ORIGINAL

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-6** **APPROVED:** OCT 20 2010

BY THE COMMISSION:
Carolene Mays, Commissioner
David E. Veleta, Administrative Law Judge

On August 4, 2010, Indiana-American Water Company, Inc ("Indiana-American" or "Petitioner") filed 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 170 I.A.C. 6-1.1-1 *et seq.* As required by 170 I.A.C. 6-1.1-4, Petitioner's August 4, 2010 Petition constituted its case-in-chief in support of the requested DSIC. On August 12, 2010, Petitioner filed the supplemental testimony of Stacy S. Hoffman and a revised version of Petitioner's Exhibit SSH-1. On September 3, 2010, the Indiana Office of the Utility Consumer Counselor ("Public") filed a report on Petitioner's proposed DSIC pursuant to Indiana Code § 8-1-31-9.

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 September 29, 2010 at 9:30 a.m. EDT in Room 224 of the PNC Center, Indianapolis, Indiana. At the public hearing, the prefiled evidence of Petitioner and the Public was offered and admitted into the record of the proceedings of this Cause. No members of the general public appeared or participated at the evidentiary hearing.

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

1. **Notice and Jurisdiction.** 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. 43680 on April 30, 2010 (the "2010 Rate Order"). Petitioner's most recent DSIC was approved in Cause No. 42351 DSIC 5 on April 15, 2009 (the "DSIC-5 Order"), but the DSIC was reset to zero as a result of the 2010 Rate Order. In accordance with the Commission's rules, Petitioner submitted a Reconciliation Report on May 13, 2010, which included the twelve month reconciliation of DSIC-5 (April 15, 2009 through April 14, 2010) as well as the previously unreconciled period for DSIC-4 (April 2, 2009 through April 14, 2009). Petitioner's Case-in-Chief included an updated Reconciliation Report which includes the reconciliation for the period of April 15, 2010 through May 2, 2010, which was the final DSIC billing period before the DSIC surcharge was re-set to zero due to the implementation of new rates pursuant to the 2010 Rate Order.

The rate base cutoff in Cause No. 43680 consisted of property in service as of June 30, 2009. Therefore, Petitioner proposes to implement a DSIC to include non-revenue producing projects placed in service between July 1, 2009 and June 30, 2010 that were not included in rate base in Petitioner's rate base in the 2010 Rate Order. Petitioner's proposed DSIC would produce total annual DSIC revenues of $5,445,718, which would equate to an increase of approximately 2.82% above the base revenue level approved in Petitioner's 2010 Rate Order.

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.

A. **Calculation of DSIC-6.** Mr. VerDouw testified regarding the filing requirements and methodology for calculating the DSIC. Mr. VerDouw provided 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. He explained that Petitioner is proposing to treat the DSIC as per the Commission's April 2, 2008 Order in Cause No. 42351 DSIC-4, in that the rate would be a percentage that would be applied to both the consumer's volumetric and metered service charge revenues. He further explained that, as per the 2010 Rate Order, Petitioner calculated the DSIC as a single percentage of bills that will be the same for all rate groups.

Mr. VerDouw testified that Petitioner proposes to include only non-revenue producing projects placed in service before June 30, 2010 that were not included in rate base in the 2010 Rate Order. He added 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 2010 Rate Order. He further testified that the final revenue requirement approved in the 2010 Rate Order provides a reasonable estimate of sales for the period in which the DSIC is to be in effect.

Mr. VerDouw then discussed how Petitioner calculated the Net Investor Supplied DSIC Additions. He stated that Petitioner reduced the DSIC Improvements of $35,434,974 by the amount of the related plant retirements associated with the DSIC Improvements, consistent with the DSIC-5 Order. Mr. VerDouw stated that retirements in the amount of $2,563,448 made from July 2009 through June 2010 include reconciled retirements to "true up" estimated retirements that were included in DSIC-5 and were described by Mr. Stacy Hoffman in his testimony included in DSIC-5, as well as an estimate of retirements that have yet to be completed but will be done as a part of the DSIC Additions. Mr. VerDouw explained that he further adjusted the retirement amount for the actual amount of the cost of removal, net of salvage in the amount of $3,412,195. Mr. VerDouw stated that there were total reimbursements from the Indiana Department of Transportation ("INDOT") as well as others, including State Revolving Funds ("SRF"), in the amount of $1,825,388. These reimbursements were removed from the DSIC Improvements, resulting in Net Investor Supplied DSIC Additions of $34,458,333, as shown on Line 5 of Petitioner's Exhibit GMV-3.

