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STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF INDIANA-AMERICAN WATER COMPANY, INC. FOR APPROVAL OF (A) A DISTRIBUTION SYSTEM IMPROVEMENT CHARGE ("DSIC") PURSUANT TO IND. CODE CHAP. 8-1-31; (B) A NEW RATE SCHEDULE REFLECTING THE DSIC; AND (C) INCLUSION OF THE COST OF ELIGIBLE DISTRIBUTION SYSTEM IMPROVEMENTS IN ITS DSIC	)	**CAUSE NO. 42351 DSIC-5** **APPROVED:** APR 1 5 2009

<u>BY THE COMMISSION</u>:
Jeffrey L. Golc, Commissioner
David E. Veleta, Administrative Law Judge

On February 9, 2009, Indiana-American Water Company, Inc ("Indiana-American" or "Petitioner") prefiled with the Commission its Petition and Submission of Case-in-Chief for approval of a new distribution system improvement charge ("DSIC") pursuant to Indiana Code § 8-1-31 and the 170 I.A.C. 6-1.1. As required by 170 I.A.C. 6-1.1-4, Petitioner's February 9, 2009 Petition constituted its case-in-chief in support of the requested DSIC. On March 11, 2009, the Indiana Office of Utility Consumer Counselor ("Public") prefiled a report on Petitioner's proposed DSIC pursuant to Indiana Code § 8-1-31-9. On March 20, 2009, Petitioner submitted information responsive to eleven questions issued in a docket entry dated March 16, 2009.

Pursuant to notice given as provided by law, proof of which was incorporated into the record by reference and placed in the official files of the Commission, a public evidentiary hearing was convened in this Cause on March 24, 2009 at 10:00 a.m. in Room 224 of the National City Center, Indianapolis, Indiana. At the public hearing, the prefiled evidence of Petitioner and Public was offered and admitted into the record of the proceedings of this Cause, and Petitioner's witnesses responded to questioning. The Presiding Officers took administrative notice of the Petitioner's docket entry response and granted Petitioner permission to file a revised DSIC calculation form and revised tariff sheet. No members of the general public appeared or participated at the evidentiary hearing. On March 25, 2009, Petitioner filed a corrected DSIC calculation form and revised tariff sheet to make corrections that Petitioner identified at the start of the evidentiary hearing.

Having considered the evidence and being duly advised, the Commission now finds:

1. **<u>Notice and Jurisdiction</u>.** Due, legal and timely notice of the public hearing in this Cause was given and published as required by law. Petitioner is a "public utility" within the meaning of that term in Indiana Code § 8-1-2-1 and is subject to the jurisdiction of the Commission in the manner and to the extent provided by the laws of the State of Indiana. The Commission has jurisdiction over Petitioner and the subject matter of this proceeding.

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 sewer utility service in Wabash and Delaware Counties.

3. **Relief Requested.** Petitioner seeks approval of a DSIC pursuant to Indiana Code 8-1-31, a new rate schedule reflecting the DSIC and approval of the costs of the eligible Distribution System Improvements ("Improvements") in Petitioner's DSIC. Petitioner's most recent rate order was approved in Cause No. 43187 on October 10, 2007 ("the 2007 Rate Order"). Petitioner seeks to recover its DSIC Costs for improvements placed in service between January 1, 2008 and December 31, 2008 that were not included in Petitioner's rate base in the 2007 Rate order. Petitioner's proposed DSIC would produce annual revenues of $3,802,319, which is 4.92% of the revenues authorized in Petitioner's last rate case.

4. **Petitioner's Direct Evidence.** Petitioner presented the direct evidence of Gary M. VerDouw, Manager of Rates and Regulations for American Water Works Service Company, and Stacy S. Hoffman, Director of Engineering for Indiana-American.

Prior to the start of the evidentiary hearing, Petitioner informed the Commission and the Public of a need to make corrections to its DSIC calculations. Mr. Hoffman testified that in DSIC-4 Petitioner had estimated the retirements for those assets which were being replaced by the new distribution infrastructure but which were still in service as of the cutoff date in DSIC-4. Petitioner had indicated in DSIC-4 that it intended to reconcile in its next DSIC the estimated retirement to the actual amount. Mr. Hoffman testified that for a small number of work orders, the estimated retirement made in DSIC-4 had been reversed, but the actual retirement had not been substituted. Following the hearing, Petitioner provided corrected workpapers showing the affected work orders together with a revised DSIC calculation form and revised DSIC tariff sheet form.

Mr. VerDouw testified regarding the filing requirements and methodology for calculating the DSIC. Mr. VerDouw provided the evidence concerning the calculation of the proposed DSIC and sponsored Petitioner's proposed rate schedules reflecting the DSIC in the same format as the existing tariff on file with the Commission.

