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STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

JOINT PETITION OF INDIANA-AMERICAN)
WATER COMPANY INC. ("INDIANA-)
AMERICAN") AND THE TOWN OF NEW)
WHITELAND, INDIANA ("NEW)
WHITELAND") FOR APPROVAL AND)
AUTHORIZATION OF: (A) THE)
ACQUISITION BY INDIANA-AMERICAN OF)
NEW WHITELAND'S UTILITY PROPERTIES)
(THE "NEW WHITELAND SYSTEM") IN)
JOHNSON COUNTY, INDIANA (THE "NEW)
WHITELAND AREA"), IN ACCORDANCE)
WITH THE PURCHASE AGREEMENT)
THEREFORE; (B) APPROVAL OF)
ACCOUNTING AND RATE BASE)
TREATMENT; (C) APPLICATION OF)
INDIANA-AMERICAN'S RATES AND)
CHARGES FOR PETITIONER'S JOHNSON)
COUNTY OPERATION TO WATER SERVICE)
RENDERED BY INDIANA-AMERICAN IN)
THE AREA SERVED BY THE NEW)
WHITELAND OPERATION; (D) ALL)
NECESSARY LICENSES, PERMITS, AND)
FRANCHISES FOR INDIANA-AMERICAN TO)
PROVIDE WATER SERVICE IN THE NEW)
WHITELAND AREA; (E) APPLICATION OF)
INDIANA-AMERICAN'S DEPRECIATION)
ACCRUAL RATES TO SUCH ACQUIRED)
PROPERTIES; AND (F) THE SUBJECTION OF)
THE ACQUIRED PROPERTIES TO THE LIEN)
OF INDIANA-AMERICAN'S MORTGAGE)
INDENTURE.)

CAUSE NO. 43883

APPROVED: MAR 02 2011

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

On April 14, 2010, Joint Petitioners, Indiana-American Water Company, Inc. ("Indiana-American") and the Town of New Whiteland ("New Whiteland" or "Town") filed their Joint Petition with the Indiana Utility Regulatory Commission ("Commission") in this matter. On April 14, 2010, Joint Petitioners filed their prepared testimony and exhibits constituting their case-in-chief. On July 23, 2010, the Indiana Office of Utility Consumer Counselor ("OUCC") filed the testimony of Margaret A. Stull and Edward R. Kaufman. Joint Petitioners' evidence in

this Cause included its response to the Commission's Docket Entry dated August 16, 2010 ("Joint Petitioners' Docket Entry Response").

Pursuant to notice of hearing duly given and published as required by law, proof of which was incorporated into the record by reference and placed in the official files of the Commission, an evidentiary hearing in this Cause was held at 10:00 a.m. on August 19, 2010 in Room 222, PNC Center, 101 W. Washington Street, Indianapolis, Indiana. Joint Petitioners and the OUCC appeared and participated in the evidentiary hearing. No members of the general public appeared.

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

1. Notice and Jurisdiction. Due, legal and timely notice of the public hearing conducted herein was given by the Commission as required by law. Indiana-American is a "public utility" within the meaning of that term in Indiana Code § 8-1-2-1 and is subject to the jurisdiction of the Commission in the manner and to the extent provided by law. New Whiteland is a municipality located in Johnson County, Indiana. On March 16, 2002, New Whiteland withdrew from the jurisdiction of the Commission for purposes of rates and charges and financing. The Commission has jurisdiction over Joint Petitioners and the subject matter of this proceeding.

2. Petitioners' Characteristics. Indiana-American is a public utility incorporated under the laws of the State of Indiana, with its principal office and place of business at 555 East County Line Road, Greenwood, Indiana. Indiana-American is engaged in the provision of water utility service to the public in and around numerous communities throughout the State of Indiana, including Johnson County. Indiana-American also provides sewer utility service in Wabash and Delaware Counties. Indiana-American has charter power and authority to engage in the business of providing such water and sewer utility service under indeterminate permits and franchises, licenses and permits heretofore duly acquired. Indiana-American owns, operates, manages and controls, plant, property, equipment and facilities for the production, treatment, transmission, distribution and sale of water for residential, commercial, industrial, other public authority, and sale for resale purposes, for the provision of public and private fire protection service and for the provision of sewer service.

