

ORIGINAL



STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

IN THE MATTER OF THE PETITION)	CAUSE NO. 43551 U
OF FORTVILLE MUNICIPAL)	INTERIM ORDER
WATER UTILITY FOR A NEW)	APPROVED: APR 22 2009
SCHEDULE OF RATES AND)	
CHARGES)	

BY THE COMMISSION:

Jeffrey L. Golc, Commissioner
Angela Rapp Weber, Administrative Law Judge

On August 7, 2008, Fortville Municipal Water Utility ("Fortville" or "Applicant") filed with the Indiana Utility Regulatory Commission ("Commission") its Small Utility Application for a Rate Change pursuant to IC § 8-1-2-61.5 and 170 IAC 14-1. Fortville applied for a 96.75% rate increase to generate \$510,836 in additional revenues in order to: (1) cover its increased operating expenses and (2) provide financing for its proposed \$3.5 million Capital Improvements Program ("CIP"). On August 26, 2008, the Commission's Staff issued a memorandum stating that Fortville's application was complete.

Pursuant to IC § 8-1-2-61.5, a formal public hearing is not required in rate cases involving small utilities with fewer than 5,000 customers unless a hearing is requested by at least ten customers, a public or municipal corporation or by the Office of Utility Consumer Counselor ("OUCC"). On September 30, 2008, the OUCC filed a request for a public field hearing in order to receive customer comment. In addition, the OUCC requested that its filing deadline be continued in order to incorporate customer comments into its report. The Presiding Officers granted the OUCC's request pursuant to a Docket Entry issued on October 14, 2008. A Public Field Hearing was held on October 29, 2008 at the Mount Vernon Intermediate School, 8414 North 200 West, Fortville, Indiana. On November 19, 2008, the OUCC filed its report, which recommended that the Commission approve an overall rate increase of 21.13% and excluded any increase for the \$3.5 million financing for Fortville's proposed CIP. The OUCC recommended that the financing be considered and approved in a later phase of this Cause. In addition, the OUCC recommended changes to Fortville's current accounting and operational practices.

On December 2, 2008, through its accounting consultant, Fortville expressed its intent to file a written response to the OUCC's report pursuant to 170 IAC 14-1-4. Subsequently, Fortville declined to provide a written response. Instead, Fortville and the OUCC (together, the "Parties") notified the Commission that they intended to negotiate a settlement in this Cause. After a lengthy negotiation period, the Parties submitted to the Commission an agreed-to proposed order. The Parties agreed to an overall rate increase of 27.93% subject to certain conditions described below. On March 23, 2009, the OUCC filed with the Commission supplemental schedules and attachments to support the proposed rate increase.

Based upon the applicable law and the evidence presented herein, the Commission now finds the following:

1. **Commission Jurisdiction and Notice.** Due, legal and timely notice of the matters in this Cause was given and published as required by law. Applicant's evidence indicates that Applicant provided to each of its customers a notice of the filing of its Application for rate change, as required by 170 IAC 14-1-2(b)(2). Applicant is a municipal water utility as defined by IC § 8-1-2-1 and a small utility as defined by 170 IAC 14-1-1(h). Fortville provides water utility service to approximately 1,730 customers in Hancock County, Indiana. The Commission has jurisdiction over the Applicant and the subject matter of this cause.

2. **Applicant's Characteristics.** Fortville Municipal Water Utility is located in northeast Hancock County and delivers approximately 445,000 gallons of water per day to approximately 1,730 customers, which includes 1,610 residential customers, eighty-seven commercial, five industrial and twenty-eight classified as other. Customer growth was 1% or less annually from 2000 to 2005. Fortville also operates municipal wastewater and storm water facilities that are not a part of this Cause. Applicant's last general rate order was issued in Cause No. 40968-U on March 11, 1998. On December 1, 1999, in Cause No. 41537, the Commission approved a decrease in Applicant's base rates and authorized a capacity fee of \$1,200 per lot.

3. **Test Period.** The test period selected for determining Fortville's revenues and expenses reasonably incurred in providing water utility service to its customers includes the twelve (12) months ending December 31, 2007. With adjustments for changes that are fixed, known and measurable, the Commission finds that this test period is sufficiently representative of Fortville's normal operations to provide reliable data for ratemaking purposes.

4. **Operating Revenue.** The OUCC has determined that Fortville's pro forma present annual operating revenue is \$524,615. The Commission agrees with this calculation.

