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STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

IN THE MATTER OF THE PETITION OF THE DEPARTMENT OF WATERWORKS OF THE CONSOLIDATED CITY OF INDIANAPOLIS, INDIANA, FOR AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR WATER UTILITY SERVICE ON BOTH EMERGENCY AND NON-EMERGENCY BASES, FOR APPROVAL OF A NEW SCHEDULE OF RATES AND CHARGES APPLICABLE THERETO, AND FOR APPROVAL OF A MECHANISM TO ANNUALLY IMPLEMENT RATE CHANGES BASED ON THE ANNUAL ADJUSTMENT TO THE DEPARTMENT'S PAYMENTS UNDER THE MANAGEMENT AGREEMENT WITH VEOLIA WATER INDIANAPOLIS, LLC	)	**CAUSE NO. 43645** **INTERIM EMERGENCY AND PREHEARING CONFERENCE ORDER** **APPROVED:** JUN 3 0 2009

BY THE COMMISSION:
Larry S. Landis, Commissioner
Loraine L. Seyfried, Administrative Law Judge
Angela Rapp Weber, Administrative Law Judge

On February 24, 2009, the Department of Waterworks of the Consolidated City of Indianapolis, Indiana ("Petitioner" or "Department") filed its Petition with the Indiana Utility Regulatory Commission ("Commission") for authority to increase its rates and charges for water utility service, for approval of a new schedule of rates and charges, and for approval of a mechanism to annually implement rate changes based on the annual adjustment to the Department's payments under the management agreement, as amended ("Management Agreement") with Veolia Water Indianapolis, LLC ("Veolia"). Although the Department is ultimately seeking approval of an increase in rates and charges on a permanent basis, the Department requested an immediate emergency increase on an interim basis pursuant to Ind. Code § 8-1-2-113. The Department also requested a prehearing conference to establish a procedural schedule governing the balance of the issues in this Cause, which includes permanent rates and charges and an annual adjustment mechanism for the Department's rates implementing changes in payments to Veolia under the Management Agreement.

Pursuant to notice duly given and published as required by law, the Commission held a prehearing conference as to the emergency phase of this Cause on March 12, 2009 at 9:30 a.m. in Room 222 of the National City Center, 101 W. Washington Street, Indianapolis, Indiana. In addition to the Department, the Indiana Office of Utility Consumer Counselor ("OUCC"), the Town of Pittsboro ("Pittsboro"), and the Indianapolis Water Industrial Group ("Industrial Group") appeared and participated in the prehearing conference. Petitions to Intervene filed by Pittsboro and the Industrial Group were granted. No members of the general public appeared.

Pursuant to the agreement of the parties, the Commission set prefiling and hearing dates in this Cause. On March 25, 2009, the Commission issued its Prehearing Conference Order.

The Department filed its direct testimony and exhibits constituting its emergency case-in-chief on March 11, 2009. On April 22, 2009, the OUCC and the Industrial Group filed their respective direct testimonies and exhibits. Pittsboro did not file any testimony or exhibits. On April 28, 2009, the Petitioner filed its Uncontested Motion for Extension to File Rebuttal Testimony, which the Presiding Officers granted on April 30, 2009. On May 1, 2009, the Department filed its rebuttal testimony and exhibits. On May 14, 2009, the Department filed its Motion for Leave to File Amended Testimony and Exhibits of Peter Grimm ("Motion for Leave").

In accordance with the Prehearing Conference Order and pursuant to notice duly given and published as required by law, the Commission convened an evidentiary hearing on May 18, 2009, at 9:30 a.m. in Room 222 of the National City Center, 101 W. Washington Street, Indianapolis, Indiana. At the hearing, the Department's Motion for Leave was granted, and its prefiled direct testimony and exhibits and rebuttal testimony and exhibits were offered and admitted into evidence. The respective prefiled testimonies and exhibits of the OUCC and the Industrial Group were also offered and admitted into evidence.

Based on the applicable law and evidence presented in this Cause, the Commission now finds as follows:

1. **Notice and Jurisdiction.** Due, legal and timely notice of the public hearings held in this Cause was given and published by the Commission as required by law. Petitioner is a "municipally owned utility" as defined in Ind. Code § 8-1-2-1(h), and exists and operates pursuant to the authority of Ind. Code § 8-1.5-4 *et seq.* and Ind. Code § 36-3-4-23. In accordance with the Commission's March 28, 2002 Order in Cause No. 41821, Petitioner is subject to the jurisdiction of the Commission for approval of rates and charges under Ind. Code § 8-1-2-1, et seq. In addition, Petitioner's operation of its system is to be in accordance with the Commission's rules of service and main extensions for water utilities contained in 170 IAC 6-1 and 6-1.5.

2. **Petitioner's Characteristics.** The Petitioner is a Department of Waterworks formed by the City-County Council of the Consolidated City of Indianapolis and Marion County, Indiana to manage and oversee the operation of the water utility. The Petitioner owns and operates plant and equipment for the production, transmission, delivery and furnishing of water to customers in Marion County, and in portions of Boone, Brown, Hamilton, Hancock, Hendricks, Johnson, Morgan and Shelby Counties. On March 21, 2002, Petitioner entered into the twenty-year Management Agreement with Veolia Water, formerly US Filter Operating Services, to manage the day-to-day operations of the utility.

3. **Interim, Emergency Relief Requested.** Petitioner's current schedule of rates and charges for water utility service was approved by the Commission on April 4, 2007, by Order issued in Cause No. 43056. Petitioner requests emergency approval of a new schedule of

rates and charges for water service on an interim basis, subject to refund. Specifically, Petitioner requests a 17.56% increase in rates and charges on an across the board basis.

4. **Motion for Administrative Notice.** On May 22, 2009, Petitioner filed a Motion for Administrative Notice requesting the Commission take administrative notice of the testimony and exhibits filed in Cause No. 43056 of OUCC witnesses John Seever and Edward Kaufman concerning the Department's debt structure. The OUCC and the Industrial Group filed a Joint Response on June 1, 2009 objecting to Petitioner's Motion. On June 5, 2009, Petitioner filed its Reply.

Contrary to Petitioner's assertion, administrative notice of testimony and exhibits filed in other proceedings before the Commission is not mandatory because they are not facts that must be judicially noticed. *Smith v. State*, 443 N.E.2d 1187 (Ind. 1983). Rather, administrative notice is discretionary pursuant to 170 IAC 1-1.1-21(h). Although Petitioner requests the Commission take administrative notice of certain testimony and exhibits, it fails to offer any explanation for their relevance or other reason that the Commission should exercise its discretion and take administrative notice of the materials. Therefore, Petitioner's Motion for Administrative Notice is denied.

5. **Summary of Evidence Presented.**

A. Petitioner's Direct Evidence. Mr. James Steele, the former Interim Executive Director of the Department from July 2008 through March 2009 and now a consultant to the Department, summarized and offered testimony in support of the Department's request for emergency relief. He testified that the need for emergency rate relief is due primarily to the current structure of the Department's bond portfolio and the impact of the uncertainty in the credit markets that has led to a fluctuation of interest rates in that portfolio. He further indicated that a much smaller contributing factor to the need for emergency relief is that system-wide revenues were significantly lower in 2008.

Mr. Steele noted that the Commission typically uses four criteria to evaluate whether an emergency exists: (1) a possible curtailment of service, (2) serious financial deterioration, (3) an inability to meet daily expenses, and (4) cost-cutting efforts. In describing the Department's situation, he stated that the Department has limited control over its expenditures because the Management Agreement with Veolia, debt service and taxes make up the majority of its revenue requirement. The Department, however, has undertaken several measures to reduce or stabilize expenses. He stated the Department is proposing to reduce revenue-funded capital expenditures and is in the process of analyzing the refinancing of its variable rate bonds. In addition, the Department has hired a chief operating officer and will be hiring an engineer, along with other staff reconfiguring. By making these hires and eliminating the need for outside consulting services, the Department anticipates a net savings of approximately $1.5 million.

Mr. Steele testified that the Department has a large percentage of variable rate debt in its portfolio (approximately 57.5%), with interest rates that have fluctuated from 3.5% to as high as 9.5% over a period of approximately nine months. As a result, the Department's annual debt service increased from approximately $31.3 million in 2007 to $57.2 million in 2008. Mr. Steele testified that the higher debt service is causing the Department to deplete its operating cash, and without immediate additional revenue the Department's financial position will erode. He stated that even with emergency relief granted at the levels requested, the Department anticipates that by July 2009 it will experience a $10.6 million cash shortfall, which does not include a $14.2 million payment to DEPFA Bank ("DEPFA"), triggered by failure of certain bond remarketing efforts.

Mr. Steele testified that the Department met with the bond rating agencies and other parties involved in the Department's refinancing analysis in February 2009. He noted that the day the Department filed its case-in-chief, Fitch, one of three credit rating agencies, downgraded the Department's credit rating and he further indicated that all three credit agencies would downgrade the Department's rating if emergency rate relief was not granted. He testified a downgrade would result in higher interest expense on the Department's debt.

Mr. Steele concluded that without emergency rate relief, the Department will: (1) exhaust its operating cash reserves, (2) face serious financial deterioration, (3) likely have its bond rating downgraded, and (4) likely face the need to curtail service.

Mr. Kevin Taylor, the Executive Director of the Indianapolis Local Public Improvement Bond Bank (the "Bond Bank") since January 8, 2008. The Bond Bank is the debt-issuing entity for the Department and purchases the Department's obligations with proceeds from the open bond market. TR at C2. He testified regarding the Department's financial situation. Mr. Taylor acknowledged the Commission does not exercise jurisdiction over the Department's financing, but indicated an explanation of the Department's debt situation would be helpful in evaluating the requested emergency rate relief.

Mr. Taylor testified that the Department has approximately $842.54 million in outstanding bonds, all of which were issued through the Bond Bank. Approximately 57.5% of those bonds are variable rate bonds. The Department has three series of variable rate bonds: Series 2005G in the outstanding principal amount of $386.5 million and Series 2005H in the principal amount of $47.81 million, both of which are variable rate demand bonds; and Series 2004A in the principal amount of $50 million, which are auction rate securities.

