our discussion of KUC's proposed projects. Therefore, we find that the Phase 2 UPIS is $1,542,212 as illustrated in the table below.

Phase 1 UPIS	$ 1,183,412
Additions:	
Influent Flow Meter	15,000
Two 850 gpm Primary Sewage Pumps	48,000
Two 850 gpm Secondary Sewage Pumps	48,000
Primary and Secondary Trickling Filters	165,000
Digester Mixing Pump	20,000
Sewer Main Replacement (Travis Ditch)	16,000
Contingency Fees (15%)	46,800
Phase 2 UPIS	$ 1,542,212

B. Accumulated Depreciation. KUC proposed $513,572 (the amount on its June 30, 2014 balance sheet) for accumulated depreciation. The OUCC challenged the amount, saying that KUC did not use the 2.5% composite depreciation that the Commission established for wastewater utilities with a treatment plant. Starting with the accumulated depreciation amount of $460,867 from

KUC's last rate order and using the 2.5% composite depreciation rate, the OUCC added accumulated depreciation for the additions included in KUC's annual reports for 2007 through 2013 and for one other addition not include in the annual reports. The OUCC calculated an accumulated depreciation amount of $660,225 as of June 30, 2014. Neither party proposed a change to accumulated depreciation for Phase 2.

In reply, KUC asserted that it did use the 2.5% composite rate and that it completed its calculations in consultation with the Commission's Water/Sewer staff. KUC explained that starting with the accumulated depreciation amount from the last rate case is inappropriate, because the utility's books contained numerous errors in calculating depreciation at that time. For this case, KUC's accountant did a thorough review of KUC's books beginning with the transfer of the utility to KUC from the federal government. Attachment 3 to KUC's application shows the recomputed accumulated depreciation.

We accept KUC's calculation of $513,572 for accumulated depreciation. KUC provided sufficient evidence to support its calculation, which corrects prior accounting errors and provides a more accurate accumulated depreciation amount.

C. <u>Contributions in Aid of Construction</u>. The OUCC discovered KUC had not included an adjustment to rate base for contributions in aid of construction ("CIAC"). The OUCC identified $79,019 in CIAC comprising $70,331 from D&I Contracting, $3,188 from Zack Baker, P.E., and $5,500 in general contracting. As a result, the OUCC made a $39,509 adjustment to KUC's rate base. KUC accepted the OUCC's adjustment.

CIAC are donations provided at no cost to the utility, which may come from state or local governments, customers, or developers as incentives to upgrade utilities to accommodate larger customers without burdening existing customers. *Ind. Office of Util. Consumer. Counselor v. Lincoln Utils., Inc.*, 834 N.E. 2d 137, 143 (Ind. Ct. App. 2005). Ind. Code § 8-1-2-6 excludes CIAC from the calculation of a utilities rate base. *Id.* at 146. Therefore, we find that the OUCC properly adjusted KUC's rate base to exclude CIAC.

D. <u>Working Capital</u>. Both the OUCC and KUC used the Federal Energy Regulatory Commission ("FERC") 45-day method to calculate working capital. The differences in their working capital amounts stem from differences in operating expenses. The OUCC proposed working capital of $29,200 for both Phase 1 and Phase 2. In its reply, KUC proposed working capital of $32,149 for Phase 1 and $32,158 for Phase 2.

In light of our findings on O&M expenses below, we find that KUC's working capital is $29,509 for Phase 1 and $30,283 for Phase 2.

E. <u>Calculation of Rate Base</u>. Based on our findings on UPIS, accumulated depreciation, CIAC, and working capital, the table below shows KUC's approved Phase 1 and Phase 2 rate base.

		Phase 1		Phase 2
UPIS	$	1,183,412	$	1,542,212
Accumulated Depreciation		(513,572)		(513,572)
CIAC		(39,509)		(39,509)
Net Utility Plant	$	630,331	$	989,131
Working Capital		29,509		30,283
Rate Base	$	659,840	$	1,019,414

7. Cost of Capital. Six elements compose the cost of capital calculation: the amount of equity, the cost of equity, the amount of debt, the cost of debt, the amount of deferred income taxes, and the cost of deferred income taxes. The parties disputed both the amount of equity and the cost of equity.