5. **Proposed Financing.** Fortville's CIP includes system improvements that consist of a new 500,000 gallon elevated tank at a cost of \$1,530,000, rehabilitation of its existing 300,000 gallon tank at a cost of \$350,000 and various water main extensions at a cost of \$1,160,000. In order to fund these projects, Fortville submitted an application to the Indiana State Revolving Fund ("SRF") for \$3,500,000, which includes financing for soft costs such as engineering, inspection, legal and bond. Applicant's proposed rate increase assumes a 20-year loan at an interest rate of 4.0%. Applicant proposed an annual payment of \$257,536 for debt service. The Application also included a \$51,507 annual revenue requirement in Fortville's proposed rates to fund its debt service reserve.

The OUCC reported that Applicant's proposal for approval of financing for its CIP has not been reduced to a Preliminary Engineering Report ("PER") and therefore lacks adequate support. As a result, the OUCC recommended that the Commission disapprove Applicant's inclusion of the CIP financing in its proposed rate increase. Further, the OUCC suggested that the financing only be approved if Fortville provides appropriate pertinent information to the Commission and the OUCC. Once Fortville completes its PER, it can submit it to the OUCC and the Commission for evaluation in a subsequent phase of this Cause—Phase II.

The Commission finds that the PER must be completed and submitted to the Commission within one year from the date the order in this cause. If Fortville fails to complete the PER and submit it to the Commission within one year of the issuance of the order in this case, Phase II will not be implemented. Thus, Fortville will have to file a separate petition pursuant to a separate cause number in order to secure Commission approval of its CIP financing.

If Phase II is implemented, rates that may be established in Phase II will be subject to a true-up to reflect the actual costs of the CIP financing. The Commission notes that SRF loans may defer principle payments for up to two years after a loan closes. If this is the case with respect to Fortville, Phase II may be designed to reflect interest only payments and a third phase, Phase III, may be needed to reflect the commencement of principle and interest payments.

The OUCC also asserted that Fortville over-funded its debt service reserve for its current debt by approximately \$77,000. The OUCC stated that these funds should be used to either reduce the amount to be borrowed for the proposed projects or reduce the amount required for the associated debt service reserve. Moreover, Applicant's proposed debt service reserve ignores the interest that Applicant will earn as it accrues its debt service reserve. The OUCC asserted that a reasonable level of interest (2.5% to 3.0% per year) should be imputed into the determination of Applicant's annual revenue requirement for debt service reserve. The OUCC added that, since a debt service reserve is a restricted account, if Applicant withdraws funds from its debt service reserve for any reason other than to make the final payment on its proposed loan, Applicant should be required to notify both the OUCC and the Commission of its intent and reasons why.

In light of the OUCC's and Fortville's concurrence that the proposed financing be approved in a later phase of this Cause, the Commission need not address Applicant's proposed debt service reserve in this order.

6. Working Capital. Fortville proposed an annual working capital revenue requirement of \$8,155 while the OUCC's report asserted that \$2,293 is sufficient. Fortville's inclusion of expenses paid in arrears in its proposal and Fortville's failure to account for all of its operating funds accounts for the difference in calculations. First, Fortville included in required working capital utility receipts taxes ("URT") in the amount of \$9,395. However, URT is paid quarterly in arrears and, therefore, no working capital is required to pay URT. Second, Fortville incorrectly included payroll taxes in its

operating and maintenance expenses ("O&M"). Therefore, Applicant inadvertently included \$12,642 in payroll taxes in the amount of working capital funds required. (See reclassification entry (e), OUCC Schedule 3) Like URT, these taxes are paid in arrears but on a monthly basis and should be excluded from required working capital funds. Third, payments for purchased power are made in arrears. While Fortville excluded purchased power from the working capital revenue requirement, it neglected to exclude additional payments made to Vectren during the test year. Instead, Fortville recorded the payments as a miscellaneous expense. (See reclassification entry (f), OUCC Schedule 3) Finally, Fortville did not exclude the amortization of rate case expenses from O&M, which are non-cash expenses similar to depreciation expenses. The remaining O&M variance is related to additional proposed adjustments discussed in this order.

