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STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

IN THE MATTER OF THE VERIFIED ) CAUSE NO. 44146  
PETITION OF DAMON RUN CONSERVANCY )  
DISTRICT FOR APPROVAL OF ITS RATES ) APPROVED:  
AND CHARGES FOR WATER SERVICE. ) JUN 19 2013

ORDER OF THE COMMISSION

**Presiding Officers:**  
**Carolene Mays, Commissioner**  
**Gregory R. Ellis, Administrative Law Judge**

On January 13, 2012, Damon Run Conservancy District (“Petitioner”, “Damon Run” or the “District”) filed a Verified Petition requesting that the Indiana Utility Regulatory Commission (“Commission”) approve the District’s existing rates and charges for water and sewer service as required by the Commission’s October 19, 2011 Order in Cause No. 43966 (“43966 Order”). On April 10, 2012, Petitioner pre-filed its direct testimony and exhibits. The Indiana Office of Utility Consumer Counselor (“OUCC” or “Public”) pre-filed its testimony on July 11, 2012, and on August 8, 2012, the Petitioner pre-filed its rebuttal testimony. The Presiding Officers issued docket entries on August 17, 2012 and September 17, 2012 requesting information from the parties. Responses were filed by the Petitioner on August 27, 2012; September 6, 2012; and September 24, 2012, and by the OUCC on August 22, 2012.

Pursuant to notice duly published as required by law, proof of which was incorporated into the record by reference and placed in the official files of the Commission, a public hearing was held in this Cause at 9:30 a.m., on October 30, 2012, in Room 222 of the PNC Center, 101 West Washington Street, Indianapolis, Indiana. The Petitioner and the OUCC were present and participated. The testimony and exhibits of both Petitioner and the OUCC were admitted into the record without objection.

Based upon the applicable law and the evidence herein, and being duly advised, the Commission now finds:

**1. Notice and Jurisdiction.**

**A. Notice.** Proper, legal, and timely notice of the hearing in this Cause was given and published by the Commission as provided for by law. The proofs of publication of the hearing notice have been incorporated into the record of this proceeding.

**B. Jurisdiction.**

**(1) Water Service Rates and Charges.** Whether the Commission has jurisdiction over a conservancy district’s provision of water service depends upon whether the district has made an election to provide service under Ind. Code § 14-33-20-4. If the district makes such an election, then it is subject to the Commission’s jurisdiction as set forth in Ind.

Code ch. 14-33-20. The pertinent section of the Conservancy District Act, Ind. Code § 14-33-20-4(a), provides:

A district established for the purpose of furnishing water supply for domestic, industrial, and public use may elect to furnish water supply under this chapter if: (1) the district plan; or (2) a part of or an amendment to the district plan; so states.

Ind. Code § 14-33-20-14 sets out that a conservancy district coming under Ind. Code ch. 14-33-20 shall file the initial schedule of rates and charges to patrons of the district with the Commission and the district is subject to the jurisdiction of the Commission.

When Damon Run filed its petition in Cause No. 43966 pursuant to Ind. Code § 14-33-20-7 and Ind. Code ch. 14-33-1 seeking Commission approval to provide water and sewage disposal service to properties located outside of Damon Run's boundaries (the "Benefitted Properties") it indicated, in error, that Damon Run had elected to provide water service under Ind. Code ch. 14-33-20. After a public hearing, the Commission granted Damon Run authority to serve the Benefitted Properties and approved the rates and charges for the Benefitted Properties on an interim basis. Because the Commission had not approved Damon Run's initial rates and charges, we also required Damon Run to file this rate proceeding in accordance with Ind. Code §§ 14-33-20-14 and 8-1.5-3-8 to support its existing water rates and charges and the use and disbursement of Damon Run's bond proceeds.

