

ORIGINAL


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STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF INDIANA-AMERICAN WATER)
 COMPANY, INC. FOR APPROVAL OF (A) A)
 NEW DISTRIBUTION SYSTEM IMPROVEMENT) CAUSE NO. 42351 DSIC 8
 CHARGE ("DSIC") PURSUANT TO IND. CODE)
 CHAP. 8-1-31; (B) A NEW RATE SCHEDULE)
 REFLECTING THE DSIC; AND (C) INCLUSION) APPROVED: DEC 18 2013
 OF THE COST OF ELIGIBLE DISTRIBUTION)
 SYSTEM IMPROVEMENTS IN ITS DSIC)

ORDER OF THE COMMISSION

Presiding Officers:

Larry S. Landis, Commissioner

Aaron A. Schmoll, Senior Administrative Law Judge

On October 1, 2013, 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 ch. 8-1-31 and 170 I.A.C. 6-1.1. On October 2, 2013, Petitioner filed revisions to its case-in-chief to correct for an error in the calculation of the "Total Revenue to Use for Rate Calculation." On October 23, 2013, Petitioner filed a second revision to correct for an error in the calculation of depreciation expense. On October 17, 2013, the City of Crown Point, Indiana ("Crown Point") filed its Petition to Intervene in this Cause, which was granted by the Commission's Docket Entry dated November 6, 2013. The Indiana Office of Utility Consumer Counselor ("OUCC") and Crown Point filed their respective cases-in-chief on October 31, 2013. Petitioner filed its rebuttal testimony and exhibits on November 7, 2013. On November 12, 2013, Sullivan-Vigo Rural Water Corp. filed its Petition to Intervene in this Cause, which was granted at the evidentiary hearing without objection.

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 November 19, 2013 at 9:30 a.m. EST in Room 222 of the PNC Center, Indianapolis, Indiana. At the hearing, the prefiled evidence of Petitioner, Crown Point and the OUCC was offered and admitted into the record. 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 also provided notice of its filing in this Cause to its wholesale customers pursuant to 170 IAC 6-1.1-4. Petitioner is a "public utility" within the meaning of that term in Ind. 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. Pursuant to Ind. Code ch. 8-1-31, the Commission has authority to review a utility's DSIC request. Accordingly, 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 ch. 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. 44022 on June 6, 2012 (the "2012 Rate Order"). Petitioner's most recent DSIC was approved in Cause No. 42351 DSIC 7 on December 27, 2012 (the "DSIC 7 Order"), approving a DSIC for water customers of 2.12% on a calculation of bills basis, calculated to produce a \$3,666,274 net revenue increase after adjusting for over-collection through the surcharge approved in Cause No. 42351 DSIC 6 of \$372,094. In accordance with the Commission's rules, a reconciliation of the DSIC 7 rates will not be due for filing until the 30 days beginning December 27, 2013.

The rate base cutoff in Cause No. 44022 consisted of property in service as of June 30, 2011. The DSIC Improvements approved in DSIC 7 consisted of non-revenue producing projects placed in service between July 1, 2011 and August 31, 2012 and not included in Petitioner's rate base in the 2012 Rate Order. Therefore, Petitioner proposes to add to the DSIC approved in DSIC 7 the non-revenue producing projects placed in service between September 1, 2012 and August 31, 2013 that were not included in rate base in the 2012 Rate Order and were not included in the DSIC Improvements approved in DSIC 7. In addition, Petitioner proposes to include certain meter assets placed in service between July 1, 2011 and August 31, 2013 replacing meter assets that had malfunctioned or that would have been 10 years of age or older as of August 31, 2013 that were not approved in DSIC 7. Petitioner's proposed DSIC would produce total annual DSIC revenues of \$4,409,013, a percentage rate of 2.55% which, when combined with the 2.12% rate directed in the DSIC 7 Order would equate to an increase of approximately 4.67% above the base revenue level approved in Petitioner's 2012 Rate Order.

4. **Petitioner's Direct Evidence.** Petitioner presented the direct evidence of Gregory P. Roach, Manager of Rates for Indiana American, and Stacy S. Hoffman, Director of Engineering for Indiana American.

A. **Calculation of DSIC 8.** Mr. Roach testified regarding the filing requirements and methodology for calculating the DSIC. Mr. Roach 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 Commission's April 30, 2010 Order in Cause No. 43680, Petitioner calculated the DSIC as a single percentage of bills that will be the same for all rate groups.

Mr. Roach testified that Petitioner proposes to include only non-revenue producing projects

placed in service between September 1, 2012 and August 31, 2013 that were not included in rate base in the 2012 Rate Order and were not included in the DSIC Improvements approved in DSIC 7. In addition, Petitioner proposes to include certain meter assets placed in service between July 1, 2011 and August 31, 2013 replacing meter assets that had malfunctioned or that would have been 10 years of age or older as of August 31, 2013, which were also not included in the DSIC Improvements approved in DSIC 7. 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 2012 Rate Order or in the DSIC Improvements approved in DSIC 7.