A. Amount of Equity. KUC proposed $634,637 for the amount of equity. The OUCC made adjustments to the UPIS, accumulated depreciation, deferred income taxes, and CIAC, resulting in total equity of $442,169. In reply, KUC accepted the OUCC's adjustments for deferred income taxes and CIAC, but modified the UPIS adjustment and rejected the adjustment for accumulated depreciation. KUC also added an adjustment for a digester painting expenditure of $16,875. In reply, KUC proposed a total equity of $554,616. As we discussed above, we accept KUC's calculation of accumulated depreciation, and we accept KUC's rebuttal adjustment for digester painting. Using the UPIS that we calculated above, we find that KUC's total equity is $554,616.

B. Cost of Equity. KUC proposed a cost of equity of 10.9% for Phase 1 and Phase 2. The OUCC agreed with the amount for Phase 2, but argued that the Phase 1 cost of equity should be 10%. The cost of common equity cannot be precisely calculated and estimating it requires the use of judgment. In the rate cases of larger investor-owned utilities, we typically review the results of extensive cost of equity studies, but as both parties point out, it is not financially feasible that a utility of KUC's size would complete such a study for every rate case. KUC did not provide any other evidence to support its 10.9% cost of equity. That amount is significantly higher than we have recently awarded to other investor-owned utilities. *See, e.g., Indiana-American Water Co.*, Cause No. 44450, 2105 WL 429993, at *15 (IURC Jan. 28, 2015) (9.75%, based on a settlement); *Twin Lakes Utils., Inc.*, Cause No 44388, 2014 WL 1712265, at *11 (IURC Apr. 23, 2014) (9.8%, based on a settlement); *Pleasantview Utils., Inc.*, Cause No. 44351U, 2014 WL 1324433, at * (IURC Mar. 26, 2014) (9.9% after a 60-basis-points reduction for poor service quality).

Both Indiana American and Twin Lakes (which is owned by Utilities, Inc.) are significantly larger than KUC. As such, they have a better ability to attract capital, so we find that Pleasantview, which is a small wastewater utility, provides a better comparison for purposes of determining the cost of equity. In *Pleasantview* we found that a cost of equity of 10.5% was appropriate for a small wastewater utility. Therefore, in this case we find that KUC's Phase 2 cost of equity is 10.5%. This cost of equity is appropriate for a utility carrying significant debt as KUC will be doing in Phase 2. But in Phase 1, KUC has no debt. When a utility has no debt, a reduction in cost of equity is appropriate because the utility carries less risk. The OUCC proposed a 90-basis-points reduction to account for the lack of debt in Phase 1. We believe that this reduction is excessive. Instead, we find that a 50-basis-points reduction to the Phase 2 cost of equity is appropriate. Therefore, we find that KUC's Phase 1 cost of equity is 10%.

C. **Amount and Cost of Debt.** For Phase 1, KUC has no debt. In this case, we find that the appropriate level of capital improvements is $358,800. KUC may finance this amount through long-term debt, which will be reflected in the Phase 2 cost of capital. Because KUC has not yet obtained the debt, we do not know the exact cost of the long-term debt. For purposes of calculating the cost of capital for Phase 2, we will assume a 7.5% cost of debt. KUC shall report its actual cost of long-term debt in its compliance filing for Phase 2.

D. **Accumulated Deferred Income Tax.** The OUCC noted that KUC did not recognize the cost-free capital created by deferred income taxes in its capital structure. The OUCC calculated deferred income taxes of $96,896. In its reply, KUC accepted the OUCC's adjustment.

Deferred income taxes are created by a timing difference between the book net income and the net tax income, often as a result of using different depreciation rates for regulatory and tax purposes. The OUCC properly calculated KUC's deferred income taxes of $96,896, and we accept the adjustment.