New Whiteland owns and operates water utility properties (the "New Whiteland System") serving approximately 2,100 individually metered customers. The New Whiteland System abuts Indiana-American's existing distribution system in its Johnson County Operation.

3. Relief Requested. Joint Petitioners request that the Commission (1) approve accounting and rate base treatments that reflect the full purchase price plus transaction costs in net original cost rate base; (2) grant such approvals as may be necessary to consummate the acquisition of the New Whiteland System by Indiana-American and permit the operation thereof by Indiana-American on the terms described in the Joint Petition and the Asset Purchase Agreement; (3) find that public convenience and necessity require water service by Indiana-American in the areas now served by the New Whiteland System; (4) authorize the application of Indiana-American's rules and regulations and rates and charges generally applicable to Indiana-

American's Johnson County Operations, as the same may be changed from time to time, to service to be provided by Indiana-American in the areas currently serviced by the New Whiteland System;¹ (5) approve the accounting entries as described in the direct testimony of Susan S. Lee (Project Finance Manager for American Water Works Service Company, an affiliate of Indiana-American) to reflect Indiana-American's acquisition of the New Whiteland System; (6) authorize Indiana-American to apply its existing depreciation accrual rates to the New Whiteland System; and (7) approve the encumbering of the properties comprising the New Whiteland System with the lien of Indiana-American's Mortgage Indenture.

4. Description of New Whiteland System. As stated in the direct testimony of Jeffrey C. Henson, Indiana-American's Senior Business Development Manager, New Whiteland owns and operates a water system serving approximately 2,100 customers in an area south of Greenwood in Johnson County. New Whiteland is a wholesale customer of Indiana-American, receiving water supplied through a connection at US 31 between Greenwood and Franklin, Indiana. The distribution system consists of approximately 25 miles of mains (ranging from 2- to 12-inch), 182 fire hydrants and 2 elevated tanks (capacities of 100,000 and 500,000 gallons). All customer accounts are metered. The New Whiteland System is currently operated by employees of New Whiteland.

5. Evidence Presented.

(a) Joint Petitioners' Evidence. The complete terms and conditions of the purchase and sale of the New Whiteland System are set forth in the Asset Purchase Agreement, filed as Joint Petitioners' Exhibit JCH-3. Mr. Henson testified that Indiana-American proposes to acquire the water storage tanks, water mains, service lines, meters, hydrants, equipment, real estate, easements and permits and all other assets located within the New Whiteland System, which are part of the transmission and distribution system utilized to provide water service to customers, excluding (a) liabilities, contingent or otherwise, (b) customer service connections which are and shall remain the property of the customer, (c) furniture, (d) transportation equipment, (e) tools, shop and garage equipment, (f) communication equipment, (g) certain miscellaneous equipment, (h) cash and accounts receivable, and (i) customer deposits.

As described in Mr. Henson's direct testimony, the Asset Purchase Agreement between Indiana-American and New Whiteland provides for the acquisition by Indiana-American of the utility assets of the New Whiteland System for a purchase price of \$4,575,000. The purchase price was determined following a statutorily required appraisal and public hearing process set forth in Indiana Code §§ 8-1.5-2-4 through -6.

Mr. John M. Perrin, an elected Member and President of the New Whiteland Town Council, testified that New Whiteland decided to sell the water utility due to a revenue shortfall caused by the lack of new development and growth in the community, which has resulted in a significant decrease in the connection fees. New Whiteland uses the connection fees to fund

¹ On rebuttal, Indiana-American agreed to postpone its request for application of the Johnson County Operation rates to New Whiteland customers until the time of Indiana-American's next rate order.

operation of the New Whiteland System. The sale will also provide funds for New Whiteland to spend on other community projects.