Mr. VerDouw also sponsored Petitioner's Exhibit GMV-4, 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 June 2010. He testified that Petitioner used the embedded debt cost rate as of June 2010 to determine the long-term debt cost rate. The common equity cost rate of 10.00% was determined in the 2010 Rate Order, and the weighted cost of capital is 7.40%, and a pre-tax return of 10.61%. Mr. VerDouw stated that the resulting pre-tax return is $3,656,028 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 $789,647 by using the annual depreciation 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 2010 Rate Order.

Petitioner's witness Stacy S. Hoffman sponsored Petitioner's Exhibit SSH-1,[1] which provides a brief description of each Improvement project, the costs 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. This is consistent with Petitioner's presentation in its past DSIC cases. Mr. Hoffman

[1] According to Mr. Hoffman's supplemental testimony, a revised version of Petitioner's Exhibit SSH-1 was filed to provide corrections to the in-service dates for a few of the projects.

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 in these cases where both mains remain in service, the retirements have been completed in the Company's accounting because the Company knows accurate asset types and quantities, and vintage of assets being retired. Mr. Hoffman also testified that for these cases, removal costs have been estimated by work order and are reflected in Petitioner's Exhibit SSH-1. Mr. Hoffman proposes to reconcile any variance between the estimated and actual removal costs 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 explained that as Director of Engineering he has familiarity with these projects through regular communication with Indiana-American Engineering staff during the planning, design and construction phases of these projects. Indiana-American project managers also confirm projects are in service through a physical inspection and then enter in-service dates for completed projects in the Indiana-American accounting software system.

Mr. Hoffman testified regarding the funding of the Improvements. He stated that Petitioner made application to the SRF for grants and loans for various infrastructure improvement projects, and subsequently was awarded $1,080,000 in SRF grants and $1,000,082 in SRF loans for funding several projects in Kokomo, Richmond, Muncie, Gary, Farmersburg and Terre Haute. He said that these projects were completed, are in-service, and are included in this filing. Mr. Hoffman testified that the offsetting reimbursements and contributions received by Petitioner in connection with this DSIC filing are summarized in Petitioner's Exhibit SSH-4.

Mr. Hoffman stated Petitioner has a five-year Strategic Capital Expenditure Plan that provides for budgeted amounts of approximately $124,500,000 for replacement mains, hydrants, services and meters for the period 2011-2015. 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 $34,000,000 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 DSIC and concluded that the Petitioner provided adequate support for its DSIC request and that the DSIC filing appears substantiated and correctly calculated.

6. **Commission 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 consistent 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 a detailed explanation of the methodology used to calculate the proposed DSIC revenue requirements of $5,445,718. The total cost for the net investor supplied DSIC Additions is $34,458,333, 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 $3,656,028. The revenue requirement for depreciation on the Improvements is $789,647. The total revenue requirement associated with the DSIC-6 improvements is 2.82% of the revenues authorized in Petitioner's last rate case and thus is not subject to reduction under Indiana Code § 8-1-31-13.

Furthermore, the evidence shows that all of the projects reflected in the proposed DSIC are in service, will not result in the addition of new customers to Petitioner's system and fall into NARUC Accounts 331, 333, 334, 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 I.A.C. 6-1.1-1 *et seq.* Further, Petitioner's proposed DSIC is non-discriminatory, reasonable and just. Petitioner is therefore authorized to collect from each of its present and future water customers a DSIC as set forth in Petitioner's Exhibit GMV-1.

D. 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 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 $5,445,718 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.

3. The above-authorized DSIC shall be subject to reconciliation as described in Finding No. 6.D. above.

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

ATTERHOLT, LANDIS AND ZIEGNER CONCUR; MAYS ABSENT:

APPROVED: OCT 20 2010

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

Brenda A. Howe

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Secretary to the Commission