In paragraph 2 of the Verified Petition in this Cause, Damon Run indicated that it had made the election to furnish water supply under Ind. Code ch. 14-33-20 and was therefore subject to the jurisdiction of the Commission for the purpose of establishing its rates and charges. However, Damon Run's August 27, 2012 response (at p. 4) to docket entry questions from the Commission indicated it had not elected to furnish water supply under Ind. Code ch. 14-33-20 in either its district plan or any amendment to its district plan. Damon Run further explained in its September 24, 2012 response (at p. 2) to docket entry questions from the Commission that previous legal counsel's interpretation of Ind. Code ch. 14-33-20 was not discovered until Damon Run prepared its responses to the Commission's August 17, 2012 docket entry questions. As part of Damon Run's responses to the questions from the Commission, a copy of the district plan and amendments thereto were submitted demonstrating that Damon Run never made an election to furnish water supply under Ind. Code ch. 14-33-20.

Because Damon Run did not elect in its district plan to provide water supply under Ind. Code ch. 14-33-20, the provisions of Ind. Code ch. 14-33-20 do not apply to Damon Run. This view is consistent with the Indiana Court of Appeals decision in *Stucker Fork Conservancy Dist. v. Ind. Util. Regulatory Comm'n*, 600 N.E.2d 955, 959 (Ind. Ct. App. 1992) noting that a conservancy district "left its 'conservancy district' hat at the door *when it elected to provide water supply systems pursuant to I.C. 13-3-3-4.*" In *Stucker Fork*, the issue before the court was whether a conservancy district that had elected to provide water service under what is now Ind. Code ch. 14-33-20 was considered a municipal utility or a public utility. *Id.* at 957. In reaching its decision, the court determined the Commission had sole authority over Stucker Fork Conservancy District's rates and charges upon its election to provide service pursuant to Ind. Code ch. 14-33-20. *Id.* at 959. Unlike Stucker Fork, Damon Run did not elect to furnish water supply under the provisions of Ind. Code ch. 14-33-20. Damon Run kept its "conservancy

district” hat and is therefore not subject to the jurisdiction of the Commission for purposes of rates and charges for water service.

In addressing the Commission’s jurisdiction relative to our 43966 Order, we note the Commission can only exercise power conferred to it by statute. *LaGrange Co. Reg’l Util. Dist. v. Bubb*, 914 N.E. 2d 807, 810 (Ind. App. 2009), (citing *Ind. Bell Tel. Co. v. Ind. Util. Regulatory Comm’n*, 715 N.E.2d 351, 354 n.3 (Ind. 1999)). Since Damon Run never elected to provide water service under Ind. Code ch. 14-33-20, the Commission lacked jurisdiction to approve either Damon Run’s provision of water service to the Benefitted Properties under Ind. Code § 14-33-20-7 or its rates and charges pursuant to Ind. Code § 14-33-20-14. In *Goldstein v. Ind. Dep’t of Local Gov’t Fin.*, 876 N.E.2d 391, 393 (Ind. Tax Ct. 2007), the Indiana Tax Court noted that subject matter jurisdiction can only be conferred upon a court by the Indiana Constitution or by statute, not by consent or agreement of the parties. In *Goldstein*, the court concluded that any judgment the court renders is void if it does not have subject matter jurisdiction. *Id.*, (citing *State Bd. of Tax Comm’rs v. Ispat Inland*, 784 N.E.2d 477, 481 (Ind. 2003)). Consequently, any parts of the 43966 Order in which the Commission did not have subject matter jurisdiction are void *ab initio*.

Therefore, because Damon Run has not elected to be subject to Ind. Code ch. 14-33-20 and wears a “conservancy district hat,” it must comply with Ind. Code § 14-33-4-2, which sets forth the requirements for adding area to the district, to provide water service to the Benefitted Properties.

(2) **Sewer Service Rates and Charges.** Ind. Code § 14-33-1-2(a) requires a conservancy district that proposes to collect, treat, or dispose of sewage and other liquid wastes produced outside of the district boundaries to petition the Commission for authority to engage in the services outside its boundaries. Ind. Code § 14-33-1-2(b)(2) also requires the Commission determine the rates and charges that the district may make for the services. Therefore, the Commission has jurisdiction over the Petitioner and its rates and charges for sewer service outside its territorial boundaries.