Mr. Taylor testified that in 2008, due to credit rating downgrades of the Department's bond insurer, MBIA, and standby bond purchaser, DEPFA, and the volatility of the market, the Department experienced a dramatic increase in rates and a series of "failed remarketings" of the bonds. He explained that a "failed remarketing" occurs when no buyers are willing to purchase the bonds. When that occurs, the standby bond purchaser is obligated to purchase the bonds and hold them as "bank bonds." The Department's existing variable rate bonds, in aggregate amount of $434.3 million, are currently held as "bank bonds" by DEPFA. On January 1, 2009, a $14.2 million accelerated principal payment to DEPFA came due, but DEPFA agreed to forbear on the payment if the Department could refund its variable rate bonds by March 31, 2009.[1]

[1] During the March 30, 2009 Attorneys Conference, the Department indicated that the forbearance had been extended to June 30, 2009. On June 15, 2009, the Department filed a response to the Presiding Officers' June 11, 2009 Docket Entry ("June 15, 2009 Response") indicating the Department had requested a final forbearance to July

Mr. Taylor stated that the other component contributing to the overall cost of financing the variable rate bonds is the associated swap payments. Although not at the Bond Bank at the time the variable rate debt was issued, Mr. Taylor surmised that in an effort to hedge against potential future increases in interest rates on the variable rate bonds, the Department entered into swap agreements with "counterparty banks." Under a swap agreement, the Department agrees to pay a fixed rate to the counterparty bank, and in return the counterparty bank pays a variable rate of interest to the Department. Mr. Taylor stated that the expectation is that the variable rate the Department receives from the counterparty will equal the interest payment to bondholders on the variable rate bonds. In the last half of 2008, however, the dislocation between the Securities Industry and Financial Markets Association Index ("SIFMA"), the index used to set the variable rate on the bonds,[2] and the London Inter-Bank Offered Rate ("LIBOR"), the index used to calculate the variable rate on the swap payments received by the Department, caused the Department to receive less than it was paying to bondholders. Historically, the SIFMA rate has been between 60-75% of the LIBOR rate. More recently, however, SIFMA has been well over 100% of LIBOR. As a result, the Department is paying high interest rates and is making high swap payments that combine to elevate the effective interest rate paid by the Department.

Mr. Taylor also testified that the general rule of thumb is that approximately 10-20% of a municipal utility's total debt should be variable rate debt, with 15% considered the maximum unless the municipal entity has significant daily cash flows. Although Mr. Taylor was not with the Bond Bank at the time, he believes that the following factors contributed to the large percentage of variable rate bonds being issued: low variable rates were enticing; the Department had agreed to a rate freeze and was under pressure to keep costs at a minimum; and the significant deterioration of the credit markets and the interest rate volatility was likely deemed a remote risk. Mr. Taylor further indicated that the Department is analyzing its refinancing options with the goal of converting a substantial percentage of the variable rate bonds to fixed-rate bonds. He noted that this would also require the termination of two interest rate swap agreements, which was estimated to be $90 million.[3]

Finally, Mr. Taylor indicated that after his review of the Department's budget and projected debt payments for 2009, he believes the Department will have trouble meeting its debt obligation in 2009. He also stated the Department's coverage ratio is lower than recommended and violates the bond covenant requirements. He further opined that without emergency relief, it appears likely the Department's bond ratings would be downgraded, which would negatively impact the Department's access to the credit markets.

Mr. John Skomp, a CPA with Crowe Horwath, presented evidence concerning the Department's revenue requirements based on his analysis of the Department's unaudited books

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31, 2009 for both the $14.2 million June 30, 2009 tranche payment and the $21.7 million July 1, 2009 tranche payment.

[2] Mr. Taylor clarified that neither the swap nor the variable rate payments on the bonds are indexed off SIFMA. However, the variable rate bonds have historically been expected to track near SIFMA. Pub. Ex. 2, MAS Attachment 1, p.14.

[3] By the time of the hearing, the swap termination payments were estimated to be $63.57 million. TR at B137. As of the close of business on June 10, 2009 and June 12, 2009, the swap termination payments for all variable rate debt were estimated to be $33.5 million and $42.5 million, respectively. *See* June 15, 2009 Response.

and records for the 2008 calendar year and its proposed refinancing. Mr. Skomp testified that although his report supports an 18.34% overall emergency increase in operating revenues, the Department has proposed a 17.56% overall increase in rates and charges due to updated information.

Mr. Stephane Jousset, an engineer with Malcolm Pirnie, Inc., testified concerning capital improvements that the Department requested to be included in emergency rates. Mr. Jousset stated that the Department is responsible for funding capital projects and employs Malcolm Pirnie to provide an independent review of the Capital Improvement Plan, whereas Veolia is responsible for operation and maintenance projects pursuant to the Management Agreement.

Mr. Jousset stated he reviewed the proposed 2009 capital projects and presented a list of projects he considered to be essential. He asserted the perennial nature of the projects illustrates they are vital to the maintenance of the Department's infrastructure and the continued supply of safe and adequate water to the Department's customers. Without identifying particular projects, Mr. Jousset stated that the following categories of projects should be funded in the amount of $12.3 million: underground infrastructure reinforcements, replacements and relocations; meters, valves and hydrants replacements; and, building, pump station, tank and plant refurbishments.

B. OUCC's Evidence. Mr. Edward Kaufman, a Senior Analyst, testified that the evidence presented by the Department is insufficient to determine either the degree of emergency rate relief necessary or whether the Department's requested relief is appropriate. Mr. Kaufman stated that in addition to a demonstration of material harm and/or potential curtailment of service if expedited relief is not granted, the utility must also show that the requested relief will prevent the material harm and/or potential curtailment of service. Further, he stated that the utility should discuss the steps it has taken and any additional actions it intends to take to defer or curtail expenses and reduce the need for emergency relief.

Mr. Kaufman stated the purpose of emergency rate relief is to provide the utility with the cash flow it needs to meet unavoidable expenses and prevent a curtailment of adequate service. Because ratepayers can be harmed by a request that is too low as well as by a request that is too high, emergency rates depend on a "cash flow" analysis, which the Department did not provide in its case-in-chief.

Mr. Kaufman identified several concerns the OUCC had with the evidence provided by the Department. First, he noted that even with the requested rate increase, the Department projects a cash shortfall of more than $9.7 million by the end of 2009 but does not explain how it intends to meet such a shortfall. Second, he stated that the Department failed to provide any cost-benefit analysis quantifying the impact of using the Cash Reserve Fund. Mr. Kaufman also noted that the interest rates on the variable rate debt can vary dramatically, and the Department failed to explain the basis for its expected annual expense of approximately $30.5 million for the Series 2005G Bonds. Nor did the Department provide any history on the cost of the variable rate loans, despite those costs being a key factor for the Department's need for emergency rate relief. Mr. Kaufman also testified that the cash flow statement provided by the Department in a discovery request appears to ignore the effect of the Department's swap agreements and fails to incorporate the effect of any anticipated refinancing. He also noted the Department's failure to explain the calculation or recovery of the estimated $90 million in swap termination costs.

Mr. Kaufman also testified that the debt service amount for emergency rates should be a one-year figure instead of the five-year average figure used by Mr. Skomp because the emergency rates are anticipated to last for one year. Mr. Kaufman acknowledged that the Department is not required to seek Commission approval to issue long-term debt, but stated that the Department still has a responsibility to justify its revenue requirement associated with its proposed refinancing for purposes of recovery of such costs in rates. He also encouraged the Department to take advantage of the Commission's resources and to voluntarily seek the Commission's input in its financing decisions.

Finally, Mr. Kaufman stated that the Department's testimony does not disclose how it intends to refinance its variable rate debt or demonstrate the benefits or cost savings to ratepayers as a result of the refinancing. Mr. Kaufman testified that based upon his analysis, the Department should require Bear Stearns and Loop (the counterparties to the 2005G swap agreements) to explain and justify the interest rate amounts for each swap termination prior to any termination of the swap agreements. Additionally, because forecasted LIBOR rates are used to calculate the swap termination fees and an underestimation could increase the termination fee, he stated it is essential that the Department have a viable independent analysis to support Petitioner's implicit contention that the termination fees are reasonably determined.

Ms. Margaret Stull, a Utility Analyst, testified that the OUCC did not agree with the Department's proposed emergency rate increase. Ms. Stull noted that the Department is requesting $21.9 million in additional revenues, but also has $26.4 million in a Cash Reserve Fund, which if used would make the emergency relief unnecessary. She also noted the OUCC disagreement with the Department's proposed debt service revenue requirement as discussed in Mr. Kaufman's testimony. She stated the OUCC also disagrees with the Department's proposed 5% increase to management fees and the inclusion of Extensions and Replacements ("E&R") in the revenue requirement due to the lack of sufficient detail and explanation for the proposed amounts.

Ms. Stull stated, based on the OUCC's review and analysis, if the Cash Reserve Fund is not used and no revenue funded capital improvements are allowed, the OUCC recommends an across the board emergency rate increase of 3.51%. However, if the Department's $12.3 million in capital improvements is allowed, then the OUCC recommends an across the board emergency rate increase of 11.91%.

C. Industrial Group's Evidence. Mr. Michael Gorman, a consultant with Brubaker & Associates, testified that the Department failed to demonstrate it will experience a cash shortfall without interim rate relief. Mr. Gorman noted that the Department's claimed shortfall was based on a debt service cost of $61 million for 2009. However, he testified that Mr. Skomp's Exhibit H demonstrated that the Department's total debt service cost for 2009 would be only $55 million. Mr. Gorman explained that the primary difference between the Department fully meeting its cash obligations in 2009 and Mr. Skomp's claim that there would be a cash shortfall related to the following factors: (1) the use of 2008 water sales that were abnormally low, (2) the assumption that the Department would make approximately $9 million of additional payment in lieu of taxes ("PILT") and utility receipts tax payments in 2009, and (3) the $2.5 million increase in the Veolia Management Agreement.

Mr. Gorman stated that based on discovery responses, the Department's 2008 water sales were approximately 5.7% lower than relative sales in 2007. Under the higher level of sales, the Department would generate approximately another $3.2 million, which would have to be off-set by approximately $450,000 in higher variable operating costs. Mr. Gorman testified that based on the 2007 level of sales, the Department would produce enough operating revenues to cover its cash operating expenses and meet its debt service obligations while leaving cash available of $2.4 million.

Mr. Gorman also testified that the Department's proposed 2009 capital expenditure budget of $12.3 million is higher than comparable capital budgets over the last five years and the highest amount experienced in the last three years. He also noted that the Department has $3.95 million in the Renewal and Replacement Fund, which could be used for capital expenditures in 2009.