Mr. Roach then discussed how Petitioner calculated the Net Investor Supplied DSIC Additions. He stated that Petitioner started with DSIC Improvements of \$33,766,728 to which he added the actual amount of the cost of removal, net of salvage of \$4,071,093. Mr. Roach stated that there were total reimbursements from the Indiana Department of Transportation ("INDOT") and others of \$809,187. These reimbursements were removed from the DSIC Improvements, resulting in Net Investor Supplied DSIC Additions of \$37,028,634.

Mr. Roach explained that for purposes of computing the incremental depreciation expense associated with the eligible distribution system improvements, he calculated the Net Investor Supplied DSIC Improvements by removing retirements at gross original cost. For purposes of calculating the incremental pre-tax return associated with the eligible distribution system improvements, Mr. Roach explained that retirements were treated differently in that retirements were not removed at their original cost. Mr. Roach testified that this accounting treatment for retirements represented a change from Petitioner's prior DSIC proposals. He explained that the Commission had issued an Order in Cause No. 44182, Indiana Michigan Power Company's proposed Life Cycle Management Project ("LCM") for the Cook Nuclear Plant (the "I&M Order"), which is consistent with the treatment proposed by Petitioner in this case, holding that only depreciation expense and not return should be adjusted by the accounting entries to remove the original cost of retired assets from utility plant. Mr. Roach testified that there is no provision in the DSIC statute for offsetting against eligible distribution system improvements the original cost of associated retirements. Historically, Petitioner has offset retirements for purposes of the calculation of Net Investor Supplied DSIC Additions on the theory that retirements are associated with the DSIC Additions. In light of the I&M Order, however, and consistent with the respective impact that retirements have on incremental depreciation expense and incremental return, Petitioner has proposed the same treatment approved in the I&M Order.

Mr. Roach testified that if there is to be an offset for retirements for purposes of calculating "pre-tax return" as that term is defined in the statute, it should be the rate base impact from the retirement transactions. He described the three essential transactions in retirement accounting: one to record the retirement of the plant from Utility Plant in Service and Accumulated Depreciation, one to record the cost of physically removing the plant, and one to record any salvage value derived from the retired plant. He explained that only the second and third transactions produce an incremental rate base impact and it would therefore be inappropriate to reduce the additions subject to DSIC by the original cost of the assets retired and artificially reduce the amount of eligible investment subject to a pre-tax return. He stated the net costs of removal are the only rate base impact from the retirement of the asset that is being replaced with the DSIC Improvements.

Mr. Roach also sponsored Petitioner's Exhibit GPR-3, Petitioner's rate of return summary.

Mr. Roach explained that the rate of return used in this proceeding is Petitioner's weighted average cost of capital computed from Petitioner's capital structure as approved by the Commission in the 2012 Rate Order. He testified that Petitioner used the embedded debt cost rate as of June 2011 to determine the long-term debt cost rate. The common equity cost rate of 9.70% was determined in the 2012 Rate Order, and the weighted cost of capital of 6.95% and a pre-tax rate of return of 9.75% were derived as shown on Petitioner's Exhibit GPR-3. Mr. Roach stated the pre-tax rate of return was calculated using a gross revenue conversion factor of 1.6841, calculated using Utilities Receipts Tax of 1.4%, State Corporate Adjusted Gross Income Tax of 7.25% and Federal Income Tax of 35%. He explained that the State Income Tax was calculated using an average of the effective tax rate for the period July 1, 2013 to June 30, 2014 by averaging the rates of 7.5% (2013) with the rate of 7.0% (2014). Mr. Roach stated that the resulting pre-tax return is \$3,610,290 when the pre-tax overall rate of return is multiplied by the net investor-supplied original cost of the Improvements.

Mr. Roach stated that Petitioner determined its depreciation expense of \$798,723 by using the annual depreciation rates by primary plant account previously approved by the Commission, multiplied by the Improvements, net of related retirements.

Mr. Roach testified and provided exhibits showing that the proposed DSIC Revenues, when combined with the DSIC Revenues from DSIC 7 are within the 5% range of Petitioner's base revenues as approved by the Commission in the 2012 Rate Order.

B. Description of DSIC Improvements. Petitioner's witness Stacy S. Hoffman sponsored Petitioner's Exhibit SSH-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 the National Association of Regulatory Utility Commissioners ("NARUC") Uniform System of Accounts for Class A Water Utilities ("USoA"), and Petitioner's Operation area where each project exists.