E. **Cost of Capital Calculation.** Using a cost of equity of 10% for Phase 1 and 10.5% for Phase 2, we find that KUC's cost of capital is 8.51% for Phase 1 and 8.43% for Phase 2, as illustrated in the table below.

Phase 1 Capital Structure

	Amount	Percent of Amount	Cost	Weighted Cost
Common Equity	$ 554,616	85.13%	10.00%	8.51%
Long-Term Debt	-	0.00%	0.00%	0.00%
Deferred Income Taxes	96,896	14.87%	0.00%	0.00%
Total	$ 651,512	100.00%		8.51%

Phase 2 Capital Structure

	Amount	Percent of Amount	Cost	Weighted Cost
Common Equity	$ 554,616	54.90%	10.50%	5.76%
Long-Term Debt	358,800	35.51%	7.50%	2.66%
Deferred Income Taxes	96,896	9.59%	0.00%	0.00%
Total	$ 1,010,312	100.00%		8.43%

8. **Authorized Net Operating Income ("NOI").** Applying the cost of capital to the rate base, we find that KUC should be allowed to earn an NOI of $56,152 for Phase 1 and $85,926 in Phase 2, subject to the true-up provisions in this order. The table below summarizes our NOI findings.

	Phase 1	Phase 2
Rate Base	$ 659,840	$ 1,019,414
Weighted Cost of Capital	8.51%	8.43%
Net Operating Income	$ 56,152	$ 85,936

9. Operating Revenues.

A. Metered Residential Revenue Normalization. The OUCC calculated a pro forma present rate revenue increase of $161 for residential customers added during the test year. KUC accepted the OUCC's adjustment. We find that the adjustment has been properly calculated.

B. Metered Commercial Revenue Normalization. The OUCC calculated a pro forma present rate revenue increase of $1,197 for commercial customers added during the test year. KUC accepted the OUCC's adjustment. We find that the adjustment has been properly calculated.

C. Imputed Leachate and Septic Revenue. KUC has written wastewater service contracts with two affiliated companies, JAGAD Truck Leasing, Inc. ("JAGAD") and Johnson Johns & Septic Service, Inc. ("Johnson"). These two companies transport waste by truck to KUC for treatment. KUC proposed an increase in the rates it charges the two companies. The OUCC argues that KUC did not make a revenue adjustment to account for the additional revenues from the rate increase. The OUCC calculated a pro forma present rate revenue increase of $34,278 for septic disposal service revenue and $14,428 for leachate disposal service revenue. KUC accepted the OUCC's adjustment for the Phase 1 revenues. We find that the adjustment has been properly calculated.

10. Disputed O&M Expense Adjustments.

A. Phase 1.

1. Employee Benefits. KUC originally calculated a $7,108 increase in employee benefits expense. The OUCC discovered an error in the calculation and corrected the adjustment to an $11,647 increase. In reply, KUC noted a further error and increased the adjustment to $12,246. We find that KUC's reply correctly calculated the adjustment as $12,246.

2. Depreciation Expense. The OUCC and KUC calculated different depreciation expense amounts, $10,633 increase and $9,386 increase, respectively, based on differences in Phase 1 UPIS. Based on our finding of Phase 1 UPIS, we find that KUC's Phase 1 depreciation expense is $29,585, which is a $9,386 increase over test-year depreciation expense.

3. Sludge Removal Costs. In its reply, KUC added $23,000 for sludge removal expense that was not included in its application. KUC said that the omitted cost was discovered as part of a response to an OUCC data request, and provided to the OUCC too late for the item to be discussed in the OUCC's report.

Applicants are required to present all necessary evidence to support their case in the case-in-chief, thus allowing the other parties sufficient time to review and respond to the evidence, and providing the Commission with a full examination of the evidence on the issue. Allowing an applicant to raise a new issue for the first time on rebuttal, especially in a small utility rate case where no evidentiary hearing is held, thwarts this purpose. Therefore, we disallow KUC's proposed $23,000 expense for sludge removal.