Mr. Gorman also addressed the Department's claimed revenue deficiency. In his opinion, the Department had overstated the claimed deficiency by utilizing an average annual debt service cost for 2010 through 2014 rather than the actual debt service cost for calendar year 2009. He stated that the use of the 2008 sales revenues, which were abnormally low, should be adjusted to reflect normal sales conditions since it is not reasonable to conclude that sales for the year would be based on anything other than normal conditions. He also recommended that for interim purposes and until a full review of the Department's claimed annual E&R budget could be conducted as part of the permanent rate case, the Commission should approve no more than $10 million for emergency funding. Finally, he noted that the requested 5% increase in the Veolia Management Agreement was far above the projected inflation rate for 2009.

Mr. Gorman recommended the Commission deny the Department's requested emergency relief for failure to adequately demonstrate that it meets the requirements for such relief. However, he stated if the Commission determined that some interim relief was necessary, the maximum increase should be 7.7%.[4]

D. Petitioner's Rebuttal Evidence. Mr. Steele expressed his disagreement that the Department had failed to provide evidence that it meets the criteria for emergency relief. Referring to Mr. Skomp's rebuttal testimony, he responded that the Department has demonstrated through a cash flow analysis, which includes the results of the refinancing of the variable rate debt, the Department will suffer a $6.2 million shortfall of its operating cash in July 2009, with or without the relief requested. He stated that if the requested relief is approved, the cash shortfall will be $6.4 million in December 2009; but without the relief requested, the cash shortfall will be about $20 million. He stated that the requested relief is necessary on an emergency basis to allow the Department to address the cash shortfall and otherwise fund operations pending a final resolution of the Department's Petition.

[4] At the evidentiary hearing, Mr. Gorman revised his recommended interim rate relief to a 9.1% increase based upon additional information from Mr. Skomp. TR at E19.

Mr. Steele noted that since the filing of his direct testimony, the Department has been advised by Moody's that without the requested emergency rate relief, the Department's bond rating will likely go down again. Mr. Steele noted that, depending on the level of relief granted, if any, the downgrade could be multiple notches, exposing the Department to increased interest expense. Mr. Steele also stated that a downgrade could limit the Department's access to credit markets and if the downgrade is significant, it could lead to the Department's inability to refinance its debt.

He stated that if the Department could not refinance its debt, it would be forced to make two tranche payments on July 1, 2009: one in the amount of $14.2 million, upon which DEPFA had previously agreed to forbear through June 30, 2009; and one in the approximate amount of $21.7 million. He stated that additional tranches of debt in the amount of approximately $21.7 million would also come due every January 1 and July 1 until the $434.3 million in bank bonds being held by DEPFA are paid off. He noted that Mr. Kaufman's suggestion that the Department use its debt service reserve fund to bridge its expense gap was impractical because the debt service reserves are only $26.4 million, which is $9.5 million less than the July 1, 2009 tranche payments.[5]

Responding to suggestions that the Department may be able to handle the projected cash shortfall without emergency relief, Mr. Steele referred to Mr. Skomp's testimony that the Department does not have unrestricted cash available to fund operations until a permanent rate increase is implemented. Mr. Steele noted the Department has a debt service reserve fund of approximately $26.4 million, but stated that the original bond resolution adopted by the Department's Board requires that the debt service reserve fund be maintained at the specified level, be spent only to pay debt service, and if spent, to be replenished within twenty-four months. He further stated that if there were to be an unscheduled draw on the fund, it would be a reportable event to the Nationally Recognized Municipal Securities Information Repositories and would result in a significant negative impact on the Department's credit.

With respect to the 5% increase in management fees, Mr. Steele testified that the amount of increase due to Veolia is based upon the formula set forth in the First Amendment to the Management Agreement.

Mr. Steele also disagreed with Ms. Stull's position that the debt service amount should be reduced because of the risk in the credit markets. Mr. Steele noted, however, that the Department had revised its debt service request based upon recently obtained information and stated that the debt service to be built into emergency rates is now projected at $57.8 million if permanent relief is granted by January 1, 2010, and $60.3 million if permanent relief is granted after January 1, 2010. He added that the projection recognizes that the level of debt service is dependent upon whether permanent rates are in place by January 1, 2010.

Finally, Mr. Steele agreed that having 57.5% of its total debt in variable rate debt is excessive, and the Department needs to restructure its debt. Mr. Steele stated that the Board has revised its fiscal policy related to its issuance of debt to establish a cap on variable rate debt at

[5] In his testimony, Mr. Kaufman referred to this debt service reserve fund as the "Cash Reserve Fund."

15% of the total outstanding debt. He added that if the Department is able to complete the restructuring of its debt as planned, it expects to have 5% of its debt as variable rate debt.[6]

Mr. Skomp stated that although he continues to recommend the Commission grant the 17.56% emergency rate increase, Petitioner agrees that $701,000 of Miscellaneous Service Revenues should be used to offset Petitioner's annual revenue requirements and that the use of the annual System Development Charges to offset the Department's revenue requirements should be based on the amount of revenue funded E&R granted by the Commission.

With respect to the adjustment for a 5% increase in the Management Agreement, Mr. Skomp acknowledged that the use of an estimated increase is normally not allowed because it is not a "fixed, known and measurable" adjustment. Mr. Skomp noted that during the first three months of 2009, the Department made payments to Veolia totaling $11.653 million compared to $10.129 million for the same time period in 2008, which is an increase of over 15% for the first quarter after the test year. Mr. Skomp testified that although Petitioner is still negotiating with Veolia on the amount of increase that will be allowed in 2009, he believes it is reasonable to expect that costs will increase.

In regard to the amount of annual debt service, Mr. Skomp testified that if a procedural schedule could be agreed to that would place permanent rates into effect by January 1, 2010, Petitioner could agree to a debt service figure using only 2009 debt service expense. However, Mr. Skomp stated that he recommended a two-year average annual debt service, using 2009 and 2010 debt service, for Petitioner's emergency rates if the general rate case does not conclude by January 1, 2010 because the Department's estimated debt service for 2010 is higher than the 2009 estimated amount. This would result in a revised debt service calculation of $60.336 million.

Mr. Skomp disagreed with Mr. Gorman's recommendation to use 2007 operating revenues to determine the appropriate level of rate increase. Mr. Skomp acknowledged that higher sales volumes would help the Department's financial condition, but stated that he had no basis on which to project that 2009 revenues would be significantly better than those experienced in 2008. He also noted that the Department's operating revenues for the first quarter of 2009 were down $1.65 million for the first three months following the end of the test year.

Mr. Skomp testified that a 16.31% emergency rate increase is needed if permanent rates are effective on January 1, 2010, and an 18.49% increase, calculated using the two-year average annual debt service, is needed if permanent rates are established after January 1, 2010.

Mr. Skomp also prepared an exhibit reflecting the Department's estimated monthly cash flows for 2009. Mr. Skomp indicated that the exhibit revised the cash flow analysis provided earlier in discovery to include actual historical financial results for March 2009, updated monthly cash flows for the current projections regarding refinancing of the 2004A, 2005G and 2005H Bonds, and a revised estimated PILT payment. Based on this updated cash flow statement, Mr. Skomp testified that even with the 17.56% emergency rate increase, the Department is expected

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[6] All variable rate debt is now expected to be refunded with fixed rate debt. Pet. Ex. Late-Filed 2 and June 15, 2009 Response.

to experience an operating deficit of over $6.1 million in July 2009 and almost $6.4 million at the end of the 2009 calendar year. He noted that these estimates include assumptions that the Department will be required to make PILT payments in 2009 and that the debt service reserve fund will not be utilized.

Mr. Taylor testified the Department had analyzed several options to deal with its debt structure. He stated the first option considered was to maintain the status quo. The Department did not consider this option practicable because it would cause rates to increase dramatically due to the tranche payments and would still result in uncertain future debt service payments. The second option was to refund the variable rate debt with new variable rate debt. He stated that while this option avoids paying swap termination fees, it is infeasible because no liquidity provider has been willing to make available the $388 million required to refund the Series 2005G Bonds. The third option Mr. Taylor identified was to refund the variable rate debt with fixed rate debt. Mr. Taylor testified that while this option would provide the greatest certainty in future debt service payments, it also has the highest price because of the swap termination payments.

The fourth option, which Mr. Taylor stated the Department had chosen, is to refund the variable rate debt with both fixed rate debt and variable rate debt.[7] He testified that this was the preferred option because he believed it would achieve debt service expense certainty, allow the lowest possible level of swap termination payments, and would provide the Department with a percentage of variable rate debt consistent with the portfolio percentages within the municipal bond industry's recommended range. Mr. Taylor testified that under the Department's plan the Series 2004A bonds and the Series 2005G bonds will be refunded with fixed rate refunding bonds and the Series 2005H bonds will be refunded through variable rate debt secured with a letter of credit from Harris Bank.[8] He noted that the swap agreements associated with the 2005G Bonds would need to be terminated and the estimated costs of $75 to $82 million rolled into the refunding bonds.

Mr. Jousset responded to the OUCC's and Industrial Group's concerns regarding the Department's requested $12.3 million in E&R. He stated that these E&R projects cannot be reasonably deferred as they pertain either to the emergency replacement of critical, failed infrastructure; or to the planned replacement of inadequate or obsolete infrastructure whose failure would lead to curtailment of service, or possibly to the endangerment of public health; or to the relocation or installation of critical equipment.

Mr. Jousset testified that he provided a list of categories of projects because he could not include projects that are anticipated but have not been requested by the Department and cannot include emergency, unplanned projects. He did, however, provide a list of essential revenue-funded capital projects for 2009 that have been identified through April 30, 2009.

Finally, Mr. Jousset responded to the Industrial Group's testimony concerning the Department's capital budget expenditures for the past 5 years. Mr. Jousset acknowledged that the capital expenditure budget is higher than 2006, 2007, and 2008, but stated it is significantly

[7] *See supra* note 6.

[8] It appears that Harris Bank is no longer willing to provide a letter of credit. Pet. Ex. Late-Filed 2. However, we have yet to receive any written confirmation.

lower than the budget in 2005. Mr. Jousset explained that Mr. Gorman had failed to include E&R incurred in 2005. Consequently, Mr. Jousset stated that the average E&R funding for the past four years is actually $10.9 million. Mr. Jousset also testified that the 2005 and 2006 budgets are not directly comparable to the 2007, 2008, and 2009 budgets because they do not include any capital expenditure for "Meters, Valves & Hydrants Replacement," which was Veolia's responsibility to fund until 2007. Mr. Jousset explained that when the Veolia expenditures of 2005 and 2006 are also considered for a more accurate comparison of recent past E&R budgets, the average E&R funding for the past four years is at least $11.7 million. Mr. Jousset also stated that one of the reasons for the higher 2009 budget is due to a mandatory water main relocation project associated with the Indiana Department of Transportation's US 40 project.