Mr. VerDouw testified that all DSIC projects included in Petitioner's request are new used and useful water utility plant projects that (1) do not increase revenues by connecting the distribution system to new customers; (2) are in service; and (3) were not included in Petitioner's rate base in the 2007 Rate Order. He further testified that the DSIC is based on a reasonable estimate of sales for the period in which the DSIC is to be in effect and that Petitioner will adjust the DSIC for any difference between the revenues recovered by the DSIC and the actual DSIC costs at the end of each twelve (12) month period. Mr. VerDouw testified that, to the extent DSIC improvements are included in Petitioner's rate base in future rate orders, the DSIC will be reset to zero and the recovery of the capital costs and depreciation on the Improvements will be reflected in base rates.

Mr. VerDouw testified that Petitioner proposes to include only non-revenue producing projects placed in service between January 1, 2008 and December 31, 2008. He stated that the costs of the DSIC Additions included in the proposed DSIC, listed in Petitioner's Exhibit SSH-1, were transferred to Utility Plant in Service ("UPIS") between January 2008 and December 2008 for all tariff groups. Mr. VerDouw concluded by stating that these DSIC Additions are all now in UPIS, but were not included in rate base in Petitioner's last rate case.

Mr. VerDouw explained how Petitioner calculated the Net Investor Supplied DSIC Additions and the proposed DSIC. He explained that Indiana-American reduced the DSIC Additions of $33,302,564 by the amount of related plant retirements associated with the DSIC improvements. He stated the amount of retirements made from January 2008 through December 2008 was $4,521,935 and that Petitioner further adjusted this amount for the actual amount of the cost of removal, net of salvage, of $1,073,881. Petitioner noted that there was no reimbursement of costs by the Indiana Department of Transportation ("INDOT") to report. Therefore, the Net Investor Supplied DSIC Additions amount to $29,854,511, as shown on Line 5 of Petitioner's Exhibit GMV-2R. Mr. VerDouw also sponsored Petitioner's Exhibit GMV-3, Petitioner's rate of return summary. Mr. VerDouw explained that the rate of return used in this proceeding is Petitioner's weighted average cost of capital computed from the actual permanent capital structure as of December 2008. He testified that Petitioner used the embedded debt cost rate as of December 2008 to determine the long-term debt cost rate. The common equity cost rate of 10.00% was determined in the 2007 Rate Order, and the weighted cost of capital is 7.51%, with a pre-tax rate of return of 10.68%. Mr. VerDouw stated that the resulting pre-tax return is $3,188,462 when the pre-tax overall rate of return is multiplied by the Net Investor Supplied Improvements.

Mr. VerDouw stated that Petitioner determined its depreciation expense of $613,857 by using the annual depreciation accrual rates by primary plant account previously approved by the Commission, multiplied by the DSIC improvements, net of related retirements.

Mr. VerDouw testified and provided exhibits showing that the proposed DSIC Revenues are within the 5% range of Petitioner's base revenues as approved by the Commission in the 2007 Rate Order.

Petitioner's witness Stacy S. Hoffman sponsored Petitioner's Exhibit SSH-1, which provides a brief description of each Improvement project, the cost of each project, the date each project was placed in service, the account number assigned to each project based on accounting standards found in NARUC's Uniform System of Accounts and Petitioner's Operation area where each project exists.

Mr. Hoffman provided greater individual detail regarding the Improvements exceeding $100,000 in total costs. For each of these Improvements, he explained why it was needed, the resulting benefits to Petitioner and its customers, and whether the plant had been retired. As to the remaining projects, Mr. Hoffman summarized the descriptions of benefits and needs in the aggregate. He stated that Petitioner has invoices and other cost support for all projects listed in Petitioner's Exhibit SSH-1.

Mr. Hoffman generally described the Improvements as either replacement or reinforcement infrastructure. He explained that replacement infrastructure includes mains, valves, hydrants, service lines and meters, while reinforcement infrastructure consists of mains, valves and hydrants with the purpose of improving pressure and flow of the existing distribution system.

Mr. Hoffman testified that some of the retirements associated with the new infrastructure have not been completed because the transfer of services from the existing main to the replacement main would have required curtailment of service. Mr. Hoffman explained that in those cases, both the replacement main and the existing main needed to remain in service to maintain service for all customers during the transfer process. Mr. Hoffman testified that the retirements and costs of removal that were not completed as of the date of Petitioner's filing of its case-in-chief have been estimated by work order and are reflected in Petitioner's Exhibit SSH-1. Mr. Hoffman proposes to reconcile any variance between the actual costs of retirement and costs of removal in Petitioner's reconciliation report.

Mr. Hoffman testified that all Improvements listed in Petitioner's Exhibit SSH-1 meet the DSIC statutory requirements. He stated that none of the projects increase revenues by connecting the distribution system to new customers; all of the projects are in service; none of the projects were included in the rate base in the last general rate proceeding; all necessary local, state and federal permits, approvals and authorizations have been obtained; and there was no affiliate involvement in any of the transactions.