B. Phase 2.

1. Purchased Power. The OUCC proposed a reduction in purchase power expense for Phase 2 of $7,205. This is a 20% reduction that the OUCC argues is attributable to the installation of new pumps that will be more energy efficient than the old pumps. KUC rejected the adjustment because it is unsubstantiated and arbitrary.

A basic premise of rate making is that pro forma adjustments to test year expenses should be fixed, known, and measurable. While we agree with the OUCC that installation of new, more efficient pumps will likely lead to some reduction in purchased power expense, we do not have any evidence with which to quantify such a reduction. Therefore, we reject the OUCC's $7,205 reduction to Phase 2 purchased power expense.

2. Depreciation Expense. Similar to Phase 1, the OUCC and KUC calculated different depreciation expense amounts, $7,175 increase over Phase 1 and $8,452 increase over Phase 1, respectively, based on differences in Phase 2 UPIS. Based on our finding of Phase 2 UPIS, we find that KUC's Phase 2 depreciation expense is $38,555, which is an $8,970 increase over Phase 1 depreciation expense.

3. Rate Case Expense. The OUCC accepted the calculation of $5,833 in rate case expenses for this case that KUC included in its application. KUC also included a $26,522 expense adjustment for case expenses from Cause No. 44327. The OUCC removed the expense from the revenue requirement as a non-recurring expense. In reply, KUC accepted the removal of the total amount of the expense from Phase 1, but proposed that $22,000 be amortized over four years at $5,500 per year.

KUC was only partially successful in prosecuting Cause No. 44327. In its Phase 1 Order in that Cause, the Commission authorized KUC to establish excessive strength surcharges for water and wastewater service, establish system development charges for water and wastewater service, and to modify non-recurring charges and fire protection charges. But, the Commission denied KUC's proposed changes to its rules and regulations because they were inconsistent with the Commission's rules. In addition, in its Phase 2 Order, the Commission denied KUC's request for financing authority in part because KUC did not offer sufficient evidence to support the proffered settlement agreement or to support its ability service the proposed debt. Therefore, we authorize KUC to recover one half of its proposed case expense for Cause No. 44327 ($11,000) amortized over three years at $3,667 per year beginning with Phase 2.

In its reply, KUC also included an additional $15,000 adjustment (amortized over three years) to its rate case expense for this case. KUC argued that it needs to adjust its original rate case expense amount to recover the additional burdens and costs of this case due to the overly litigious character of the case. Specifically, KUC cited examples of what it claims are unreasonable discovery requests and the need to defend the small utility process from parties trying to convert the case into a regular docketed proceeding.

We agree with KUC in part. Several motions were filed requesting permission to intervene in this case, requesting a prehearing conference, and requesting a formal public hearing. After being fully briefed, these motions were denied. We find that KUC should be able to recover additional rate case expenses related to these motions that were outside of its control. But we disagree with KUC that the overly litigious nature of these proceedings is solely the fault of the OUCC. KUC's reply brief, which make numerous unhelpful comments about the OUCC rather than simply addressing the issues in this case, shows that KUC's conduct also contributed to the overly litigious nature of this case. Therefore, we find that an adjustment to KUC's original rate case expense for this case of $7,500 amortized over three years is reasonable. This results in a $2,500 Phase 2 adjustment.

4. <u>Interest Costs Tax Deduction</u>. Neither party considered the impact that interest costs incurred on KUC's long-term debt will have on its taxable income. KUC will be able to deduct its interest payments from its taxable income resulting in a reduced income tax expense. Assuming long-term debt of $358,800 with 120 monthly payments at 7.5% interest, the interest payments for the first three years average $24,066 per year. Therefore, we find that an adjustment to KUC's taxable income of $24,066 and a resulting reduction to taxes payable is appropriate. KUC shall true-up this Phase 2 calculation based on the actual terms of its long-term debt.