Mr. Peter Grimm, a financial advisor with Lamont Financial, which specializes in public finance, responded to Mr. Kaufman's testimony regarding interest rate swaps. Mr. Grimm explained how the costs to terminate the Department's interest rate swaps are calculated and stated that the estimated cost to terminate the Department's swaps as of May 11, 2009 was $61.69 million for the 2005G swaps and $9.05 million for the 2005H swap.

6. Commission Discussion and Findings. The Commission's emergency powers are found in Ind. Code § 8-1-2-113, which provides in relevant part:

> [t]he commission may, when it considers necessary to prevent injury to the business or interests of the people or any public utility of this state in case of any emergency to be judged by the commission, temporarily alter, amend, or with the consent of the public utility concerned, suspend any existing rates, service, practices, schedules, and order relating to or affecting any public utility or part of any public utility in this state.[9]

Consequently, the Commission has the authority to evaluate the evidence presented, determine whether an emergency exists and take such action as it deems necessary to prevent harm to the utility or the public.

A grant of emergency relief requires proof that a situation exists which absent immediate corrective action will result in serious harm to either, or both, the petitioning utility and its customers. *Hoosier Energy Rural Elec. Coop., Inc.*, Cause No. 37294, 1984 Ind. PUC LEXIS 777, at *5 (IURC 02/15/1984). The Petitioner bears the burden of presenting sufficient evidence to establish an emergency situation exists. *Petition of HVL Utilities, Inc. and HVL Services*, Cause Nos. 36630 and 36631, 1983 Ind. PUC LEXIS 682, at *14 (IURC 01/11/1983). As noted by the parties, the Commission has typically considered the following four factors in making a determination on a request for emergency relief: (1) the possible curtailment of service; (2) serious financial deterioration; (3) an inability to meet daily expenses; and (4) cost-cutting efforts. *Id.* These four factors are neither inclusive nor exclusive. The Commission has also considered the effect on future financing and the accelerated erosion of earnings. *In re Indiana and Michigan Elec. Co.*, Cause No. 33834, p. 5 (IURC 01/23/1975). If the evidence

[9] The Court of Appeals has held that Ind. Code § 8-1-2-113 authorizes the Commission's use of emergency powers for a municipal utility. *City of Richmond v. Public Serv. Comm'n*, 406 N.E.2d 1269, 1276 (Ind. Ct. App. 1980).

demonstrates that an emergency situation exists such that immediate action is required to prevent serious injury, then the Commission should grant a reasonable level of interim emergency rate relief subject to terms and conditions that the Commission deems appropriate. *Petition of HVL Utilities*, 1983 Ind. PUC LEXIS at *14.

It is not sufficient for Petitioner to merely recite the criteria required to support emergency rate relief and simply claim those criteria apply. Rather, it is necessary as a matter of proof to establish a factual basis for a conclusion that the criteria apply. There has to be a determination of the anticipated results of not taking immediate action. *Indiana & Michigan Electric Company,* Cause No. 33834, p. 5 (IURC 01/23/75). Any such determination must be supported by specific findings of fact and sufficient evidence. *Citizens Action Coalition v. Public Serv. Co.,* 582 N.E.2d 330, 333 (Ind. 1991).

The OUCC and the Industrial Group generally disputed that the Department had provided sufficient evidence to demonstrate the existence of an emergency. The Commission shares the OUCC's and the Industrial Group's concerns that much of the Department's direct testimony lacked the necessary underlying factual support, and instead consisted of general opinions and conclusions that an emergency rate increase is necessary. Without sufficient facts to support the claims and opinions of the witnesses, it is simply a request for immediate action based on supposition and guess-work.

However, the Department, in its rebuttal testimony and exhibits, provided additional documentation for its projected cash flow shortage, support for its proposed debt refunding plan and further explanation of the possible financial repercussions to the utility should it default on its bond obligations. Consequently, we find that sufficient evidence was ultimately presented to support a determination that an emergency exists based on the Department's potential shortfall to cover its debt service requirement and the need to refund the existing variable rate debt. We find that if an increase in rates and charges is not ordered on an emergency basis, the Department will suffer serious financial deterioration and be unable to meet its daily expenses. However, as discussed more fully below, we believe the Department has overstated its revenue requirements and has failed to sufficiently support the requested 17.56% across the board rate increase in emergency relief. In addition, while we recognize that the Department has made some effort to reduce operating costs, we find that additional steps as set forth further below are required. Furthermore, based on the Department's compliance history with Commission requirements and the evidence presented at the hearing, we have concerns whether the Department currently has the managerial capabilities to address the financial emergency situation in which it finds itself. Consequently, the Commission finds that the emergency relief authorized herein shall be conditioned upon the Department's full compliance with all of the conditions set forth herein to assure that the public interest is protected.

The Department requested an emergency rate increase of 17.56%. The OUCC recommended emergency relief, if any, ranging from 3.51% to 11.91% depending on the amount of revenue funded capital improvements allowed. The Industrial Group's recommendation was an increase, if any, of 7.7% based on the Department's case-in-chief testimony and 9.1% based on revisions at the hearing. The disagreement on the amount of the emergency rate increase was focused on four main issues: the amount of the increase and terms of the Veolia Management

Agreement, the proper level of debt service expense, the level of revenue funded capital projects and the correct level of operating revenues on which to base an emergency increase.

A. Veolia Management Fee. The Department's daily operations are conducted by Veolia under the Management Agreement and Veolia's fee represents approximately 80% of the Department's annual operation and maintenance expense.[10] Not only does the Department seek emergency rates to continue the Veolia payments at the 2008 level, it also requested a 5% increase in the management fees based on an "expectation" that fees would increase. Although Mr. Steele indicated that the amount of the increase is based on a formula in the First Amendment to the Management Agreement, Mr. Skomp testified that the Department is still negotiating the amount of the increase to be allowed. Pet. Ex. JRS-ER, p. 5.

It is the Department's position that the Management Agreement fees must be paid and cannot be reduced. However, when asked at the hearing whether the Department had approached Veolia about reopening the Management Agreement due to the current financial situation or discussed with them the possibility of containing costs, Mr. Steele testified that they had not. TR at A62-63. And, when asked whether it would be prudent to contact Veolia, Mr. Steele indicated he thought it could be considered. TR at A64. However, he stated that he thought Veolia's response would be that because it had not issued the variable rate debt or done anything to cause the immediate harm, it should not be required to adjust its fees. *Id.*

As noted above, one of the factors considered by the Commission in making a determination on a request for emergency relief is the utility's efforts at cost cutting. We have often found the following analogy by Chairman Wallace to be extremely relevant to an analysis of a utility's need for an emergency rate increase:

> Mr. Doudiet made reference to a sick person and indicated a sick person should not be allowed to remain sick, but if a person were losing blood it seems the first thing would be to try to stop the flow before you give them a transfusion, and there is not much evidence here of an attempt to stop the flow other than some discussion of an apparent freeze on hiring. . . (In Re Northern Indiana Public Service Company, Cause No. 37023, excerpt from hearing held on December 20, 1982, p. 10-x.)

Petition of HVL Utilities, Inc. and HVL Services, 1983 Ind. PUC LEXIS 682, at *11.

As Mr. Gorman noted, Veolia in effect constitutes the Department's workforce. Pursuant to the Management Agreement, Veolia is responsible for performing the day-to-day operations of the water utility and employs the personnel needed to meet that responsibility. If the Department operated the utility through its own employees, the Commission would expect the implementation of cost cutting measures relating to those employees, such as a freeze on pay raises, and other costs that are embedded in the Veolia management fees. The Commission certainly would not anticipate a proposed increase in salaries in the face of an emergency

[10] To the extent necessary, as none of the parties offered a copy of the Management Agreement into evidence, the Commission takes administrative notice of the Management Agreement previously filed with the Commission on July 24, 2006 in Cause No. 43056.

financial situation. *See Emergency Petition of South Haven*, Cause No. 40595, 1996 Ind. PUC LEXIS 450, at *10-*15 (IURC 11/26/1996). The Commission would also expect the utility to reduce operation and maintenance expense by eliminating or delaying non-essential activities.

The evidence is undisputed that the Department has made no attempt to contact or negotiate with Veolia on maintaining the 2009 management fees at the 2008 level or postponing any increase given the Department's current financial situation. The Commission notes that Mr. Steele testified that in 2007 when Veolia was hurting financially, the Management Agreement was renegotiated to help alleviate Veolia's losses. TR at A31-32. Yet, the Department has made no attempt to renegotiate the current fees given the Department's financial difficulties. Nor are we aware of Veolia having made such an offer.

Mr. Steele did testify that the Department has undertaken several measures to reduce or stabilize those expenses it believes to be within its control and not subject to the Management Agreement. Mr. Steele noted the Department's reduction of its 2009 revenue funded capital improvements to $12.3 million. He also noted the Department's efforts to refinance its bonded indebtedness to avoid debt service expense volatility. Last, he noted that in order to rely less on consultants, the Department has hired a chief operating officer, will be hiring an engineer and is reconfiguring its staff. Mr. Steele asserted that these staffing changes will result in a net savings of approximately $1.5 million per year. Even though, the Department has minimized some costs, the Commission believes it is essential to take additional steps to reduce and contain expenses.

Ind. Code § 8-1-2-113 is broad in its terms, and comprehensive in meaning. *State of Ind., ex rel. Indpls. Traction and Terminal Co. v. Lewis,* 120 N.E. 129, 131 (Ind. 1918). The Indiana Supreme Court has indicated that this law contemplates service supervision by the Commission and to that end, it should be liberally construed with a view to public welfare. *Id.* Further, while discussing the Commission's ability to act during an emergency, the Court stated, "Under this section the commission may judge of the full scope and requirements of the emergency, its probable effects and duration, and to make such order as the exigencies of the case demand." *Id.* The Commission may act in emergency situations in order to protect the welfare of the people notwithstanding the interference with contracts. *Wilfong v. Ind. Gas Co.,* 399 N.E.2d 788, 791 (Ind. Ct. App. 1980) (citing *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398 (1934)). Specifically, Indiana courts have explicitly recognized that Ind. Code § 8-1-2-113 contemplates the use of the state's reserved power, not to formally annul or set aside contractual obligations, but to temporarily suspend such obligations to meet a public necessity. *See, State of Ind. v. Lewis,* 120 N.E. at 131; and *Wilfong,* 399 N.E.2d at 791. In short, the Court in *Wilfong* explained that contracts are subject to the police power of the state. 399 N.E.2d at 791.