Mr. Perrin described a public process where the Town Council approved the proposed sale. New Whiteland hired Mr. Don Corey, Mr. Patrick Zaharako and Mr. Stephen Cobb to conduct an appraisal to establish a value for the New Whiteland System assets. As required by Indiana Code § 8-1.5-2-4, Mr. Corey and Mr. Zaharako are registered professional engineers, and Mr. Cobb is a licensed real estate appraiser. The three independent appraisers were retained at a public meeting to begin their appraisal. They ultimately determined that the estimated replacement cost less depreciation to construct the system as set forth in the appraisal report was the just and true value. Joint Petitioners' Exhibit SSL-2. After the appraisal was returned, there was a public hearing. Indiana-American made a presentation at the hearings and numerous questions were asked and answered. During that time and thereafter, no customers have objected to the proposed sale. At the conclusion of the public hearing, the Town Council unanimously adopted an ordinance directing that the New Whiteland System be sold. New Whiteland did not receive a petition requesting that the question of the sale be submitted to a referendum, as could have been required had a petition bearing signatures equal to two percent (2%) of the votes cast in New Whiteland for Secretary of State in the last election. Indiana Code §§ 3-8-6-3 and 8-1.5-2-5(f). The purchase price as set forth in the Asset Purchase Agreement is equal to the value as ultimately determined by the appraisers.

Ms. Lee provided testimony concerning the accounting and ratemaking treatment proposed by Indiana-American in connection with its acquisition of the New Whiteland System. Joint Petitioners' Exhibit SSL-4 sets forth the proposed journal entry, which shows a recorded net original cost of the New Whiteland System assets as equal to the purchase price plus estimated transaction costs. Both Mr. Henson and Ms. Lee explained why they believe this accounting treatment is appropriate given the unique circumstances present in connection with the sale of a municipally owned system where the statutory procedure requires an independent appraisal of the assets and prohibits a sale for less than the appraised value. Mr. Henson opined that because of the statutory procedure involved, such a sale will always be the result of an arm's length negotiation. He explained that the circumstances present in this case included the lack of complete books and records reflecting the net original cost of the assets in the New Whiteland System. Ms. Lee referred to the Commission's Order dated April 4, 2001 in *Indiana American Water Co.*, Cause No. 41655 (IURC 4/4/2001) ("Freeman Field") as support for the proposed journal entry in this Cause. Ms. Lee proposed to record the original cost of the New Whiteland System as a debit to Account 101 – Utility Plant in Service and to record all associated accumulated depreciation as a credit to Account 108 – Accumulated Depreciation. Ms. Lee further testified that the depreciation accrual rates to be applied to the New Whiteland System assets would be the rates approved by the Commission in Cause No. 43081 on November 21, 2006, as included in the calculation of rates with the approval of Indiana-American's rate case in Cause No. 43187 on October 10, 2007.

Mr. Henson and Deron E. Allen, Indiana-American's Vice President of Operations, testified that the customers of the New Whiteland System and Indiana-American's existing customers will benefit from the acquisition. New Whiteland customers will have consistent access to highly trained and experienced operational resources and will not have to be concerned

with their water supply meeting water treatment regulations. In addition, being part of the American Water system also provides an advantage in economies of scale that will directly benefit these customers as environmental, water quality, and operational issues become the responsibility of Indiana-American. Mr. Henson explained that New Whiteland System customers will continue to have full-time management of their water system including, but not limited to, a full-time operations staff, 24/7 customer service and emergency response. In addition, Mr. Henson stated the New Whiteland customers will gain full-time functional specialists in areas such as engineering and water quality. Mr. Henson further explained that New Whiteland System customers will benefit from many programs that Indiana-American uses to ensure customer satisfaction, such as routine valve operating programs, hydrant flushing and inspection, meter replacement, and plant security.