In addition to the differences in required working capital, the Parties differed in the amount of working capital currently available. Fortville has six funds related to the water utility: Operating, Construction, Depreciation, Customer Deposits, Bond and Interest, and Debt Service. The OUCC reported that Fortville inappropriately included as available working capital the balance of the Depreciation Fund as of December 31, 2007. Also, the OUCC noted that Fortville failed to include the Construction Fund in its available working capital. The OUCC believes that the Depreciation Fund should be restricted to the replacement or extension of utility plant and, as such, should not be available for operating purposes. Furthermore, the OUCC determined that the \$17,661 in the Construction Fund is left over from a previous construction project. The OUCC advised that these funds are no longer restricted and should be transferred to the Operating Fund and made available for general operating purposes. Both the OUCC and Fortville amortized the working capital deficiency over three years. The OUCC proposed that this requirement be reviewed and updated as necessary in any subsequent phases of this rate case. (See OUCC Schedule 8)

Subsequent to the OUCC's report, Fortville advised that its available cash had been depleted. The OUCC agreed to revise Fortville's working capital revenue requirement to allow recovery over a much shorter period. However, the OUCC's consent to a shorter recovery period is conditioned on the elimination of the working capital revenue requirement once the required level of working capital is anticipated to be reached. The Parties agreed to an annual revenue requirement of \$31,108 for working capital, which will be eliminated when Fortville reconciles its proposed financing, but reconciliation will not occur more than twenty-one months from the issuance of this order.

The Commission hereby finds that Fortville shall revise its schedule of rates and charges to eliminate \$31,108 from its annual revenue requirement when it reconciles its rates to reflect the actual debt service requirements of its proposed financing. If such financing reconciliation will not occur within twenty-one months of this order, then within twenty-one months of this order, Fortville shall revise its schedule of rates and charges to eliminate working capital from its revenue requirement.

7. **Existing Debt Service.** Fortville has existing debt service requirements in the annual amount of \$135,200. If Fortville applies its anticipated debt service reserve to the current debt, the debt will be retired on or before January 1, 2012. However, the OUCC and Applicant agreed that Applicant will work with the SRF to combine the payments of its proposed loan with its current loan. Thus, combining the two loans would lead to a consistent revenue requirement that continues even after the currently existing debt is retired. In the next phase of this case (Phase II), Applicant will provide specific details regarding its proposed loan and subsequent annual debt service. However, in the event that Applicant is unable to combine its proposed loan with its current loan, the Commission finds that on or before January 1, 2012 Applicant shall eliminate from rates the revenue required to serve its existing debt. In such case, Fortville shall revise its schedule of rates and charges to reflect the elimination of the \$135,200 revenue requirement needed to serve the current existing debt.

8. **Depreciation Expense.** Fortville calculated its historical Utility Plant in Service ("UPIS") by taking its December 31, 2006 balance of \$3,068,883. Fortville then added \$10,271 in test year additions and the proposed project costs of \$3,500,000 to its UPIS, which yielded gross utility plant in service in the amount of \$6,579,154. Fortville arrived at its *pro forma* depreciation expense of \$131,583 by multiplying \$6,579,154 by the applicable composite depreciation rate of 2%.

The OUCC calculated depreciation using the same December 31, 2006 balance for gross utility plant but increased it by \$17,604, which is the amount of costs that were deemed capital in nature. (Adjustment 7, OUCC Schedule 6) This yields depreciable plant in the amount of \$3,086,484.¹ The OUCC multiplied this amount by the applicable composite depreciation rate of 2% to arrive at its *pro forma* depreciation expense of \$61,730. (Adjustment 10, OUCC Schedule 6) The OUCC noted that Fortville maintained records for additions to their UPIS, but they had not recorded any retirements during a ten-year period. The OUCC recommended that Fortville begin using the Uniform System of Accounts to track its assets and depreciation by asset category. The OUCC further recommended that Fortville be required to establish a restricted fund account into which monthly depreciation expense is deposited.

The Commission agrees with the OUCC's calculation as noted. Fortville is required to keep its depreciation funds in a restricted segregated account and use the funds only for extensions and replacements or other capital improvements. If unexpected circumstances require access to these funds to meet debt service requirements, then Fortville may access the funds for this purpose. In such case, Fortville shall immediately notify the Commission and the OUCC that it intends to access the funds for debt service, state the amount to be used and explain the circumstances causing the need. Moreover, until its next rate case, Fortville shall report annually how much it deposits into its depreciation account and the amount spent from such fund and on what projects. Fortville may file this report with the Commission as an attachment to its annual report.