Mr. Hoffman provided greater detail regarding the Improvements exceeding \$100,000 in total costs. For each of these Improvements, he explained why the improvement was needed, the resulting benefits to Petitioner and its customers and whether the plant had been retired. This is consistent with Petitioner's presentation in its past DSIC cases. At the hearing, Mr. Hoffman committed to add, in future DSIC cases, the total cost and new pipe diameters per project in his detailed description of Improvements exceeding \$100,000. Some of the projects described by Mr. Hoffman were replacing distribution system facilities that were in poor condition, and some of which still had book value for accounting purposes. Other projects included distribution system facilities replaced because they were located in right-of-way and had to be moved because of road or other projects. Because these were in the right-of-way, they had to be removed at Petitioner's cost and as such, had no remaining life. As such, all of the projects had reached the end of their useful life from a service standpoint, even though they may have continued to have remaining book value for accounting purposes. Mr. Hoffman 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 water mains, tanks, tank coating systems, 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. At the hearing, Mr. Hoffman testified that reinforcement infrastructure

has been included in several prior DSICs. He testified regarding two reinforcement mains included in DSIC 7, each of which have been connected to four additional residential customers since the DSIC 7 Order was issued. He stated that the annual revenue for water service for four residential customers would be approximately \$1,900, or \$3,800 for all eight additional connections.

Mr. Hoffman testified about the inclusion of tank-related projects in Petitioner's proposed DSIC, referring to the DSIC 7 Order in which the Commission authorized DSIC recovery on tank-related projects consisting of foundation rehabilitations, a paint rehabilitation, a tank roof replacement and some distribution pump work to enable Indiana American to take the tanks offline. He testified that the tank-related projects included in this DSIC 8 are similar to those included in DSIC 7 insofar as they consist of capital rehabilitation work on existing tanks and not construction of new tanks. He noted the projects are recorded in USoA distribution accounts, do not increase water storage capacity, and otherwise meet the statutory criteria to qualify as eligible distribution system improvements.

Mr. Hoffman testified that not all of the retirements associated with the new infrastructure have been completed because transfer of service lines from existing water mains to replacement mains was still in progress for some projects. He stated that retirements that were not physically completed as of the date of Petitioner's filing have been completed in the Petitioner's accounting for those retirements because Petitioner knows accurate asset type and quantities, and vintage of assets being retired.

In addition to the change in presentation of retirements in this DSIC 8, Mr. Hoffman described a change in Petitioner's accounting process for cost of removals for blanket mass assets, which are short-term projects typically taking only one day to complete, including replacement of meters, service lines, hydrants and valves. Mr. Hoffman explained that Petitioner had implemented a new process for monthly accounting for cost of removals ("CORs") with the implementation of its new SAP system. He stated the new COR accounting process for blanket mass asset projects accounts for CORs monthly using a multi-year historical percentage split of costs between additions and CORs for this type of work. With respect to non-blanket mass asset projects (including main replacements, main relocations, system main reinforcements, and tank painting system replacements), Petitioner's new COR accounting process accounts for CORs monthly using the specific project bid costs for CORs as a percentage of additions. At project completions, the total of the monthly CORs are reconciled to actual CORs. He explained that any variations between actual COR values and the sum of monthly accounted COR values are true-up in the Petitioner's accounting software at the final completion of the projects, and proposed that any true-ups be reflected in the Petitioner's next rate filings. Mr. Hoffman stated these process changes were implemented to result in a more accurate, consistent and efficient process for accounting for CORs.

Mr. Hoffman then described two categories of meter replacements included in this DSIC 8: meters replaced as part of the Company's length of service ("LOS") plan, and meters replaced under the Company's accelerated automated meter reading ("AAMR") plan that were or would have been 10 years old or older as of August 31, 2013. He described the LOS plan, which consists of replacing meters at the LOS age approved by the Commission in Petitioner's 30-Day Filing No. 2610 approved on January 20, 2010 and of replacing stuck and broken meters regardless of age. He then described the AAMR category of meters, citing the DSIC 7 Order as support for inclusion of meters that were or would have been 10 years old or older as of August 31, 2013. Petitioner's Exhibit SSH-4 shows that approximately \$3.3 million of the Improvements related to meters are in

the AAMR category. The balance of meter-related Improvements shown on Petitioner's Exhibit GPR-2, Schedule 3, Page 1 of 7 are in the LOS plan category and amount to approximately \$6.6 million. Mr. Hoffman explained that meter replacements included in this DSIC either (a) under the LOS plan or (b) under the AAMR plan meeting the criteria of being 10 years old or older, date back to July 2011 because these meters were not included in the approved revenue from DSIC 7.

Mr. Hoffman testified that all Improvements listed in Petitioner's Exhibit SSH-1 meet the DSIC statutory requirements. 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 projects included in this DSIC 8 were funded by Petitioner or were reimbursed by INDOT or others, as noted by Mr. Roach.

Mr. Hoffman stated Petitioner has a five-year Strategic Capital Expenditure Plan that provides for budgeted amounts of approximately \$170,900,000 for replacement mains, reinforcement mains, DSIC tank related work, hydrants, services and meters for the period 2014-2018. He testified that included in this amount is approximately \$29,300,000 budgeted over the same period for water main replacements required by state and local governments as a result of road improvements and other projects.