Ms. Lee described the impact of Indiana-American's proposed acquisition of the New Whiteland System on the average monthly bill for a New Whiteland residential customer. The average monthly bill for a residential customer using 6,000 gallons would increase from \$27.40 under New Whiteland's current rates to \$44.82 inclusive of a fire protection surcharge under Indiana-American's approved rates in Cause No. 43680. However, Mr. Henson noted in his rebuttal testimony that the most recent rate study performed for the Town, dated July 21, 2010, proposed a rate increase by the Town that would yield a monthly bill of \$29.98 for consumption of 6,000 gallons.²

Ms. Lee's direct testimony also described the encumbrance that would be placed on the New Whiteland System assets as a result of the acquisition under Indiana-American's General Mortgage, which secures most of Indiana-American's utility property for the benefit of Indiana-American's bond holders. Ms. Lee testified that Indiana-American has access to all of the necessary funds to support the acquisition. Initially, Ms. Lee explained, those funds will come from internally-generated funds and/or short-term debt, but when appropriate, the short-term debt will be funded with permanent common equity and long-term debt financing, upon approval from the Commission. The short-term debt for the initial financing would be funded through Indiana-American's cash management arrangement with American Water Capital Corporation, an affiliate of Indiana-American. Ms. Lee testified that the acquisition will not impair Indiana-American's ability to raise necessary capital on reasonable terms while maintaining a reasonable capital structure. According to her testimony, the projected investment to acquire the New Whiteland System is equal to less than 0.8% of Indiana-American's total capital structure.

(b) OUCC's Evidence. The OUCC's witness Margaret A. Stull, a utility analyst in the OUCC's Water/Wastewater Division, testified concerning Joint Petitioners' proposed acquisition. Ms. Stull stated that while the OUCC does not oppose Indiana-American's acquisition of the New Whiteland System, it does have several concerns or questions regarding certain aspects of the Asset Purchase Agreement. According to Ms. Stull's testimony, the OUCC opposes Joint Petitioners' request for (1) authority to include the full purchase price plus transaction costs (\$4,575,000) in net original cost rate base for both accounting and rate base purposes for Indiana-American and (2) approval of the accounting entries as described in Ms. Lee's testimony. Edward R. Kaufman, a senior analyst with the OUCC, further testified that the

² The rates for which the July 21, 2010 rate study was performed went into effect August 5, 2010.

OUCC disagrees with Indiana-American's proposed application of Indiana-American's Johnson County Operation's rules, regulations, rates and charges to the existing customers of the New Whiteland System at this time.

Ms. Stull stated that the OUCC believes the proposed ratemaking treatment of the acquisition seeks a return on and return of an acquisition adjustment consisting of the difference between the purchase price and the net book value as should be reflected on New Whiteland's books and records. Ms. Stull does not believe the purchase price accurately reflects the fair value of the assets to be acquired so as to qualify for a return on the acquisition adjustment. Further, Ms. Stull does not believe the Joint Petitioners have established the criteria necessary to qualify for depreciation of the entire purchase price (*i.e.*, a return of the acquisition adjustment). Ms. Stull based her determination that an acquisition adjustment was included in the purchase price because of the difference between the purchase price (equal to the value as determined by the appraisers) and the estimated net book value reflected in New Whiteland's 2009 financial statements.

First, with respect to Ms. Stull's position that Indiana-American has not demonstrated that the purchase price meets the criteria for a return on an acquisition adjustment, she stated that she does not believe the purchase price reflects the fair value of the utility. Ms. Stull argued that the fact that the purchase price is the result of an appraisal does not make it the result of an arm's length transaction where the parties agree on a negotiated purchase price. Ms. Stull proposed that the Commission should consider whether the appraisal took into account the correct factors in a manner consistent with Indiana law. Among those factors, Ms. Stull believed, should be whether a portion of the assets were contributed to the utility as well as whether any going concern value is included in the purchase price. Ms. Stull stated that although the appraised value does not appear to include any going concern value, it does include the value of plant that was contributed or paid for through contributions of cash.