¹ The Parties calculated depreciation on land, which is a non-depreciable asset. However, the effect of this error is immaterial.

9. **Capacity Fee.** In Cause No. 41537, the Commission approved the \$1,200 capacity fee and ordered Fortville to place all collected capacity fees in a separate restricted fund to be used for future capital improvement projects, including but not limited to a water storage facility. The OUCC reported that Fortville has not set up a separate restricted fund or account where these funds have been accumulated. The OUCC recommended that Fortville establish the required restricted fund and begin recording any capacity fees collected to this fund. Further, the OUCC recommended that Fortville be required to report to the Commission and the OUCC, on an annual basis, the amount of capacity fees collected and detail any disbursements made from this restricted fund. Finally, the OUCC recommended that Fortville be directed to record capacity funds as contributions in aid of construction on its balance sheet rather than as revenue on its income statement.

The Commission finds that Fortville shall keep its capacity funds in a restricted segregated account and use the funds only for capital improvements needed to serve increased demand (customer growth). Further, Fortville shall report each year how much it collected in capacity fees and how much it spent from each of these funds and on what projects. Fortville shall file this report as an attachment to its annual report filed with the Commission.

10. **Tap Fees.** In its report, the OUCC advised that Fortville recorded its tap fees as revenue. The OUCC stated that tap fees are cost-based charges used to cover costs of connecting new customers and should therefore not be considered revenue. The OUCC stated that tap fees collected from new customers should be recorded as contributions in aid of construction. Correspondingly, the costs associated with these new customer taps should be capitalized as part of UPIS on its balance sheet. The Commission agrees and so orders.

11. **Revenue Requirements.** Based on the evidence of record and agreement of the Parties and subject to the conditions and limitations set forth herein, the Commission finds that the revenue requirements contained in this table should be approved.

Revenue Requirements

Operating Expenses	\$402,214
Taxes Other Than Income Taxes	19,287
Depreciation	61,730
Payment in Lieu of Taxes	11,072
Working Capital	31,108
Debt Service - Existing Debt	135,200
Debt Service - Proposed Debt	-
Debt Service Reserve - Proposed Debt	-
Total Revenue Requirements	<u>\$660,611</u>
Less: Interest Income	2,139
Add: Utility Receipts Tax	<u>1,436</u>

Net Revenue Requirements	\$659,908
Less: Present Rate Revenues	<u>524,615</u>
Revenue Increase Required	<u>\$135,293</u>

The revenue requirements determined by the OUCC supports an across the board increase in water sale rates of 27.93%.

12. **Outside City Limits Surcharge.** Fortville's current tariff includes a 50% surcharge imposed on customers that live outside the corporate boundaries. Although this surcharge has been included on Fortville's tariffs since 1980, the OUCC advised it could not find any Commission approval for it. Moreover, the Town of Fortville annexed several sections of land near the town. Currently, there are only ten customers who are required to pay the surcharge. Total water sales from outside customers in the test year were \$10,772, including surcharge collections of \$3,591. The customers that pay the surcharge are served by the same infrastructure as customers located inside the corporate limits, and in some cases, they are located directly across the street from inside city customers. The OUCC posited that there is no additional cost incurred by Fortville to serve these outside city customers and eliminating the surcharge will have a minimal effect on revenues generated from outside the city limits. In addition, the cost can be easily absorbed by the customers of the entire system. Both the OUCC and Applicant agreed to this change. For the foregoing reasons, the Commission finds that the surcharge should be eliminated.

13. **Water Sales Contract with Mt. Vernon Schools.** In Cause No. 41537, the Commission approved a potable water tap on contract with the Mt. Vernon Community School Corporation. This contract provides for monthly payments of \$1,500 for a maximum of 50,000 gallons of water per day. These revenues, which total \$18,000, have been classified as revenues not subject to increase because the contract specifies how and when the rates can be increased. Currently, Fortville has no established procedure for reviewing and increasing the price charged under this contract. The duration of the contract is seven years. After the initial seven years, the price can be increased using the consumer price index as a ceiling. The contract also requires notification of any price increase by June 1 of the year preceding the year it intends to initiate an increase. The OUCC recommended that Applicant establish a procedure to review the price charged pursuant to this contract in order to ensure compliance with its terms and to ensure that the rates charged represent Fortville's current cost of producing water. The Commission agrees and so orders.