5. OUCC's Case-in-Chief. The OUCC presented testimony of Harold H. Riceman and Margaret A. Stull. Mr. Riceman described his review of Indiana American's petition for a DSIC. He explained Petitioner presented approximately 1,000 work orders, including many blanket orders, totaling \$33,766,728, retirements totaling \$5,609,657 and costs for removal and salvage totaling \$4,071,093. The brief time permitted in this proceeding and the number of improvements requires the use of auditing procedures to only a representative sample of the improvements to project or extrapolate the sample results and make inferences about the entire population. Consistent with past practice in DSIC cases, Mr. Riceman selected a representative sample of work orders to review from Petitioner's Exhibit SSH-1. Mr. Riceman concluded that, based on Ms. Stull's testimony, the OUCC recommends an additional DSIC of 2.23% for a total DSIC of 4.35% compared to Petitioner's additional DSIC of 2.55% for a total DSIC of 4.67%.

Ms. Stull testified in opposition to Petitioner's proposed accounting treatment for retirements. Ms. Stull noted that since the Commission's final order in DSIC 1, in which it determined how retirements should be treated, Petitioner has calculated the net original cost of eligible distribution system improvements by netting distribution plant additions against related distribution plant retirements. Ms. Stull noted the foregoing calculation included the following components:

DSIC Additions
Add: Removal Costs related to retired plant
Less: DSIC Retirements
Salvage Value
Contributions-in-aid of Construction (CIAC)

Ms. Stull noted that for the first time since Petitioner's DSIC 1 filing, Petitioner proposes to exclude retirements from its calculation of the net original cost of eligible distribution system improvements, thereby increasing the net original cost of eligible distribution system improvements. She argued that Petitioner's proposal to exclude retirements from its calculation of the net original cost of eligible distribution system improvements is inconsistent with the Commission's order in Cause No. 42351 DSIC 1 issued on February 27, 2003 ("DSIC 1 Order").

Ms. Stull indicated Petitioner has already made this argument and the Commission has already rejected it. Ms. Stull noted that in its case-in-chief in DSIC 1, Petitioner likewise did not include retirements in its calculation of net original cost of distribution system improvements. She explained that the OUCC responded in that case by reducing what it considered to be the eligible distribution system improvements by the original cost of the related retirements. Ms. Stull noted that in that first DSIC, Indiana-American responded to the OUCC by arguing, "under mass asset accounting rules, retirements are treated as fully depreciated with the original cost being deducted from both utility plant and accumulated depreciation." Ms. Stull added Indiana-American's witness in DSIC 1 argued that since such a retirement results in no change to the net book value of the Company's assets, "it is inappropriate to reduce the additions subject to DSIC by the original cost of the assets retired and artificially reduce the amount of eligible investment subject to a pre-tax return." *Indiana American*, Cause No. 42351 DSIC 1 at 12 (Feb. 27, 2003). Ms. Stull advised that the Commission rejected this argument and found that in determining net eligible distribution system improvements, retirements should be included in the calculation. Ms. Stull noted that the Commission explained in its DSIC 1 Order that while retiring an asset has no impact on the utility's net book value under mass accounting rules, this factor is irrelevant since such a factor would only apply in original cost ratemaking, and Petitioner's rate base is based on the fair value of its assets. Ms. Stull also recited that part of the DSIC 1 Order, which noted that when any asset with a positive fair value is retired that will reduce the utility's fair value rate base, and "thus, if retirements are ignored and a utility is allowed to earn a return on new plant through a DSIC, they will collect a return on both the new plant through its DSIC and on the retired asset through its return on the fair value rate base determination from the utility's last rate case."

Ms. Stull advised that the Commission further noted in that Cause:

Mass accounting rules do not apply to the Commission's determination of a utility's fair value and any retirement of plant will impact the fair value rate base. . . . While aged plant that is retired may have a negligible original cost, the fair value of such retired assets may not be negligible and not so easily determined.

Ms. Stull rejected Petitioner's assertion that there is no provision in the DSIC statute for offsetting retirements against eligible distribution system improvements since the DSIC statute states that one component of the DSIC rate is the return on the "net original cost of eligible distribution system improvements." Ms. Stull acknowledged that the statute does not include a definition of the term "net original cost of eligible distribution system improvements," but noted that the Commission construed the term "net" to include both salvage value and retirements. Ms. Stull added that the Commission has the ability and expertise to interpret the statutes it is required to implement. Ms. Stull asserted that the Commission's determination in DSIC 1 properly construed the term "net original cost of eligible distribution system improvements" to authorize it to offset retirements against Indiana-American's eligible distribution system improvements.

Noting Petitioner's reliance on the Commission's final order in Cause No. 44182 for its proposed treatment of retirements, Ms. Stull referenced a more recent final order issued in Cause No. 42150 ECR 21, which reaffirmed the principle that in a tracker, a utility should not be permitted to earn a return on both the retired assets as well as the assets replacing them. Ms. Stull noted that the order indicated that ratepayers should not be required to pay for both additions "when only one is actually in service." *Northern Ind. Pub. Serv. Co.*, Cause No. 42350 ECR 21, at 14 (Oct. 16, 2013). Ms. Stull indicated this finding comports with the DSIC procedures established in the DSIC 1 Order and with the OUCC's position in this Cause. Ms. Stull concluded that based on the methodology used in all previous Indiana-American DSIC cases, the OUCC recommends an additional DSIC of 2.23% for a total DSIC of 4.35% (MAS-2).