Based upon the evidence presented, the Commission finds that the emergency condition presented by the Department necessitates additional cost cutting measures that go beyond those which the Department believes to be within its control, to prevent further injury to the public and the water utility. Since the Department's daily operation and maintenance of the utility is governed by the Management Agreement, the Commission finds that the Management Agreement shall be temporarily altered to the extent that it calls for the payment of fees in excess of those paid in the 2008 test year. The Department shall immediately contact Veolia to discuss and determine appropriate measures that can be implemented to contain and reduce costs and the associated management fees during the time of this emergency situation.[11] The Department shall file with the Commission the plan developed with Veolia, detailing the measures and reductions to be taken, within thirty (30) days from the date of this Order.

The Commission further notes that there are a number of aspects of the Management Agreement which, on the basis of the testimony presented, we find profoundly disturbing given Petitioner's claim of emergency.[12] First, the Commission's March 28, 2002 Order in Cause No. 41821 required the Department to notify the Commission of any changes to the Management Agreement within ten (10) business days of any change. The Commission has never been notified of the First Amendment to the Management Agreement entered into by the Department and Veolia on June 26, 2007. In fact, the Commission was unaware of the First Amendment until Petitioner filed a copy of it in this Cause. We are particularly troubled by the Department's non-compliance with this requirement given the fact that the First Amendment amended and increased the fees owed to Veolia.

Second, as pointed out by the OUCC, the First Amendment to the Management Agreement requires the Department to pay a total of $5 million, in three equal installments, to Veolia for past unexpected expenses incurred during the years of 2002 through 2006. Pet. Ex. JHS-ER3, p.4. The third and final payment of $1.667 million is expected to be paid in September 2009. This third payment has not been included in Petitioner's requested revenue requirements in the emergency portion of its case and no testimony was presented concerning where Petitioner will obtain the necessary funds to make the payment. As noted by the OUCC, recovery by a utility of past expenses is impermissible as retroactive ratemaking. Consequently, the Commission finds that the third and final payment of $1.667 million owed to Veolia under the First Amendment to the Management Agreement should not be paid to Veolia until the issuance of a final order in this Cause determining whether this payment is reasonable and in the public interest.[13]

Third, Mr. Steele testified that the Management Agreement provides for "incentive" payments in the aggregate of up to 25% of the fixed fees for that billing year, depending on whether Veolia successfully meets any or all of a total of approximately 37 factors or performance-based criteria. TR at A57-58. The record does not indicate the degree to which Veolia has been able to reach or exceed the performance metrics in the first few years, but at least in each of the last three years, the evidence indicates that Veolia was able to claim well in excess of 90% of the "incentive" payments. TR at A65-66.

Mr. Steele testified that the Management Agreement requires the Department to remit 60% of the possible "incentive payments" for a given year in quarterly installments *during the course of that year* and months before it is technically determined that those payments have in

[11] We also note that Section 5.04 of the Management Agreement provides for the renegotiation of the fees upon the occurrence of an Uncontrollable Circumstance, which is defined in Section 2, and would appear to include an Order from the Commission.

[12] We note that the Commission has never approved, nor has it ever been asked to approve, the Management Agreement or the First Amendment.

[13] In addition, as noted by the parties, the First Amendment specifically provides that Veolia's compensation under the terms of the First Amendment may be reduced in the event the Commission disallows such fee or expense. Pet. Ex. JHS-ER, p. 13.

fact been earned. TR at A57-58. Indeed, the final payment made in the year following that for which "incentives" were paid was described as an "incentive true-up" in testimony by Mr. Steele. TR at A66.

The Business Dictionary defines "incentive" as an "inducement or supplemental reward that serves as a motivational device for a desired action or behavior" and "performance" as "accomplishment of a given task measured against preset standards of accuracy, completeness, cost, and speed."[14] To characterize compensation for which there is somewhere between a 60% and better than 90% probability of being paid, and for which that can be determined almost a year in advance, as being "incentive" compensation which is purportedly "performance based" stretches credulity at a minimum and approaches disingenuousness. If the intent of the agreement is simply to expand Veolia's compensation by an amount little short of 25%, on top of the fixed fee amount, then the Commission suggests that the agreement should have simply said so. On the other hand, if the intent is to set up a system of rewards for true performance which is not out of reach but achievable only with an exceptional effort which exceeds standard or average performance, then both the standards and the criteria should be set accordingly. Even Mr. Steele agreed that perhaps the incentives under the Management Agreement "should be re-addressed based upon knowledge of the last five or six years, and they need to be re-evaluated to more accurately reflect the quality of service provided by Veolia to the customers." TR at A67.

Mr. Steele also testified that the compensation system of the Management Agreement could also possibly be made better based upon past experience indicating that the annual revenues and expenses of both the Department and Veolia appear to be greatly impacted by abnormal weather (i.e., extremely wet or extremely dry). TR at A67-68. He indicated that when the weather has been very dry, the Department's revenues are up while Veolia's earnings are down due to increased expenses; and when the weather has been very wet, the Department's revenues are down while Veolia's earnings are up due to decreased expenses. *Id.*

As indicated above, we find that no reasonable basis was presented for including in emergency rates the 5% estimated increase in Veolia's management fees and that additional steps to contain and reduce fees under the Management Agreement are necessary. Therefore, we find that the 2008 test year amount of management fees should be used for the Department's payments to Veolia until further order of the Commission. Such determination results in a total operation and maintenance expense of $63.199 million.

The Department is further cautioned that the Commission must find any decision rendered in the final disposition of this case to be in the public interest. In determining whether requested rates and charges are just and reasonable, the Commission "may properly review the utility's overall financial condition including all revenue and expense aspects and may disallow, for rate purposes, excessive and imprudent expenditures." *Bd. of Directors for Utilities of the Dept. of Public Utilities of the City of Indianapolis v. OUCC*, 473 N.E.2d 1043, 1051-1052 (Ind. Ct. App. 1985). The payments and terms governing the relationship between the Department and Veolia, as framed by the Management Agreement and First Amendment, constitutes a sizeable portion of the cost structure of the utility. Therefore, we find that the Department shall

[14] http://www.businessdictionary.com/definition/incentive.html; http://www.businessdictionary.com/definition/performance.html

undertake a comprehensive review of Veolia Management Agreement for the purpose of determining whether the terms of the Management Agreement and the First Amendment are reasonable, appropriate and in the public interest given the concerns noted above, the concerns raised by Mr. Steele at the hearing, and the perceived inability of the Department to approach Veolia and renegotiate the contract based on exigent circumstances, such as those presented in this Cause. Upon completion of its review, the Department shall contact Veolia to discuss and resolve any issues identified with the Management Agreement. The results of the Department's review and any amendment(s) to be made to the Management Agreement shall be addressed in the Department's request for permanent rates.

B. Debt Service. The Department initially requested an annual debt service of approximately $59.5 million based on a prospective five-year average, factoring in the proposed refinancing of the Department's variable rate debt. Both the OUCC and the Industrial Group opposed the use of a five-year average and recommended that debt service be set at the actual debt service cost for 2009 of approximately $55.1 million. The OUCC also suggested that the Department's debt service reserve fund of $26.4 million be used to make the Department's debt service payments.

On rebuttal, Mr. Skomp testified that the Department could agree to a debt service amount based on 2009 debt service if a procedural schedule could be agreed upon that would allow for an order on permanent rates by January 1, 2010. If not, Mr. Skomp recommended that a two-year average for 2009 and 2010 be used, which would result in a revised debt service amount of $60,336,000. As discussed further below, the parties could not agree upon a procedural schedule that would allow for an order on permanent rates by January 1, 2010.

During cross-examination, Mr. Gorman suggested that if the Commission were to accept a two-year average for debt service, then revenue requirements other than debt service should also be considered for that time period. TR at E14.

The Department's rebuttal testimony and evidence at the hearing lead us to conclude that use of the debt service reserve funds is prohibited by the bond documents and would not be in the public interest. As indicated by the Department, the bond resolution provides for the use of the funds in the event of a default and requires replenishment of the funds within a short time. Pet. Ex. JRS-ER, p. 10-12; TR at C46. Further, the evidence indicates that use of the funds would require reporting to the Nationally Recognized Municipal Securities Information Repositories, which would have an adverse affect on future debt issuances by the Department, as well as the City of Indianapolis. *Id.*; TR at C65-66. Since the debt service reserve funds would need to be restored in the permanent rate case, the ratepayers would not receive any real savings, but instead would be subject to the potentially adverse affects in future debt issuances.

When establishing the appropriate debt service amount to be recovered in rates, the objective is to provide the level of revenue that will match the amount of debt service payments over the expected life of the rates. Petitioner originally proposed a five-year average. It is clear that the rates established in this emergency rate order will not be in place for five years and would provide revenues well above the expected debt service payments. The proposal by the OUCC and the Industrial Group to use only 2009 actual debt service payments also fails to provide the revenue levels required to meet debt service over the expected life of these rates given the agreed upon procedural schedule for the establishment of permanent rates. Therefore, the Commission finds that the use of a two-year average of 2009 and 2010 debt service payments to be the most accurate and appropriate for debt service recovery.

At the hearing, Mr. Taylor testified that he had received notice that Harris Bank had agreed to provide the Department with a letter of credit for $50 million, which would allow the Department to keep the 2005H bonds as variable rate bonds (thereby avoiding swap termination payments) and remove MBIA and DEPFA from the bonds. TR at C68-69. However, on June 8, 2009, the Department filed a supplemental late-filed exhibit explaining it had been informed by Harris Bank that a business decision had been made to stop issuing letters of credit for revenue backed bonds, and as a result will withdraw its commitment to the Department and will not issue the letter of credit in connection with the refunding of the 2005H bonds. Pet. Ex. Late-Filed 2. The Department further indicated that it would now likely refinance its 2005H bonds using fixed rate debt and terminate the associated swap agreement due to the difficulty in finding a new liquidity provider within a short time period.

In response to a June 11, 2009 Docket Entry, the Department confirmed that it plans to refund all of its variable rate debt with fixed rate debt, and in order to minimize issuance costs, to refund the 2004A, 2005G and 2005H bonds with a single issue of fixed rate refunding bonds. Exhibit 1 attached to the Department's June 15, 2009 response contained an amortization schedule that reflects one bond issue for 2009 and an estimated combined amortization schedule. The combined debt service for January 1, 2009 and January 1, 2010 are estimated to be $58,905,227 and $62,663,872, respectively. We note that the proposed 2009 debt service for the three bonds to be refunded was higher than the amortization schedules provided in Petitioner's direct testimony. Based on the updated information, the Commission has adjusted Petitioner's two-year average to include the change in proposed refinancing, which resulted in an average debt service of $60.785 million.