She stated that the OUCC identified several sources of contributed cash and plant, including New Whiteland's "Connection, permit and inspection fee," payments under main extension agreements with certain customers, and probably contributions of plant received from developers in its service territory. Ms. Stull's testimony stated that this contributed plant should be recorded as contribution in aid of construction ("CIAC") for ratemaking purposes, effectively excluding it from rate base and precluding Indiana-American from earning a return on investment in these assets, except for authorized depreciation expense on the gross book value. Ms. Stull testified that she was unable to determine the net book value of all contributed plant in New Whiteland's System.

Ms. Stull also expressed the OUCC's concern with other aspects of the valuation of the assets, including (1) the significant difference between the depreciated original cost value and the reproduction cost new less depreciation ("RCNLD") value, (2) the lack of evidence that the appraisers examined the current state of New Whiteland's assets, and (3) the lack of any testimony from the persons preparing the appraisal.

Ms. Stull stated that lack of testimony from the appraisers deprived the Commission and the OUCC the opportunity to determine the methodologies employed, the assumptions made, the

accuracy and completeness of the data relied upon, the level of scrutiny exercised, and whether their review included any bias.

According to Ms. Stull, the difference between original cost and replacement cost of New Whiteland's assets is \$3,492,845, or a 320% increase over the net original cost of these assets based on the net book value of those assets as reflected on New Whiteland's 2009 financial statements. Ms. Stull testified that the effect of the difference between the values was that Indiana-American's current and future customers would pay a higher return without receiving any additional benefit from the higher value.

Ms. Stull also expressed disagreement with Ms. Lee's testimony that in order to determine the net original cost of the assets of the New Whiteland System, it would be necessary to recreate New Whiteland's books and records. She contested Mr. Henson's testimony that cost estimates for some assets were needed because New Whiteland maintains a fixed asset system, which Ms. Stull contends indicates it has fixed asset records. As support for her assertion that estimates are not necessary in this case, Ms. Stull pointed to (1) the fact that the appraisers relied on the inventory information provided by New Whiteland to form the basis of their Summary Appraisal Report, (2) that New Whiteland is audited by the State Board of Accounts, and (3) that New Whiteland's Clerk-Treasurer indicated that New Whiteland has fixed asset software. Ms. Stull also relied on the 2009 New Whiteland financial statements, contained in an attachment to her direct testimony, as evidence that New Whiteland maintains adequate fixed asset records and there is no need to estimate the original cost value of its water utility assets.

Finally, Ms. Stull addressed Joint Petitioners' stated benefits to New Whiteland's and Indiana-American's existing customers as a result of the acquisition. She asserted that the New Whiteland customers will not soon experience any improvement in water quality as a result of the acquisition, given that New Whiteland already purchases all of its water from Indiana-American and Indiana-American has no specific plans to improve the infrastructure. Ms. Stull expressed concern with Joint Petitioners' stated benefits of the acquisition to Indiana-American's existing customers, suggesting that the acquisition will result in increased costs to Indiana-American's customers.

According to Ms. Stull, the value of the acquired assets for purposes of earning a return on the plant should be \$1,082,155. Additionally, the OUCR recommended that Indiana-American be allowed to earn a return of the gross original cost of the utility plant being acquired, estimated by the OUCR to be \$1,897,495 less any assets not being conveyed to Indiana-American (such as vehicles), based on New Whiteland's 2009 financial statements.

Mr. Kaufman addressed Indiana-American's proposal to apply its Johnson County Operation rates to New Whiteland customers upon closing of the acquisition. He stated this would result in an increase to New Whiteland's rates of 64% taking into account charges for fire protection. Mr. Kaufman recommended that New Whiteland's rates not be increased until Indiana-American's next rate case in order to allow the New Whiteland customers proper notice and an opportunity to challenge the proposed rate increase to which they would be entitled in the context of a general rate case.