6. Crown Point's Case-in-Chief. Gregory T. Guerrettaz, President of Financial Solutions Group, Inc., offered testimony on behalf of Crown Point. Mr. Guerrettaz recommended the exclusion from recovery in this DSIC 8 period the meters replaced under Petitioner's AAMR plan that were or would have been ten years old or older as of August 31, 2013 and were included in Petitioner's DSIC 7 filing but were not approved in that Order. He also recommended that Petitioner be required to continue to deduct retirements from additions in the DSIC process and observed that if such an accounting change is to be considered, it should be considered in a separate docket or as part of Petitioner's next base rate case, not in the compressed time frame of ongoing DSIC adjustments.

Mr. Guerrettaz disagreed with Petitioners' reliance on DSIC 7 to justify inclusion of the AMR expense in DSIC 8 denied in DSIC 7. He cited the DSIC 7 Order language that expressed concern that Petitioner failed to provide the AMR evidence the OUCC had requested:

Further, recovery of the replacement cost of newer traditional meters with AMR meters does not fit within the context of the DSIC in that the Commission stated in DSIC 1 that the purpose of DSIC recovery is to replace aged infrastructure. We agree with Mr. Kaufman's assessment that the replacement of meters older than 10 years could be recoverable in a DSIC. However, despite having the opportunity to respond to Mr. Kaufman, Petitioner did not include in the record the necessary information for the Commission to determine what the DSIC factor would be if only 10 year and older meters were considered. While Petitioner's Exhibit SSH-R1 indicates the number of meters replaced older than 10 years, it is unclear whether that discovery response is solely for the DSIC 7 period. Further, we do not have the retirement costs of the 10-year and older meters that were replaced, nor do we have the cost of meters and associated installation costs related to the AMR meters used to replace 10-year or older meters.

Unlike Mr. Hoffman, Mr. Guerrettaz did not view the Commission statement that ten year and older meters "could be recoverable in a DSIC" as an agreement of recoverability or an invitation to, in a subsequent DSIC period, provide that missing information. He viewed it as a past invitation for Petitioner to seek leave to file additional evidence within DSIC 7. However, instead of following that route within the context of DSIC 7, Petitioner unsuccessfully appealed the Commission's DSIC order. Mr. Guerrettaz testified Petitioner should not be allowed to carry forward the AMR amounts rejected in DSIC 7.

Regarding Petitioner's proposed change in DSIC accounting to not reduce DSIC Additions by Retirements, Mr. Guerrettaz testified Petitioner has again exceeded the intent and tolerance of the water utility DSIC process by trying to modify its DSIC accounting treatment based on an I&M Order for nuclear electric generation plant life cycle management. Mr. Guerrettaz stated that this proposal to modify the DSIC accounting process mid stream is inappropriate for the 60-day DSIC process and it abruptly results in higher charges to water customers.

Mr. Guerrettaz disagreed with Mr. Hoffman's assertion that "[t]he Commission agreed with our proposed treatment and held that retirements are only appropriately removed for purposes of computing depreciation expense and not return." Mr. Guerrettaz pointed out that the I&M LCM Project was a standalone docketed case of substantial size and effort that took more than 15 months to complete. The accounting treatment for that nuclear plant was given as part of "financial incentives" within LCM for nuclear generation plant. To request that same accounting treatment for Petitioner's DSIC water plant is at best misplaced. He testified if the Company wants in DSIC the same accounting treatment as given as part of "financial incentives," it should make that proposal in a base rate case or some other case, not in the DSIC. He testified Petitioner should stop trying to expand the broadness of DSIC and instead keep it simple, straight-forward, and appreciate the benefits from being able to track in rates its aged plant replacements. Mr. Guerrettaz also noted that as recently as October 16, 2013, the Commission issued an Order in Cause No. 42150 ECR 21 for NIPSCO treating retirements as they have been in past DSICs stating, "We conclude that NIPSCO shall be allowed to seek recovery of its full depreciation expense (return of investment) for the replacement layer. However, NIPSCO shall only be allowed to seek recovery of the incremental amount of the return on its investment for the replacement catalyst layer that exceeds the return on investment currently included in its base rates and charges for the original catalyst layer."