The Department also explained in its response to the June 11, 2009 Docket Entry that the aggregate swap unwind termination fee, which was at its lowest recent value of $33.5 million as of close of business on June 10, 2009, was factored into its attached amortization schedule. However, it also noted that as of the close of business on June 12, 2009, the fee stood at $42.5 million. Therefore, the Commission finds that Petitioner should be required to true-up its rates after it issues its 2009A bonds. Within ten (10) days of closing, Petitioner shall file a true-up report in this Cause containing the following: the actual principal amount borrowed; the interest rate; the sources and uses of funds; and an amortization schedule. A revised revenue requirement and an amended tariff shall also be submitted with Petitioner's true-up report. The OUCC or any party to this proceeding shall have three (3) business days to file any objections with respect to the calculation of the rates contained within such amended tariff.

Based on the evidence presented, the Commission finds that the proper level of debt service expense for setting emergency relief should be $60.785 million. This amount reflects the estimated average debt service for 2009 and 2010.

The Commission also finds that Petitioner will no longer have remarketing fees associated with its proposed variable rate debt. Therefore, the $49,000 included in Petitioner's proposed Purchase Agreement and Remarketing fees should be excluded.

C. Revenue Funded Capital Projects. The Department has requested approval for $12.3 million of revenue funded capital projects, which consists of $6,932,667 in specifically identified projects through April 30, 2009 and the remainder in unidentified and unplanned E&R project estimated costs. The Department consistently stated that the $12.3 million budget for revenue funded capital projects in 2009 includes only essential projects necessary to assure continued service. However, the Department's direct testimony in support of the essential nature of the projects consisted primarily of an assertion that they are essential because they are perennial in nature. In fact, testimony from Mr. Jousset at the hearing concerning the category of meters, valves and hydrants indicated that the category included an allocation of funds for not only broken meters, but for the replacement of meters pursuant to a scheduled preventive maintenance plan. TR at B116. No testimony or explanation was offered as to why these replacements were necessary to continue during this period of emergency.

As noted by the OUCC, funding of extensions and replacements is typically deferred as non-essential until an order on permanent rate relief can be issued. *See e.g., South Lawrence Utilities*, Cause No. 43324 (IURC 01/07/2007); *Town of Paoli*, Cause No. 41405 (IURC 04/14/1999). The Petitioner has the burden of proving the requested extensions and replacements are of such an essential nature as to justify being included in emergency rates. The Department has failed to demonstrate an essential need for the requested $12.3 million to be included in emergency rates.

As noted by the Industrial Group, the requested $12.3 million amount is higher than the Department's comparable budgets over the past five years and the highest amount experienced in the last three years. Consequently, Mr. Gorman recommended no more than $10 million be included based on the Department's highest expenditure in the last three years. In rebuttal, the Department contended that Mr. Gorman failed to recognize the significant amount of capital expenditures in 2005. However, on cross-examination, Mr. Jousset could not explain the reason for the significant amount of capital projects in 2005. TR at B124.

The OUCC recommended that the Commission allow no revenue funded capital projects in the emergency rates based on the Department's case-in-chief evidence. The OUCC also indicated that if the Department could justify the essential nature of the requested $12.3 million in capital projects, then it would recommend they be included in the emergency rates.

The Commission is left with a varying range of options based on the evidence in this case and the recommendations and requests of the parties. The Commission finds that the Department has failed to support the essential nature of the entire $12.3 million in capital projects for 2009. Therefore, we decline to authorize emergency interim rates that include a revenue requirement for E&R projects that the Department has not sufficiently identified or supported as necessary and essential for the safe and adequate provision of water. The Commission acknowledges that on rebuttal the Department did identify several specific projects as essential in nature, some of which are currently on-going, in the amount of $6,932,667 as of

April 30, 2009. Given the financial nature of the emergency presented, the Commission finds the inclusion of these essential projects to be reasonable. Therefore, the Commission finds that the amount for revenue funded capital projects should be limited to those projects identified with a total estimated cost of $6.933 million.

Mr. Gorman also pointed out that the Department has $3.95 million in the Renewal and Replacement Fund, which could be used for capital expenditures. However, Mr. Skomp testified at the hearing that the Commission's Order in Cause No. 43056 approved a settlement requiring such funds be kept in a restricted account and used for capital improvements designed to increase system capacity. TR at B76; OUCC's Ex. CX-1, p. 5. The Commission finds that these funds should remain restricted for capital improvements designed to increase system capacity. However, during the term of this emergency order, the Commission finds it appropriate to allow funds from the system development charges ("SDC") collected during the emergency to be used for essential E&R revenue funded projects only.

The Commission also finds that the Department should file monthly reports in this Cause on the status of the E&R projects. The monthly reports shall be filed no later than ten (10) days following the end of each month, beginning with June 2009 and continuing through September 2009. The report shall indicate the project name and number, estimated project cost, the amount expended to date, and the amount of the SDC funds collected and used.

D. <u>Operating Revenues</u>. In calculating its revenue deficiency, the Department relied upon its sales revenues from 2008. The Industrial Group used 2007 in its recommendations because 2008 sales were abnormally low. The Department contested Mr. Gorman's recommendation and testified that a weather normalization adjustment is not a standard, generally accepted adjustment in water utility rate cases.

In making its argument that weather normalization adjustments are not standard and generally accepted adjustments for Indiana water utilities, the Department cites to the Commission's Orders in *City of Bloomington*, Cause No. 38607, 1989 Ind. PUC LEXIS 28 (IURC 01/25/1989) and *Indianapolis Water Co.*, Cause No. 38868, 1990 Ind. PUC LEXIS 159 (IURC 05/16/1990). Although the Commission did reject a weather normalization adjustment based on staff recommendation in the *City of Bloomington* water rate case, the Commission denied an adjustment advocated by the OUCC in *Indianapolis Water Co.* because, although there was evidence of some correlation between the amount of rainfall and customer usage, the Commission found no direct correlation. 1990 Ind. PUC LEXIS 159, at*32-*34. We also note that the Commission approved a weather normalization that represented an averaging of revenues in *Indiana Cities Water Corp.*, Cause No. 38851, 1990 Ind. PUC LEXIS 229, at *34, (IURC 07/05/1990).

However, more recently, the Commission has recognized the appropriateness of making a usage normalization adjustment "to adjust test year revenue levels so as to eliminate the effects of unusual events and weather variations." *Ind. American Water Co., Inc.*, Cause No. 42029, 2002 Ind. PUC LEXIS 432, at *108 (IURC 11/06/ 2002). In that case, the Commission approved the use of a three-year average because it approximated the thirty-year average for rainfall. In doing so, the Commission stated that, "[b]ecause weather during the three-year period approximates the thirty-year average, the use of the three-year period appropriately captures this most significant variable for which the usage normalization is an attempt to adjust."[15]

Based on the evidence presented herein, the Commission finds that the appropriate revenues from sales to be included in the emergency rates should be based on 2008 sales revenues. Mr. Gorman testified at the hearing that the objective in a rate case is to set rates which will provide an expected level of revenue under normal conditions. TR at E9. Adjustments to test year revenue are typically made, or allowed, to the extent that they are fixed, known and measurable. Although the Department acknowledged that 2008 revenues were lower because of a wetter summer and that revenues were higher in 2007, which was a drier year, the Department also noted that its first quarter 2009 revenues are lower than they were in the first quarter of 2008. TR at A67 and Pet. Ex. JRS-ER, p.7. While Mr. Gorman testified that lower revenues during the first quarter of the year may be the result of the economic downturn, we also recognize that the first half of 2009 has been wetter than usual. TR at E9.

While the parties appear to agree that 2008 was a wetter than normal year and that 2007 was a dryer than normal year, we lack any evidence demonstrating that an average of the two years is representative of "normal weather conditions" on a going forward basis. The testimony presented fails to provide a sufficient basis upon which to make a reliable adjustment to the test year revenues, and we therefore find that the 2008 revenues should be used for the setting of emergency rates.

Accordingly, the Commission finds that the proper operating revenue on which to base emergency rates is $120.726 million.

7. <u>Total Revenue Requirement and Emergency Rate Increase</u>. The Commission finds that, on an emergency basis, the Department's current rates and charges are insufficient to provide for its cash needs for the year 2009 or for the Department's annual revenue requirement, and are, therefore, unreasonable. Based on the evidence of record, including the Petitioner's June 15, 2009 response to the Commission's June 11, 2009 Docket Entry requesting updated information, the Commission finds that the Petitioner's *pro forma* annual revenue requirement for emergency purposes is $143.095 million.

Regarding Taxes Other Than Income, none of the parties' proposals reduced revenues subject to the Utility Receipts Tax ("URT") calculation by the "Sales for Resale" or "Wholesale Sales" revenue, which is exempt from URT pursuant to Ind. Code § 6-2.3-3-5(a). Nor did any of the parties in their recommendations reduce bad debt expense from operating revenues, which is an allowed deduction before computing URT pursuant to Ind. Code § 6-2.3-5-2. Consequently, after making these adjustments, the appropriate calculation for Taxes Other Than Income is $1.653 million.

[15] In *Ind. American Water Co., Inc.*, Cause No. 42520, 2004 Ind. PUC LEXIS 351, at *199-*200 (IURC 11/14/04), the Commission rejected the proposed normalization adjustments based on insufficient evidence to support an adjustment. However, the Commission again acknowledged the purpose of usage normalization is to account for unusual or unseasonable conditions during the test year that might affect demand for water. *Id.* at *181.