11. <u>Authorized Rate Increase</u>. Based on our findings in this order, we authorize KUC to increase its rates and charges in Phase 1 by 12.97% across the board to produce additional operating revenue of $22,493. We also authorize KUC to increase its rates in Phase 2 by 27.96% across the board to produce additional operating revenues of $54,789. The phase 2 rate increase is subject to true-up following KUC's compliance filing. Under the new Phase 1 rates, a residential customer using 5,000 metered gallons of water would pay approximately $37.45 per month compared to the current rate of $33.15. These increases are reasonably calculated to allow KUC the opportunity to earn an NOI of $56,152 in Phase 1 and $85, 936 in Phase 2 as illustrated in the table below.

	Phase 1	Phase 2
Operating Revenue	$ 398,817	$ 453,606
O&M Expenses	272,123	278,357
Depreciation	29,585	38,555
Other Taxes	23,778	30,968
Income taxes	17,179	19,790
Total Operating Expense	342,666	367,670
Net Operating Income	$ 56,152	$ 85,936

12. <u>Financing Approval</u>. KUC proposed to issue long-term debt to fund its capital improvements in the amount of $480,000 with maturities not to exceed 30 years at market interest rates. Based on our findings above, we find that the appropriate level of capital improvements and contingency costs is $358,800. But as discussed above, we require additional evidence before we can make a finding regarding the Travis Ditch project. Therefore, we authorize KUC to incur long-term debt at market rates for terms not to exceed 30 years in the amount not to exceed $358,800 on an initial basis. This amount is subject to change based on our finding of the reasonable cost for the Travis Ditch project.

13. **Other Issues.**

A. **Cost of Service Study.** The OUCC recommended that KUC perform a cost of service study ("COSS") before its next rate case. The OUCC's recommendation relates primarily to KUC's treatment of hauled waste from JAGAD and Johnson and a concern that the true cost of treatment the hauled waste is unknown and the rates could be subsidized by KUC's other customers. In reply, KUC argued that the cost of the COSS far outweighs the potential benefits to its customers.

We agree with KUC that the potential costs of a COSS outweigh the possible benefit to ratepayers. Therefore, we will not require KUC to complete a COSS at this time.

B. **Income Tax.** The OUCC pointed out that KUC has not been recording income taxes to its general ledger as required by the National Association of Regulatory Utility Commissioners' ("NARUC") Uniform System of Accounts. The OUCC recommended that KUC be required to adhere to NARUC's 1996 Uniform System of Accounts for Class "B" Wastewater Utilities and to record estimated state and federal income taxes on its general ledger. In its reply, KUC agreed to the OUCC's recommendation.

C. **Hauled waste Rates.** KUC proposed to increase the hauled waste rates from $0.015 to $0.020 per gallon (33.33% increase) for JAGAD and from $0.055 to $0.072 per gallon (30.9% increase) for Johnson. The OUCC accepted the increased rates, but the OUCC noted that the rates KUC charges for hauled waste treatment have never been approved by the Commission. The current rates charged to Johnson and JAGAD are based on affiliated contracts between those companies and KUC, which have been filed with the Commission, but the rates are not included on KUC's tariff. The OUCC also argued that KUC has not provided any evidence that the rates are cost-based.

In reply, KUC said that hauled waste treatment service is a competitive business, and that similar services are available locally for rates at or below those being proposed by KUC in this case KUC said that further increases could cause the hauled waste customers to cease doing business with KUC.

Ind. Code § 8-1-2-38 requires KUC to file schedules with the Commission showing *all* rates, tolls, and charges for *any* service provided by it within the state, and Ind. Code § 8-1-2-42(b) says that no schedule of rates, tolls, and charges is effective without the approval of the Commission. Further, Ind. Code § 8-1-2-44 makes it unlawful for KUC to charge a rate that is not included on its tariff for any service provided within the state.

KUC did file the affiliated contracts, which include the original rates for hauled waste treatment with the Commission for review, but it did not seek formal approval of the rates and the rates are not included in its current tariff. Therefore, we agree with the OUCC that KUC's hauled waste rates must be approved by the Commission and, once approved, must be included on KUC's tariff and filed with the Commission.