7. Petitioner's Rebuttal.

A. Retirements. Mr. Roach offered testimony to respond to Ms. Stull's and Mr. Guerrettaz's suggestion that Petitioner's proposed accounting treatment for retirements be rejected. Mr. Roach explained that Petitioner's retirement accounting entries are made in accordance with NARUC 1996 USoA, accounting Instructions for Additions and Retirements. He walked through the journal entry for retirements, consisting of a debit to accumulated depreciation of the original cost of the retired unit and a credit to utility plant in service ("UPIS") of the original cost of the retired unit. He stated this has a net zero impact on the rate base calculation, while generally resulting in a reduction of depreciation expense. He testified that it would not be appropriate accounting practice, or fair to Petitioner, to reduce DSIC additions by the original cost of the replaced asset because that treatment disregards the fact that the accumulated depreciation reserve is charged with an equal amount, resulting in net zero rate base impact upon retirement. Mr. Roach further noted that Ms. Stull's proposed netting of UPIS for retirements assumes that Petitioner's rates reflect a return on the gross original cost of the replaced asset when in fact the return is calculated on the net original cost.

Mr. Roach explained it could be appropriate to offset the DSIC Improvements for depreciation expense that has accrued on the assets from their in-service date to the filing date, thus producing the "net original cost" of the DSIC Improvements. He acknowledged that Petitioner's filing did not include a deduction from the revenue requirements of accumulated depreciation recorded on DSIC additions from the in-service date through the DSIC recovery period of August 2013. He testified the total amount of accumulated depreciation for that purpose would be

\$705,102. The resulting Net Investor Supplied DSIC Additions net of this amount would be \$36,323,532, pre-tax return on additions of \$3,541,544, Total DSIC Revenue for this DSIC 8 of \$4,340,267 for a DSIC Percentage Applied to Bill of 2.51% and DSIC Percentage Increase of 2.19%. The resulting net reduction to the DSIC 8 revenue requirement would be \$68,746.

Mr. Roach addressed Ms. Stull's reliance on the NIPSCO Order. He first reiterated that Petitioner's proposed treatment of retirements is completely consistent with the I&M Order, which he explained is consistent with the USoA. Mr. Roach noted that the NIPSCO Order was issued after Petitioner had filed its case-in-chief in this Cause and reaches a different result from the I&M Order. He pointed out that the NIPSCO Order indicates that the Commission intended to be consistent with the provisions of the I&M Order, but the actual result of the two orders is somewhat difficult to reconcile. Under the NIPSCO Order, he explained, the retirements are removed at net original cost in computing the incremental return that would be allowed, but are not removed for purposes of computing incremental depreciation expense. He also stated that the result reached in the NIPSCO Order is inconsistent with the treatment of retirements proposed by Ms. Stull. Ms. Stull proposed that retirements be removed for purposes of computing both return and depreciation expense. In addition, the NIPSCO Order does not require removal of the retirements at gross original cost as Ms. Stull proposes, but at net original cost. If the NIPSCO Order was followed, Mr. Roach explained, Petitioner would not make any reduction to the depreciation expense for retirements and would be required to estimate a theoretical reserve associated with the retired assets to net against UPIS in the return calculation. He explained that the offset to accumulated depreciation based on this theoretical reserve could, in some instances, exceed the original cost of the retired asset if its actual life exceeds its estimated useful life for depreciation purposes. He supplied the following information showing the estimated percentages of the DSIC 8 retirements falling into various age categories (stated in terms of amount of useful life remaining at retirement) to illustrate the impact it would have on Petitioner's DSIC calculation if the NIPSCO Order were followed:¹

<i>Indiana American Water Company</i>		
<i>DSIC 8 Retirements</i>		
<u><i>Remaining Estimated Useful Life % at Retirement</i></u>		
0.00% (reached or exceeded life)	(\$1,179,703.17)	21.03%
1.00% to 25.00% life remaining	(763,306.61)	13.61%
25.01% to 50.00% life remaining	(2,095,277.24)	37.35%
50.01% to 75.00% life remaining	(603,215.66)	10.75%
75.01% to 95.08% life remaining	(968,154.34)	17.26%
	<u>(\$5,609,657.02)</u>	100.00%

¹ Using this information, Mr. Roach testified that the offset for retirements would not be \$5,609,657 as proposed by Ms. Stull but would be for a lower amount to reflect the accumulated depreciation that would have theoretically been recorded on these retired assets. Under the most conservative estimate (e.g., all of the amount which had reached or exceeded its useful life was precisely at 0% (i.e., the end of its useful life), all of the amount from 1% to 25% remaining was at 25% remaining, etc.), the most the offset for net original cost of the retired assets would be \$2,659,031.

Mr. Roach also testified that Petitioner's proposed accounting treatment is an appropriate issue to be determined in a DSIC proceeding, because the proposal is simply to follow the USoA as required by the Commission's rules.

Mr. Roach also addressed Ms. Stull's contention that Petitioner's treatment of retirements should be impacted by the fact that Indiana is a fair value state and that Indiana American receives a fair return on fair value. He explained that since 1996, the only incremental return associated with the Commission's making a fair value determination and fair rate of return finding with respect to Indiana American has been to increase the return associated with the fair value increment to purchase the Indiana Cities system. The Commission has not authorized an additional return over net original cost ratemaking because a particular main, hydrant, valve, etc. has a fair value in excess of its net original cost. Instead, Mr. Roach explained, in all subsequent orders, the Commission's fair value finding has simply been an update of the prior fair value finding from that 1996 order and the treatment for fair value is solely to reflect a full return on the Indiana Cities acquisition.