(c) Joint Petitioners' Rebuttal Evidence. In rebuttal, Mr. Henson responded to the OUCC's testimony regarding the proposed accounting and rate base treatment of the purchase price for the proposed acquisition of the New Whiteland System. Mr. Henson testified that the question before the Commission in this case is whether to approve the acquisition with Indiana-American's proposed accounting treatment or not approve it at all. He noted that if the Commission were to accept the position of the OUCC in this case, pursuant to the terms of the Asset Purchase Agreement, a precondition to closing would not be satisfied. He stated that under the OUCC's proposed ratemaking, Indiana-American could not responsibly and in the name of good business sense complete the acquisition. Mr. Henson pointed out that despite the OUCC's concerns over ratemaking treatment, neither of the OUCC's witnesses testified that the transaction should not be approved as being not in the public interest if the journal entries are to be as Indiana-American has proposed.

Mr. Henson explained that if the OUCC's proposed ratemaking treatment were accepted in this case, it would negatively impact Indiana-American's willingness to engage in future consolidations. He further explained that because the minimum amount required to purchase a system such as New Whiteland's system is established by law, Indiana-American knows what it must invest to purchase such a system. If a portion of the dollars Indiana-American must invest to purchase the New Whiteland System are to be disregarded, Indiana-American will be unwilling to make such acquisitions. This, he explained, would be bad for Indiana municipalities. It would mean that appraisers would be required to start diminishing the value they would otherwise independently determine in order to make deductions requested by the OUCC. If the lack of regulatory approval means that purchasers are no longer willing to pay more than an estimated net original cost less CIAC (as proposed by Ms. Stull), then the value of municipal systems will have been artificially depressed.

In response to Ms. Stull's contention that there is an acquisition premium that results from the purchase price in the proposed transaction, Mr. Henson testified that there is no way to determine that an acquisition adjustment results from the purchase price, or to determine the amount of any such adjustment. He explained that such a determination would require determination of the net original cost, which would require recreating New Whiteland's books and records.

Mr. Henson refuted Ms. Stull's contention that his direct testimony and the direct testimony of Ms. Lee both indicated New Whiteland does not maintain fixed asset records. He responded that their testimony stated the fixed asset records were not complete. He reiterated Ms. Lee's statement that determining the original cost of New Whiteland's utility plant would require recreating New Whiteland's books and records. He explained that the fixed asset software mentioned in Ms. Stull's testimony contains approximately 10 years of data for assets of a system that is nearly 60 years old, and only included purchases exceeding \$5,000 and material costs. He stated labor was not capitalized on New Whiteland's books, underscoring the fact that some estimation and recreation of the books would be necessary in order to determine net original cost. He stated that this is a common problem for municipal systems which utilize fund accounting.

Mr. Henson further testified that even if an acquisition adjustment were found to exist, favorable ratemaking treatment of any acquisition adjustment would be warranted in this case since the relevant criteria had been met, namely (1) that the purchase price be reasonable and result from an arm's length transaction and (2) that the acquired utility be small or troubled. Mr. Henson stated that the purchase price must be considered a fair and reasonable price since it was determined in compliance with the statutorily required independent appraisal process. The General Assembly has dictated how the purchase price for the sale of a municipally owned system is to be determined, namely that the purchase price can be no less than the amount determined by a team of three independent appraisers who are qualified in education and experience to make such valuation determinations. Mr. Henson explained that a purchase price equal to this appraised value must be a fair and reasonable price because it is the minimum amount by law for which the utility may be sold. Anything lower would be illegal.

With respect to the second element of the standard for including an acquisition adjustment in net original cost rate base, Mr. Henson next described the New Whiteland System as "small," having only approximately 2,100 customers. He also stated that the system is nearly 60 years old and much of the pipe could be nearing the end of its useful life; thus, New Whiteland faces uncertainty about the future cost to operate the system and is anticipating the need for major capital improvements as system elements begin to fail.

Mr. Henson also responded to Ms. Stull's concern that there must be some deduction made for CIAC. No CIAC was booked by the Town. Even if the sources identified by Ms. Stull were determined to be "contributions," Mr. Henson disagreed with the OUCC's proposed ratemaking treatment for those amounts in the case of municipally-owned systems. He explained that in both this case (according to Ms. Stull's testimony) and in Freeman Field there was CIAC. In reality, according to Mr. Henson, the entire municipal system is paid for with funds from another governmental entity or customer dollars (either through contributions, rates or taxes). Unlike an investor-owned utility, there are no outside entities who "own" the system and can supply equity capital. The customers are effectively the owners of the system, and CIAC in the case of municipal systems is just another source of equity capital.