In *South Haven Sewer Works, Inc.*, the Commission considered hauled waste rates. Cause No. 41903, 2002 WL 31107491 (IURC June 5, 2002). The Commission recognized that treatment of hauled waste is not a typical regulated utility service. *Id.*, slip op. at 27. Hauled waste customers are not captive customers and may seek treatment elsewhere. *Id.* Thus, it is important for KUC to charge a competitive rate. But that is not to say that KUC may subsidize competitive hauled waste rates on the backs of its captive customers, especially when the hauled waste rates are being charged to affiliated companies.

The parties agree that KUC's proposed hauled waste rates are reasonable, and the rates are similar to those we approved in *South Haven* ($0.045 per gallon). Therefore, we approve the proposed hauled waste rates, and order KUC to include the rates on its tariff and to file them with the Commission's water and wastewater division. But we are concerned that the rate may not be sufficient to recover the cost of treating the hauled waste. As discussed above, it is not economically feasible for KUC to perform a full COSS, but we do find that KUC shall provide evidence in its next rate case supporting a cost-based rate for hauled waste treatment service.

D. <u>Operational Recommendations</u>. The OUCC included several recommended strategies for operational improvements, including: trickling filter operation, clarifier operation, UV disinfection operation, using the aerobic digester for leachate treatment, etc. The OUCC requested that we order KUC to comply with these recommendations. KUC strenuously objected to these recommendations.

KUC is responsible for the day-to-day management of its operation, and, absent evidence demonstrating that KUC is failing in this responsibility, the Commission will not attempt to substitute its judgment for that of the utility. As a result, we decline to order KUC to comply with the OUCC's recommendations. That is not to say, however, that the recommendations are without merit. We encourage KUC to consider the OUCC's recommendations, and to continue to consult with the expert staff at the OUCC and at the Commission. KUC should also consider hiring an experienced consulting engineer to create a whole plant design summary that recognizes existing configuration and waste streams of the plant. This would assist KUC in developing a capital improvement plan to address the long-term needs of the treatment facility and to ensure KUC is providing safe, efficient wastewater treatment service to its customers.

E. <u>Timing of Phase 2 Increase</u>. The parties agreed that KUC may not implement its Phase 2 rates until it has completed the approved capital projects, and the new utility plant is used and useful and in service. Therefore, KUC shall notify the Commission and the OUCC when it has completed the approved capital projects. The notice shall identify the capital improvements by project, including specific detailed invoices to support the project costs.

KUC shall also file revised schedules to reflect actual project costs, the actual amount of long-term debt and the actual cost of long-term debt, the updated Phase 2 cost of capital, and any other changes to the amounts reflected in KUC's original and revised schedules. The OUCC will have 15 days to file a notice that it either agrees with KUC's compliance filing, or that it objects to the filing. In the event that the OUCC objects to the filing, the presiding officers will issue a docket entry with a brief procedural schedule to address the objections. Prior to implementing approved Phase 2 rates, KUC shall submit a revised tariff under this Cause for approval by the Commission's Water and Wastewater Staff.

IT IS THEREFORE ORDERED BY THE INDIANA UTILITY REGULATORYCOMMISSION, that:

1. Consistent with the findings above, KUC is authorized to increase its Phase 1 rates and charges by 12.97% for an annual net revenue increase of $22,496, so as to produce net annual revenues of $398,817.

2. Prior to implementing the authorized rates, KUC shall file the applicable rate schedules under this Cause for approval by the Commission's Water and Wastewater Division.

3. For Phase 2 rate approval, the parties shall follow the process outlined in Section 13(E) above.

4. KUC is authorized to incur long-term debt as described above.

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

STEPHAN, MAYS-MEDLEY, HUSTON, AND ZIEGNER CONCUR; WEBER ABSENT:

APPROVED: MAR 02 2016

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

Shala M. Coe

Shala M. Coe
Acting Secretary to the Commission