In summary, Mr. Roach testified on rebuttal that the Commission needs to first decide whether to follow the I&M Order or the NIPSCO Order. If the I&M Order is followed, the accounting treatment prescribed by the NARUC USoA would apply. If the NIPSCO Order is followed, the result would be a much more limited reduction to the DSIC total investment than Ms. Stull proposes, because the retirements should be offset by associated accumulated depreciation using the percentages Mr. Roach supplied. Retirements would not be offset in computing the depreciation expense on the DSIC Improvements under the NIPSCO Order's approach.

B. AAMR Meter Replacements. Mr. Hoffman addressed Mr. Guerrettaz's testimony that meter replacements that were not approved in DSIC 7 should not be included in this DSIC. Mr. Hoffman disagreed with Mr. Guerrettaz's interpretation of the DSIC 7 Order. He clarified that all AAMR meters included in this DSIC 8 were installed in the time period from July 1, 2011 through August 31, 2013 and none of those meters have heretofore been included in rate base. He testified that Petitioner has now provided the information the Commission identified in its DSIC 7 Order as being necessary for approval in a DSIC. He explained that he is unaware of any principle in rate proceedings that would prohibit a Petitioner from requesting review of an issue discussed in a prior case, especially when supplemental information is being provided. He asserted that this principle of allowing fair review is all the more pertinent given the Commission had never previously discussed in detail DSIC eligibility parameters for AAMR meters.

Mr. Hoffman responded to Mr. Guerrettaz's suggestion that Petitioner should have included supplemental information in rebuttal in DSIC 7 or petitioned for leave to submit additional evidence in DSIC 7 after the Order was issued. He pointed out that the only party who has suffered detriment by not having done so is Petitioner, which has gone for an extra year without recovering costs of ten year old and older AAMR meters. He further pointed out that, by waiting to include the additional information in DSIC 8, the parties and the Commission have actually been provided more time to review the additional information in the full time allotted in this proceeding as compared with the abbreviated time that would have existed had Petitioner submitted the additional information on rebuttal in DSIC 7 or after the DSIC 7 Order was issued.

8. Commission Discussion and Findings.

A. DSIC Requirements. Indiana Code ch. 8-1-31 requires 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. Approval of Proposed DSIC.

(1) **Retirements.** Petitioner proposed to treat retirements as an offset for purposes of calculating the incremental depreciation expense but not for purposes of calculating the incremental pre-tax return associated with the DSIC Improvements. This proposal differs from how the Commission stated, in DSIC 1, that DSIC retirements should be calculated, and Petitioner's proposal in this Cause was rejected by the OUCC and Crown Point.

In support of its position, Petitioner cited to our Order in Cause No. 44182, which stated:

With regard to the OUCC's concern that there could be additional recovery on replaced equipment in base rates at the same time new equipment will be tracked through the LCM, we are not persuaded that this concern is justified. As Mr. Krawec explained, I&M's proposal mitigates this potential by virtue of the Company requesting recovery of incremental depreciation expense, incremental property tax increase, and carrying charges for post-in-service equipment. Further, we agree with Mr. Krawec that when the replaced item is retired, the remaining original cost is transferred to the accumulated depreciation reserve account. This causes depreciation expense to decrease, but there is no effect on net plant balances, and accordingly, no effect on rate base. And because rate base is unchanged by the retirement, it would not be appropriate to reduce the incremental carrying charge on the new asset as suggested by Mr. Blakely.

I&M, Cause No. 44182 (IURC July 17, 2013). Petitioner stated that its proposed treatment of the original cost retirements in this Cause is similar to the treatment approved for *I&M*.

Our Order in DSIC 1 directly addressed this issue, and we see no reason to adopt a new methodology in this Cause, especially given that Petitioner's current proposal is essentially the same as what this Commission rejected in DSIC 1. We note that our Order in Cause No. 44182

dealt with an entirely different statutory scheme to incent energy utilities to undertake “clean energy projects,” and thus provides little guidance in this case.

Moreover, contrary to Mr. Roach’s statement that there is no provision in the DSIC statute for offsetting the original cost of associated retirements against eligible distribution system improvements, Ind. Code § 8-1-31-11 requires the Commission to determine an “appropriate pretax return.” “Appropriate pretax return” is defined as “the revenues necessary to [] produce net operating income equal to the public utility’s weighted cost of capital multiplied by the net original cost of eligible distribution system improvements.” While “net original cost” is not defined in statute, our treatment of retirements from DSIC 1 appropriately nets the original cost of the retired asset from the DSIC improvement. Otherwise, “if retirements are ignored and a utility is allowed to earn a return on new plant through a DSIC, they will collect a return on both the new plant through its DSIC and on the retired asset through its return on the fair value rate base determination from the utility’s last rate case.” DSIC 1 at 23. Any proposal to change existing DSIC accounting methodologies should be addressed in Petitioner’s next rate case, not in the context of an expedited DSIC proceeding.