For the emergency portion of this cause, the Commission finds that the Petitioner's rates should be increased in the aggregate by 12.27% to produce additional operating revenue of $14.675 million in order to meet its annual revenue requirements as follows:

Statement of Revenue Requirements
(in thousands)

Operating Expenses	$ 63,199
Taxes Other Than Income	1,653
PILT	8,923
Debt Service	60,785
Purchase Agreement and Remarketing Fees	539
Indpls. Local Public Improv. Bond Bank	1,063
Debt Service Reserve	-
Extensions and Replacements	6,933
Working Capital	-
Total Revenue Requirements	143,095
Less: Other Operating Income not subject to rate increase	701
SDCs	2,400
Carmel Repymt of Note	1,800
Interest Income	3,168
Net Revenue Requirement	135,026
Less: Pro-forma Present Rate Revenue	120,726
Net Increase Required	14,300
Divided By: Revenue Conversion Factor	0.9745
Required Revenue Increase	$14,675
Percentage Increase	12.27%

8. **Petitioner's Financial Safeguards.** While not the sole factor for this emergency proceeding, the Department's debt status is certainly the predominant one. Throughout the testimony, cross-examination and rebuttal by the parties, the focus was on describing the circumstances which led to the current predicament as a "perfect storm" or "black swan" event[16]; in fact, it was not. Certain outcomes of the refinancing package, such as failure of the swaps to work as anticipated, the dramatic collapse in the credit ratings of precisely those third-parties whose presence was intended to protect the utility against a rising rate scenario, and the repeated failure of auctions to result in market-based purchase of the variable rate obligations could

[16] A black swan event is a highly improbable event with three principal characteristics: it is unpredictable; it carries a massive impact, and after the fact, we concoct an explanation that makes it seem less random, and more predictable, than it was. NASSIM NICHOLAS TALEB, THE BLACK SWAN: THE IMPACT OF THE HIGHLY IMPROBABLE, Random House (2007). "Why do we not acknowledge the phenomenon of black swans until after they occur?" Taleb asks rhetorically. Part of the answer is that humans are hardwired to learn specifics when they should be focused on generalities. "We concentrate on things we already know and time and time again fail to take into consideration what we don't know."

legitimately be categorized as highly improbable. They are also an indication that in one sense, those who effected these transactions were quite probably too clever by half. The fundamental issue here is simple: whether far too much of the utility's debt was vested in variable rate obligations. The common-sense answer is equally simple: yes.

The common-sense answer is supported by the testimony of the Department in this proceeding. In rebuttal, Mr. Steele testified that he agreed with the OUCC witnesses that having 57.5% of its bond portfolio in variable rate debt is excessive. Pet. Ex. JHS-ER, p. 7. Mr. Taylor also testified that unless a municipal utility had significant daily cash flows, 15% should be the maximum percentage of variable rate debt for a portfolio. Pet. Ex. KDT-E, p. 9.

With the exception of Mr. Taylor's attempted reconstruction of the events leading to the Department's financial situation, apparently without benefit of legacy records, the evidence in this proceeding is mostly silent on how the utility got into this position, the extent of due diligence performed on the complex swaps and hedging mechanisms, representations that may have been made by retained advisers and the parties whose services were ultimately engaged. At the hearing, Mr. Taylor indicated that the Bond Bank had nothing more than a "fundamental, cookie cutter type swap policy" and that the previous administration did not even keep records of the payments or constituent parts thereof, which were made subsequent to the refinancing. TR at C86. He stated that "[t]here was no tracking of the variable rate debt, interest and swaps since the time of issuance." TR at C19-20. This is akin to an individual opening a checking account, then not recording payments or deposits in the ledger as they were made, and throwing out the periodic statements unopened as they were received.

At this point, we simply do not know what considerations were weighed that would cause the utility's decision makers to abandon the simple notion that 57.5% of all debt being variable rate debt is too much. While Mr. Taylor surmised at the hearing that the Department may have assumed that the presence of the swaps would offset or mitigate the volatility in the interest rate trends, he stated that there was a whole mix of risks associated with variable rate debt and swaps (e.g., market risk, interest rate risk, and counter-party risk) that should have been considered. TR at C88-91. If the former staff was not competent or responsible enough to keep even basic records, it is not unreasonable to assume that they were not sufficiently competent to undertake these transactions without outside advice. In short, we do not know if there was culpability, either in the form of misrepresentation of the risks or failure to adequately address them, on the part of those who advised the Department or the Bond Bank. It is incumbent on the Department to explore these questions vigorously and with alacrity to determine whether there is any likelihood of partial or full recovery of the massive losses that the ratepayers are asked to shoulder in this instance; and if there is even a reasonable doubt, to pursue every remedy to recover those funds on behalf of the ratepayers. We will expect the Department to further address this issue in the proceeding to set permanent rates.

Petitioner also indicated at the hearing that the current administration, with the apparent support of the City-County Council, is exploring detailed, written policies designed to prevent a recurrence of the failed financial strategy currently before this Commission. TR at C95-98. Mr. Steele testified that the Department had adopted a new policy that establishes a cap on variable rate debt at 15% of the total outstanding debt. Pet. Ex. JHS-ER, p. 7 and JHS-ER4. At the hearing, Mr. Taylor identified the need for measures and policies that addressed: (1) the appropriateness of, stated objective of and a limit on variable-rate debt for a proposed bond issuance, (2) a mechanism to monitor the variable-rate debt and swap performance, including counter-party risks, at both the Bond Bank and the qualified entity level and (3) an exit from the variable-rate mode, if the monitoring tracks a trend that proves to be moving against the intended variable-rate objective. TR at C85-97. He also explained the necessity for the Bond Bank, the Department, and the City to each have a solid swap policy and variable rate debt policy. TR at C96. Mr. Taylor also indicated that although it didn't appear to be the past practice of the Bond Bank, in the future, the entire debt planning process would be conducted using a "team-approach" that requires full involvement of the qualified entity. TR at D26-27.

While the Commission commends both the administration and the City-County Council, such policies when completed and implemented are no more foolproof or lasting than the next election. What can be done by one administration and one legislative body can be undone by the next. As noted by the Department, the Commission does not have jurisdictional authority over the Department's financing decisions. However, this certainly does not prohibit, as noted by the OUCC, the Department from voluntarily seeking the Commission's input, either formally or informally, on proposed financing decisions. This Commission is required to determine that the rates and charges proposed in this Cause are in fact just and reasonable, and that they are in the public interest. Such a determination implicitly requires a review of the Department's revenue and expenses, including debt service. And, as previously noted, the Commission has the authority to disallow, for ratemaking purposes, excessive and imprudent expenditures. *Bd. of Directors for Utilities of the Dept. of Public Utilities of the City of Indianapolis*, 473 N.E.2d at 1051-1052. Consequently, the Commission expects the Department to fully and completely address the reasonableness of the amount of debt service it will seek to recover through its proposed rates and charges in the permanent rate proceeding.

9. Petitioner's Management Capabilities. Since the Department's last rate case two years ago, a number of management issues have surfaced. As set forth above, the primary concerns raised in this emergency proceeding include the Veolia Management Agreement, which was fully discussed earlier, and the Department's financing decisions. While some may suggest that hindsight is 20/20, several factors related to the Department's financing situation are simply related to poor management. As indicated by the Department's own witnesses, the prior management's decision (or lack thereof given the nature of its relationship with the Bond Bank as indicated by Mr. Taylor's testimony) to finance 57.5% of its debt with variable rate debt represents an unreasonable level of risk for a municipality. That decision, combined with the failure of the Department to monitor the effective interest rate of the debt and swap payments, will result in the payment of tens of millions, rather than the $100,000 that Mr. Taylor indicated the Department could have paid if it had been monitoring the payments, to exit the swap agreements and reduce the amount of variable rate debt. TR at C-96. The ultimate indignity is that this payment to exit the swap agreements creates no tangible asset; the money leaves Indiana with only the cost of financing that payment remaining to be paid by the ratepayers for the next 28 years.

In the Department's last rate proceeding, the Commission approved a settlement with the OUCC in which the Department agreed to revise its accounting system and policies to comply with the National Association of Regulatory Commissioners ("NARUC") Uniform System of Accounts, and to revise its computer system to generate reports and statistical information for Commission reports. The agreement was not made simply to change the format of the utility's accounting, but was made to address numerous concerns with the reliability of the financial statements. The Department not only failed to complete this task in the time required by the Commission's Order, but appears to have continuing issues with its accounting records given the Department's (and the other parties') preference to delay the proceedings of the permanent rate case until it receives audited financial statements. We also note that the Department's balance sheet for the year ending December 31, 2008, which was provided in Petitioner's 2008 Annual Report submitted on April 30, 2009, fails to appropriately balance. Resolution of accounting deficiencies warrants the same "emergency" sense of urgency on the part of Petitioner and its providers as this Commission has accorded to the first phase of this rate case. We expect the Department to fully and completely address this issue and its compliance with the Commission's prior order in the permanent rate proceeding.

The Commission has also recently conducted an informal investigation into the Department's billing practices as a result of complaints received by the Commission's Consumer Affairs Division in early 2008. These complaints resulted from a number of estimated bills that were significantly higher than actual use and where no meter reading was occurring for extended periods of time. While the customer issues appear to have been addressed, the Department has failed to take appropriate follow-up action concerning the bill estimation method. The informal investigation revealed that the Department changed the bill estimation method reflected in its rules on file with the Commission without first seeking the Commission's approval. It is now the middle of 2009 and the Department has yet to take any action to obtain the Commission's approval for the change in bill estimation method.

Rather than wait to address the next debacle characterized as an emergency situation, the Commission believes it is necessary that the Department conduct a comprehensive review of its management structure, whether it does so itself or with the assistance of an independent auditor or consultant, to identify appropriate management policies and procedures that need to be in place to assure proper, timely and reasonable management of utility operations. We note that in the Department's 2007 Annual Report, it indicated that a "major goal" for 2008 included completing a strategic plan. As part of the permanent rate proceeding, the public interest requires that these issues be addressed, and any rate relief will be dependent, at least in part, on satisfactory responses to the concerns raised herein and a demonstration that the Department's management and structure is appropriate. Consequently, the Commission finds that the Department shall provide the results of its management structure review and a copy of the Department's strategic plan with its case-in-chief filing in the permanent rate proceeding.

In reviewing its management structure, the Department should also consider whether it would be appropriate to adopt benchmarking standards outlined in industry literature, such as the American Water Works Association. The benchmarking standards to be considered should extend beyond operation practices by including management standards such as strategic and financial planning and risk management. It may also be possible to use benchmarking data to demonstrate the reasonableness of the fees associated with the Management Agreement. The Department should also consider evaluating each of its employees and positions, including the duties, responsibilities and qualifications necessary to meet those responsibilities. These are just a few suggestions that the Department should consider in evaluating the appropriateness of its management structure and capabilities.

In addition, the Department shall also address the measures that have been taken by the Department's management to address the financing issues identified herein. More specifically, Mr. Taylor indicated that the Department, the Bond Bank and the City-County Council are taking steps to address the financing issues raised in this cause, including the establishment of a cap on variable rate debt, policies for and a mechanism to monitor variable rate debt and swap performance, and an exit strategy developed from variable rate mode. In the permanent rate proceeding, the Department shall provide documentation demonstrating the measures that have been implemented, including those identified by the Department in response to Paragraph 10A below, as well as any others that may subsequently be adopted or implemented.