Finally, Mr. Henson addressed Mr. Kaufman's suggestion that New Whiteland's ratepayers not be charged the rates and charges applicable to water service within Indiana-American's Johnson County Operation until Indiana-American's next rate case. Mr. Henson stated that this was agreeable to Indiana-American (except to the extent New Whiteland adopts an ordinance pursuant to Indiana Code § 8-1-2-103 to eliminate directly billed hydrant charges).

Indiana-American also offered the rebuttal testimony of Patrick W. Zaharako, an engineer and Project Manager for water and wastewater infrastructure projects with Commonwealth Engineers, Inc. Mr. Zaharako was one of the three independent appraisers who prepared the appraisal. His rebuttal testimony was offered for the sole purpose of allowing the OUCC to ask him questions regarding the appraisal through cross-examination at the hearing.

(d) Commission's Docket Entry. Joint Petitioners' Docket Entry Response stated that Joint Petitioners have not undertaken any effort to recreate the books and records of the New Whiteland System or otherwise determine the net original cost of the assets. Joint Petitioners'

response indicated that although no contributions were reflected on the books of New Whiteland, it is assumed there would be CIAC if New Whiteland kept its books and records pursuant to the Uniform System of Accounts. Given that the appraisers worked from system maps and did not exclude any assets from their appraisal, it is further assumed that the appraisal included assets that were contributed.

6. Commission Discussion and Findings. Indiana Code §§ 8-1-2-12 and -14 give the Commission authority over the accounting procedures utilized by public utilities in Indiana. Indiana-American proposes that it be permitted to book an amount for net original cost rate base equal to the purchase price plus reasonable transaction costs. The OUCC disagrees with this proposed treatment. Instead, the OUCC recommends that Indiana-American be allowed to earn a return of the gross original cost of the utility plant being acquired, estimated by the OUCC to be \$1,897,495, less any assets not being conveyed to Indiana-American based on New Whiteland's 2009 financial statements. At issue in this case is Joint Petitioners' request that the Commission approve a purchase price which includes CIAC.

CIAC are donations provided at no cost to the utility. *South Haven Waterworks v. OUCC*, 621 N.E.2d 653, 655-656 (Ind. Ct. App. 1980). This Cause involves the sale of a municipal utility to an investor owned utility. In *City of South Bend v. The Users of the Sewage Disposal Facilities of Clay Utilities, Inc.* 402 N.E.2d 1267 (Ind. Ct. App. 1980), the City of South Bend ("City") wanted to enter into a contract with Clay Utilities, Inc. ("Clay Utilities"), an investor owned utility, to purchase Clay Utilities' sewer disposal system in an urban area outside of South Bend's city limits. The City appealed the Public Service Commission's ("PSC")³ determination that lease rental payments, which were agreed upon by the City and Clay Utilities, were unfair and unreasonable. The lease payments were based on a purchase price that the City argued was the utility plant's fair market value. *Id.* at 1271. The City hired an engineer to appraise the value of Clay Utilities' sewer disposal system, and the engineer included CIAC funded assets in his appraisal of the value of the utility. The PSC determined the lease payments to be unfair and unreasonable because of the inclusion of CIAC in the price. *Id.* at 1271-72.