In conclusion, for purposes of determining the appropriate DSIC revenues in this Cause, we direct Petitioner to calculate retirements as set forth in OUCC Exhibit 2 by Ms. Stull.

(2) **AAMR Meter Replacements.** Crown Point’s witness Guerretaz recommended we disallow recovery for Petitioner’s meter replacements that were included in Petitioner’s filing in DSIC 7 but not approved in our DSIC 7 Order.

In that Order, the Commission stated:

We agree with Mr. Kaufman’s assessment that the replacement of meters older than 10 years could be recoverable in a DSIC. However, despite having the opportunity to respond to Mr. Kaufman, Petitioner did not include in the record the necessary information for the Commission to determine what the DSIC factor would be if only 10 year and older meters were considered. While Petitioner’s Exhibit SSH-R1 indicates the number of meters replaced older than 10 years, it is unclear whether that discovery response is solely for the DSIC 7 period. Further, we do not have the retirement costs of the 10 year and older meters that were replaced, nor do we have the cost of meters and associated installation costs related to the AMR meters used to replace 10-year or older meters.

Given our statement in DSIC 7, we find that Petitioner has not waived the right to seek DSIC recovery in this Cause for meter replacements of older meters during the period July 1, 2011 through August 31, 2013. Petitioner’s decision to appeal the Order in DSIC 7 versus seeking leave to supplement the record in DSIC 7 resulted in a substantial self-inflicted delay in recovering its AAMR investments. Nothing in the DSIC statute prevents a utility from seeking recovery of DSIC-eligible assets that were not previously included in a DSIC or a rate case. Accordingly, we include the AAMR meter replacements (meters ten years old and older) from DSIC recovery in this Cause.

While we grant relief as requested by Petitioner with respect to AAMR replacements, we believe that as an accelerated meter replacement plan, Petitioner would be better served by proposing a different mechanism for AMR recovery, outside of the DSIC process, in its next rate case. *See Indiana-American Water Co., Inc.*, Cause No. 44059 (IURC, Dec. 19, 2012) (approving

settlement agreement that provided for deferral accounting treatment for IT system replacement). Such a proposal could provide Petitioner the opportunity to recover costs for all AMR meter replacements, and allow the DSIC proceedings to continue to focus on replacement of aging infrastructure.

(3) **Projects and Amounts to be Included as Distribution System Improvement Charges.** The OUCC used the DSIC 1 methodology to calculate the DSIC revenue requirements of \$3,862,073. The total cost for the net investor supplied DSIC Additions is \$31,418,976, and the evidence shows the pre-tax return associated with those additions, as calculated in accordance with Indiana Code ch. 8-1-31 is \$3,063,350. The revenue requirement for depreciation on the Improvements is \$798,723. The total revenue requirement associated with the DSIC 8 Improvements is 2.23% 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, do not result in the addition of new customers to Petitioner's system and fall into NARUC Uniform System of Accounts for Water Utilities Accounts 330, 331, 333, 334, or 335. As such, they are eligible for inclusion in a DSIC. Crown Point questioned whether Petitioner's reinforcement mains provide for customer growth. We find that while new customers may eventually connect to replacement or reinforcement mains once they have been installed, the possibility that such connections may occur in the future does not change the initial eligibility for DSIC inclusion.

Finally, at the hearing, Mr. Hoffman suggested that DSIC revenues in the next DSIC could be offset by the annual revenues added by the eight new customers. We appreciate Mr. Hoffman's proposal, but as previously noted, DSIC eligibility is not conditioned on whether future connections occur. We decline to make a finding in this Cause on what amount of new connections may suggest that a project was intended to connect new customers despite labeling to the contrary, and thus not eligible for DSIC treatment.

(4) **Filing Requirements.** In response to a request from Crown Point, Petitioner committed to add, in future DSIC cases, the total cost per project in his detailed description of Improvements exceeding \$100,000. In response to a request from the OUCC, Petitioner also committed to add the new pipe diameters of replacements in its description of those projects. We find those changes to be appropriate and find that Petitioner's use of a materiality threshold in its presentation of the DSIC Improvements is appropriate.

C. **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 DSIC calculated on a percentage of bill basis and designed to generate \$3,862,073 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.

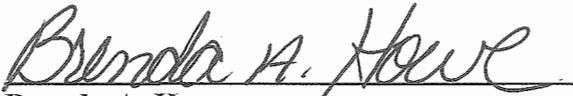
3. The above-authorized DSIC shall be subject to reconciliation as described in Paragraph 8(C) above.

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

ATTERHOLT, LANDIS, MAYS, AND ZIEGNER CONCUR:

APPROVED: DEC 18 2013

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



Brenda A. Howe
Secretary to the Commission