14. **Unaccounted-for-Water.** The OUCC in its report noted that Fortville's water loss over the past few years has been approximately 35%. The OUCC also noted that Fortville's most recent leak detection survey occurred ten years ago and stated that a new survey is necessary. Fortville budgeted \$2,000 per year for five years (a total of \$10,000) for a professional leak detection survey. Fortville shall file with the Commission's Water/Sewer Division the results of the leak detection survey no later than thirty days after the survey's completion.

The OUCC also noted in its report that Fortville does not currently have a residential meter replacement program and a large meter testing program. The OUCC stated these programs can reduce water loss and, therefore, should be implemented. Accordingly, the OUCC allotted \$5,000 annually for large meter testing and repair. (See OUCC Schedule 6, p. 3) In addition, the OUCC pointed out that currently \$60,000 annually is available from depreciation funds for capital purchases, including purchases of new meters. Funds from depreciation will almost double when proposed capital projects are operational and rates are revised. The OUCC suggested that Fortville implement a fifteen-year meter replacement program once revenues from depreciation increase.

The Commission finds that because of Fortville's high percentage of unaccounted-for-water, it shall create a plan to test its large meters. Fortville shall submit this plan to the Commission's Water/Sewer Division for approval no later than sixty days from the date of this order. Once Fortville implements this plan and tests its large meters, it shall file the test results with the Commission's Water/Sewer Division no later than thirty days after testing is complete. Moreover, because of its high percentage of water loss, Fortville shall create a fifteen-year meter replacement program. Fortville shall submit its plan to the Commission's Water/Sewer Division no later than sixty days after the date of this order. Fortville shall include its progress in replacing meters in the annual report it files with the Commission.

15. Accounting Practices. After conducting an on-site audit, the OUCC made several recommendations regarding Fortville's accounting practices. First, the OUCC reported that Fortville utilizes fund accounting to maintain its water utility accounting records rather than proprietary accounting. The OUCC stated that proprietary accounting is double entry accounting that is used by most non-governmental businesses. Proprietary accounting allows the utility to prepare a balance sheet, an income statement and maintain proper utility plant records. Second, the OUCC reported that Fortville does not allocate costs consistently between all public departments (i.e. water, sewer and town general funds). The OUCC recommended that Fortville allocate costs appropriately among the departments and on a monthly basis. Otherwise, some departments subsidize other departments. Finally, the OUCC suggested that Fortville employ the Uniform System of Accounts.

Accurate and consistent accounting records allow the OUCC and Commission to determine the financial condition of a utility and allow the utility to monitor expenses and operate more efficiently. Such records are essential for determining appropriate utility rates and charges, for obtaining debt and for qualifying for state and federal funding programs. The use of the Uniform System of Accounts allows for the creation and maintenance of accurate and consistent financial records. The Commission notes that 170 IAC 6-2-2 requires water utilities to employ the Uniform System of Accounts. Therefore, the Commission finds that Fortville shall, pursuant to 170 IAC 6-2-2, use the Uniform System of Accounts to maintain its financial records.

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

1. In accordance with the above findings, Fortville is hereby authorized to increase its rates and charges by \$135,293 annually so as to produce total annual revenue of \$659,908, which represents a 27.93% increase in its water sale rates and charges.

2. Prior to placing into effect the rates and charges approved herein, Fortville must file with the Commission's Water/Sewer Division a tariff schedule in accordance with Commission rules for filing utility tariffs. Once the Commission's Water/Sewer Division approves the rate schedule, such tariff shall cancel all prior rates and charges.

3. This Order shall be an interim order, and this cause shall remain open to permit Fortville to secure financing for its proposed capital improvement projects and to secure Commission approval of such financing and projects, which shall be done in a subsequent phase of this cause—Phase II, in accordance with paragraph 5 above.

4. In accordance with Ind. Code § 8-1-2-70, the Petitioner shall pay within twenty (20) days from the date of this Order, and prior to placing into effect the rates approved herein, the following itemized charges, as well as any additional charges which were or may be incurred in connection with this Cause.

Commission Charges	\$ 1000.00
Legal Advertising Charges	\$ 29.48
OUCG Charges	<u>\$ 2000.00</u>
Total:	\$ 3029.48

Petitioner shall pay all charges into the Treasury of the State of Indiana, through the Secretary of this Commission.

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

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

APPROVED: APR 22 2009

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



**Brenda A. Howe
Secretary to the Commission**