The Court of Appeals in *South Bend* discussed the practice in Indiana of deducting CIAC when determining the rate base for an investor-owned utility. The Court of Appeals also explained that property included in rate base is that property on which the utility may earn a return. CIAC is excluded from rate base because the utility did not invest in such property, and the ratepayers should not be required to pay rates that allow the utility to earn a return on property that has been contributed. *Id.* The City argued that since municipal utilities have no rate base and operate on a cash-needs basis, this treatment of CIAC is not relevant. However, the Court of Appeals rejected this argument. *Id.* at 1273. The lease payments, according to the Court of Appeals, are payable from rates and charges collected from ratepayers by the municipality, and rates must be sufficient to pay for expenses associated with the leased facilities. *Id.* The Court noted that an investor-owned utility essentially looks to itself for funding, while municipalities rely on ratepayers, "the very persons who directly or indirectly made the contributions in aid of construction" and can charge whatever is necessary. *Id.* The Court affirmed the PSC's determination regarding the lease payments and stated that "the lease-

³ The PSC is the Indiana Utility Regulatory Commission's predecessor.

purchase agreements negotiated by the [City] would be repugnant to a private investor, and they are likewise repugnant to the users who must pay the negotiated price.” *Id.* at 1275. Based on the Court of Appeal’s decision in *South Bend*, CIAC cannot be included in a utility’s value for purposes of determining a utility’s rate base.

Ms. Lee asserts that the accounting entries proposed by Indiana-American in this Cause are consistent with the Order in Freeman Field. In Freeman Field, Indiana-American purchased a water utility from the City of Seymour. In determining the appraised value of the Seymour municipal utility, the appraisers, although they did include property obtained by a federal grant, they did not include the value of CIAC contributed from customers. *Indiana-American Water Co.*, Cause No. 41655, 2001 Ind. PUC LEXIS 292, at *23 (IURC 4/4/01). Consequently, Freeman Field does not support Indiana-American’s broad proposition that the proper accounting in the case of an acquisition of a municipal system is simply to record the purchase price as the net original cost of the assets. Rather, Freeman Field stands for the proposition that CIAC should be excluded from any appraisal under Indiana Code §§ 8-1.5-2-4 through -6, and that in certain cases, depending on the evidence presented, the purchase price may be recorded as the net original cost. *Id.*

Joint Petitioners’ Docket Entry Response indicates that although no contributions were reflected on the books of New Whiteland, they assume there is CIAC that would have been recorded if New Whiteland kept its books and records pursuant to the Uniform System of Accounts. The Commission has no way of knowing how much contributed property is included in the appraisal. The OUCC suggests that the original cost of New Whiteland’s utility assets was \$1,897,495. The OUCC’s number is a result of reviewing New Whiteland’s 2009 annual financial statements, which also appears to include CIAC. The OUCC was unable to determine the amount of CIAC in the New Whiteland System. Therefore, neither of the numbers proposed by the Joint Petitioners or the OUCC are reliable due to the inclusion of CIAC. Joint Petitioners’ Docket Entry Response also states that Joint Petitioners have not undertaken any effort to recreate the books and records of the New Whiteland System or otherwise determine the net original cost of the assets excluding CIAC. Because Joint Petitioners are aware that some of the utility assets were contributed, Joint Petitioners should have made a reasonable effort to determine how much contributed property is included in the appraisal. However, Joint Petitioners chose to make no effort at all. Consequently, the Commission lacks sufficient evidence to determine a fair value on which Indiana-American is authorized to earn a return and cannot approve Indiana-American’s proposed accounting treatment.

Based on the foregoing and our inability to determine the fair value of the New Whiteland System, we are unable to address the relief requested by Joint Petitioners in this Cause. Should Joint Petitioners desire to make a reasonable effort to determine the amount of CIAC that should be excluded from the net original cost of the New Whiteland System and present that evidence to the Commission for its consideration, Joint Petitioners shall so notify the Commission within thirty (30) days of the date of the Order.

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

1. Joint Petitioners' proposed accounting treatment is hereby denied.
2. Joint Petitioners shall notify the Commission within thirty (30) days of its intent to provide additional evidence in this Cause and provide a proposed procedural schedule for the submission of the additional evidence.
3. This Order shall be effective on and after the date of its approval.

ATTERHOLT, LANDIS, MAYS, AND ZIEGNER CONCUR; BENNETT ABSENT:

APPROVED: MAR 02 2011

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



Brenda A. Howe
Secretary to the Commission