In summary, the Commission finds that the Department shall provide sufficient evidence in the permanent rate proceeding to demonstrate that it has the technical, financial, and managerial capabilities to reasonably and adequately operate the water utility.[17] In fulfilling this requirement, we fully expect Petitioner to also offer testimony from the Department's Board members and individuals that are employed full-time by the Department, as opposed to only offering testimony from individuals that are employed by other entities or employed by the Department as a consultant or in an "acting" capacity as was done in this emergency proceeding. We fail to understand the reasoning of the Department for not presenting the testimony of at least one of its Board members or full-time management personnel to support its request for emergency rate relief and are left to wonder what additional information or insight may have been provided had such an individual testified in this proceeding.

10. Additional Conditions on Interim Emergency Rate Relief. Based on the evidence presented herein, the Commission further finds that the emergency rates authorized herein shall be subject to the following additional conditions:

A. Petitioner shall file with the Commission, the OUCC and other parties in this Cause, a copy of the 2008 audited financial statement upon receipt of such statement by the Department. The Department shall also direct the auditor to provide a separate Independent Auditor's Report ("Report") on the Department's financial statements and submit that Report within 60 days. The auditor should include an opinion on the Department's financial statements in its Report.

B. Petitioner shall file copies of all policies adopted, approved, and currently under consideration by the Department, the Bond Bank, and/or the City-County Council concerning the issuance and monitoring of debt of the Department within ten (10) days.

[17] We note the Indiana Department of Environmental Management has published an Information Handbook for preparing a water system management plan designed to address the necessary technical, financial and managerial capabilities necessary for the operation of a water utility. The Information Handbook and additional information concerning the operation of existing water utilities can be found on IDEM's website at www.in.gov/idem.

C. Petitioner shall update and file with the Commission, the OUCC and any other interested party in this Cause, monthly cash flow projections to reflect any changed conditions beginning with June 2009 and continuing through September 2009, or in the event Petitioner's prefiling date is extended, through the month in which Petitioner's prefiling actually occurs. Such filings shall be due by the 10th of the following month.

D. Petitioner shall file monthly unaudited financials, including a balance sheet and a statement of revenues and expenses, beginning with June 2009 and continuing through September 2009, or in the event Petitioner's prefiling date is extended, through the month in which Petitioner's prefiling actually occurs. Such filings shall be due by the 10th of the following month.

E. Petitioner shall not enter into any contracts, agreements, joint ventures, or other type of transaction relating to the operation, management, sale or transfer of the water utility or its assets without prior Commission approval.

11. **Prehearing Conference Findings.** As noted previously, the Department has also requested an increase in water rates and charges on a permanent basis, as well as authority to implement an annual adjustment mechanism to its rates and charges to account for annual changes in the management fee paid by the Department to Veolia. While off the record and with the agreement of the parties, an informal discussion was held, during which an agreement was reached regarding procedural matters for the non-emergency phase of this case.

It is the Commission's understanding that the agreed upon filing date of the Department's case-in-chief was driven by the desire of the Department and the parties to use audited financial data, which will not be available until June 30, 2009. Given the Department's issues with its legacy financial records, the Commission understands the desire to use audited financials for purposes of evaluating the utility's permanent rates and charges. However, the Commission is discouraged by the lack of explanation from the Department regarding what efforts, if any, have been made to obtain audited financial statements prior to the June 30, 2009 expected date.

Notwithstanding the foregoing, the Commission finds the following should become a part of the record in this Cause and govern the parties for the non-emergency phase of this proceeding:

a. Test Year and Accounting Method. The test year to be used for determining the Department's actual and pro forma operating revenues, expenses and operating income under present and proposed rates shall be the twelve months ended December 31, 2008, adjusted for changes which are fixed, known and measurable for ratemaking purposes and which will occur within twelve (12) months following the end of the test year.[18]

[18] The Department's proposed order allowed for adjustments to be made within twenty-four (24) months following the end of the test year. No such proposal was made at the prehearing conference or agreed upon by the parties. If the Department believes that the standard twelve (12) month period for making adjustments is not acceptable, the Commission will readily entertain a more expedited schedule for completing the permanent rate proceeding.

b. Petitioner's Prefiling Date. Petitioner shall prefile with the Commission and serve on all parties of record its prepared testimony and exhibits constituting its case-in-chief, with the exception of its cost of service and rate design testimony and exhibits, on or before September 30, 2009. Petitioner's cost of service and rate design testimony and exhibits shall be due on or before October 14, 2009.

c. Field Hearing. A field hearing will be scheduled in early 2010 at a date, time and location to be determined by subsequent docket entry in this Cause. The OUCC shall, within two (2) weeks following the date of the field hearing, file any exhibits from the field hearing with the Commission and serve them on all parties of record.

d. OUCC's and Intervenors' Prefiling Date. The OUCC and all Intervenors shall prefile with the Commission and serve on all parties of record the prepared testimony and exhibits constituting their respective cases-in-chief on or before February 16, 2010.

e. Cross-Answering Testimony. The OUCC and all Intervenors shall prefile with the Commission and serve on all parties of record their respective cross-answering testimony and exhibits on or before March 16, 2010.

f. Petitioner's Rebuttal Prefiling Date. The Department shall prefile with the Commission and serve on all parties of record its rebuttal testimony and exhibits on or before April 6, 2010.

g. Sworn Testimony. Any witness testimony to be offered into the record of this proceeding shall be made under oath or affirmation. In accordance with 170 IAC 1-1.1-18(h), if the prefiled testimony of a witness is to be offered into evidence at the evidentiary hearing, and the witness sponsoring the prefiled testimony is not required to, and does not, attend the evidentiary hearing, the prefiled testimony shall be accompanied by the witness's sworn affidavit or written verification at the time the evidence is offered into the record.

h. Evidentiary Hearing. An evidentiary hearing in this Cause shall commence on May 24, 2010 at 9:30 a.m. in Room 222, National City Center, 101 W. Washington St., Indianapolis, Indiana, at which time the respective testimonies and exhibits of the Department, the OUCC and all Intervenors shall be presented and their witnesses cross-examined. The parties shall file their respective witness lists and order of witnesses no later than May 17, 2010.

i. Workpapers. When prefiling technical evidence with the Commission, each party shall, within two (2) days thereafter, file copies of the workpapers used to produce that evidence. Copies of the same shall also be served on each other party to the proceeding.

j. Corrections and Copies. Any corrections to prefiled testimony shall be made as soon as practicable after discovery of the need to make such corrections. An original and five (5) copies of all prepared testimony and exhibits shall be filed with the Commission.

Parties may also elect to file documents with the Commission using the Commission's Electronic Filing System in lieu of filing paper documents. Pursuant to the terms and conditions of the Electronic Filing System, documents filed electronically are deemed filed the date they are submitted, subject to verification and acceptance by the Commission, and will receive an electronic file stamp. For filings greater than thirty (30) pages in length, a party shall file with the Commission an original and one (1) paper copy within two (2) business days of the electronic filing. When supplying such copies, the party must provide a copy of the email reflecting the electronic filing was accepted by the Commission.

k. Intervention. Any party permitted to become an Intervenor in this Cause shall be bound by the record as it stands at the time that the petition to intervene is granted.

l. Discovery. Discovery should be conducted on an informal basis and shall be available to all parties. Any party receiving a discovery request shall respond to or object to the discovery request within ten (10) calendar days of receipt. Objections not made within ten (10) calendar days shall be deemed waived unless an extension is agreed upon or obtained from the Commission. After the date for filing of Cross-Answering Testimony, responses and objections to discovery shall be due within five (5) business days. After May 10, 2010, no further discovery request may be propounded by any party. Discovery requests received after 12:00 p.m. on a business day immediately preceding a non-business day shall be deemed to have been received on the next business day.

m. Motions to Strike and Objections to Testimony. Motions to Strike and objections to testimony or exhibits shall be made at least five (5) business days prior to the evidentiary hearing in this Cause.

n. Settlement. If a settlement is reached in this Cause, the parties thereto shall file the settlement agreement and any testimony and exhibits in support of the settlement with the Commission no later than ten (10) business days prior to the evidentiary hearing. Given the May 24, 2010 evidentiary hearing date, a settlement and supporting testimony and exhibits shall be filed no later than May 7, 2010.

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

1. Petitioner shall be and is hereby authorized to temporarily increase its existing rates and charges on an emergency basis, subject to refund and interest pending the Commission's order on Petitioner's request for permanent rate relief, as provided in Finding Paragraph 7 and subject to the conditions set forth in this Order.

2. Petitioner shall file within thirty (30) days from the date of this Order, a plan to address the containment and reduction of costs under the Management Agreement and First Amendment with Veolia as provided in Finding Paragraph 6.A.

3. Petitioner shall file with the Water/Sewer Division of the Commission a tariff in accordance with the Commission's rules and consistent with this Order. Said tariff, when approved by the Water/Sewer Division, shall cancel all previously approved rates and charges

and Petitioner's new charges shall be in full force and effect until Petitioner files and receives approval of its amended tariff filed pursuant to changes made as a result of its true-up report.

4. In accordance with Finding Paragraph 6.B, Petitioner shall file with the Commission and all parties of record, within ten (10) days of closing on its refinancing, a true-up report containing the following: the actual principal amount borrowed; the interest rate; the sources and uses of funds; and an amortization schedule. Petitioner shall also file an amended tariff with the Water/Sewer Division. Such tariff shall be effective upon approval by the Water/Sewer Division and shall apply to water usage from and after the date of approval.

5. Petitioner shall provide the Commission with monthly reports concerning its E&R funding beginning with July 2009 and continuing through September 2009 as provided in Finding Paragraph 6.C.

6. Petitioner shall comply with the conditions set forth in Finding Paragraph 10.

7. The rates and charges approved in this Order are for the emergency portion of this Cause only and shall remain in effect until permanent rates are established in this Cause, or until otherwise ordered by the Commission.

8. The procedural schedule for the non-emergency phase of this Cause shall be as set forth in Finding Paragraph 11 of this Order.

9. In accordance with Ind. Code § 8-1-2-70, Petitioner shall pay within twenty (20) days of the date of this Order to the Secretary of the Commission, the following itemized charges and any additional costs which were or may be incurred in connection with this Cause:

Commission charges	$ 23,446.65
Legal advertising charges	$ 101.79
OUCC charges	$ 31,836.39
TOTAL	$ 55,384.83

Petitioner shall pay all charges prior to placing into effect the rates and charges approved herein.

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

HARDY, GOLC, LANDIS AND ZIEGNER CONCUR; ATTERHOLT NOT PARTICIPATING:

APPROVED: JUN 3 0 2009

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

Brenda A. Howe

Brenda A. Howe
Secretary to the Commission