Mr. Hoffman stated Petitioner has a five-year Strategic Capital Expenditure Plan that provides for budgeted amounts of approximately $125,000,000 for replacement mains, hydrants, services and meters for the period 2009-2013. He testified that the budgeted amount for water main replacements required by state and local governments as a result of road improvements and other projects is approximately $27,000,000 over the same time period.

5. Public's Report. The Public presented its report, which included the testimony of Harold H. Riceman. Mr. Riceman described his review of Petitioner's application for the DSIC and concluded that the Petitioner provided adequate support for its DSIC request and that the DSIC filing appears substantiated and correctly calculated. At the evidentiary hearing, Mr. Riceman did not indicate that the corrections discussed by the Petitioner affected his report in any substantive manner.

6. Commission's Discussion and Findings.

A. DSIC Requirements. Indiana Code § 8-1-31-1 *et seq.* authorizes the Commission to approve a DSIC in order to allow a water utility to adjust its basic rates and charges to recover a pre-tax return and depreciation expense on eligible distribution system improvements. Indiana Code § 8-1-31-5 defines eligible distribution system improvements as new, used and useful water utility plant projects that:

(a) do not increase revenues by connecting the distribution system to new customers;

(b) are in service; and
(c) were not included in the public utility's rate base in its most recent general rate case.

Under Indiana Code § 8-1-31-6, the rate of return allowed on eligible distribution system improvements is equal to the public utility's weighted cost of capital. Unless the Commission finds that such determination is no longer representative of current conditions, Indiana Code § 8-1-31-12 provides that the cost of common equity to be used in determining the weighted cost of capital shall be the most recent determination by the Commission in a general rate proceeding of the public utility.

B. DSIC Rule. Indiana Code § 8-1-31-17 authorizes the Commission to adopt by order certain procedures for DSIC administration that are not inconsistent with the provisions of Indiana Code § 8-1-31-1 *et seq.* Pursuant to that authority, the Commission promulgated regulations establishing the policy and procedure governing the efficient recovery of depreciation expenses and pretax returns associated with eligible distribution system improvements. On November 2, 2005, the Commission promulgated General Administrative Order 2005-4, which provided specific forms and formats intended to streamline the application process for establishing a DSIC, facilitate the administration of a DSIC and benefit the public interest.

C. Approval of Proposed DSIC. Petitioner's direct evidence provides an explanation of the methodology used to calculate the proposed additional DSIC revenue requirements of $3,802,319. The total cost for the net investor supplied DSIC Additions is $29,854,511, and the evidence shows the pre-tax return associated with those additions, as calculated in accordance with Indiana Code § 8-1-31-1 *et seq.*, is $3,188,462. The revenue requirement for depreciation on the Improvements is $613,857. The total revenue requirement associated with the DSIC-4 improvements of $3,931,470 is added to Petitioner's DSIC-5 improvements of $3,802,319, which is 4.92%[1] of the revenues authorized in Petitioner's last rate case. This amount is less than 5% of the base revenues approved by the Commission for Indiana-American's water operation and, as such, is not subject to reduction under Indiana Code § 8-1-31-13.

Further, the evidence shows that all of the DSIC improvements are in service, will not result in the addition of new customers to Petitioner's system and fall into NARUC Accounts 331 and 335. As such, they are eligible for inclusion in a DSIC.

Based on the evidence presented, the Commission finds that Petitioner's request for a DSIC complies with the requirements of Indiana Code § 8-1-31-1 and 170 IAC 6-1.1.

7. Reconciliation of Petitioner's DSIC. Petitioner should be prepared to reconcile the DSIC approved by this Order in the manner prescribed by Indiana Code § 8-1-31-14 and 170 I.A.C. 6-1.1-8. Under Indiana Code § 8-1-31-14, at the end of each 12-month period a DSIC is

[1] Petitioner's Exhibit GMV-2R lists the total base water revenue level approved in Cause No. 43187 as $156,876,906, but the total base water revenue approved in Cause No. 43187 was actually $157,229,608.

in effect, the difference between the revenues produced by the DSIC and the expenses and the pre-tax reflected in it should be reconciled and the difference refunded or recovered as the case may be through adjustment of the DSIC.

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

1. A Distribution System Improvement Charge ("DSIC") calculated on a percentage of bill basis and designed to generate $3,802,319 in additional annual revenues shall be and hereby is approved for Petitioner Indiana-American Water Company, Inc.

2. Prior to placing into effect the above-authorized DSIC, petitioner shall file with the Water/Sewer Division of the Commission an appendix to its schedule of rates and charges for water service in the form described in Finding No. 6(C) above.

3. The above-authorized DSIC shall be subject to reconciliation as described in Finding No. 7 above.

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

GOLC, LANDIS, SERVER AND ZIEGNER CONCUR; HARDY ABSENT:

APPROVED: APR 1 5 2009

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