2. **Petitioner’s Characteristics.** Damon Run has its principal office at 2 West Shakespeare Drive, Valparaiso, Indiana. Damon Run is a conservancy district established by the January 26, 2004 order of the Porter County Circuit Court in Cause No. 64C01-0307-MI-6142. The District was established pursuant to the Conservancy District Act for purposes of providing water supply service and sewage service, among other things, to customers within its service area in unincorporated portions of Porter County, Indiana. Damon Run’s service area now includes approximately six lineal miles within Porter County. Since the District’s creation in 2004, the District has expanded its boundaries to serve additional customers through annexations approved by the Porter County Circuit Court.

Damon Run uses its own infrastructure to provide water service to its customers and obtains water through a contract with Indiana American Water Company (“IAWC”). Pursuant to the Commission’s 43966 Order, Damon Run received authority to provide water service to the three Benefitted Properties that are outside of its boundaries. However, as discussed above, the Commission lacked jurisdiction to approve water service to the Benefitted Properties and Damon Run must seek authority to provide water service to the Benefitted Properties pursuant to Ind. Code § 14-33-4-2.

Damon Run also provides sewage disposal service through its own infrastructure and provides for treatment of wastewater through a contract with the City of Portage, Indiana. Damon Run received authority to provide sewer service to the three Benefitted Properties that are outside of its boundaries through the Commission's 43966 Order. Damon Run presently serves approximately 285 customers which include residential and commercial customers.

3. **Relief Requested.** In its Verified Petition, Damon Run sought Commission approval of its existing rates and charges for water and sewer service. Damon Run also requested in the future it be allowed to file with the Commission, through a 30-day filing process, a tracker to reflect any changes to its rates that are attributable to a change in IAWC's water rates. Damon Run's existing water rates and charges were established through Ordinance 2009-2 adopted by the Damon Run Board of Directors on December 14, 2009. Damon Run's existing sewer service rates and charges were established through Ordinance 2006-2 as amended by Ordinance 2009-1 and adopted by the Damon Run Board of Directors on January 28, 2009.

4. **Evidence Presented.**

A. **Damon Run's Direct Testimony.**

(1) **John C. Barko.** Mr. John C. Barko, Chairperson of the Board of Directors of Damon Run Conservancy District, testified that he is also the managing member of Indiana Utilities Management, LLC and also employed by Nardo Builders as the General Manager. He indicated that through Indiana Utilities Management, LLC he is primarily responsible for the day-to-day operations of the District. He testified that he was the project manager for the installation of the District's sewer and water infrastructure and has been involved in the day-to-day operations of the District since it began operating in 2005. Mr. Barko is involved with customer relations, new customers and district growth, infrastructure coordination with IAWC for water supply, the City of Portage for sewer treatment coordination, the District's tap inspections, management of the maintenance of the District's infrastructure, and various day to day operational activities.

Mr. Barko testified that the District was created in order to provide water and sewage disposal service in an unincorporated area of Porter County, Indiana that was not being served by another utility when properties were first developed in the area. The District purchased its initial water and sewer infrastructure in 2006. Mr. Barko testified that the District issued bonds in 2005 and 2006 that were approved by the Indiana Department of Local Government Finance ("DLGF") in order to finance the purchase. Mr. Barko stated that the District recovers the cost of the bonds from the customers inside the District's boundaries through a Special Benefits Tax that is established annually by the DLGF, a Payment-in-Lieu of Tax ("PILT") from the customers outside the District's boundaries and through sewer connection fees.

Mr. Barko noted that the District is governed by and operates according to the Indiana Conservancy District Act, Ind. Code art. 14-33. The District has a five member Board of Directors, and Board Members are elected at-large by the District's freeholders in accordance with Ind. Code ch. 14-33-5 with each Board Member serving a four-year term.

Mr. Barko testified that Damon Run's service area includes approximately six lineal miles within Porter County. He indicated that since the District's creation in 2004, the District has expanded to serve additional customers. Mr. Barko stated that as of the date that the Petition

in this proceeding was filed, the District's customer base included approximately 285 customers, and he noted that a petition was pending in the Porter Circuit Court for the annexation of approximately 68 acres directly west of Porter Hospital that is expected to be developed to include an assisted living facility; a residential development; a mixed medical complex, and commercial space. Mr. Barko stated that since its creation in 2004, the District has experienced steady growth.

Mr. Barko testified that Damon Run owns and operates approximately 60,786 lineal feet of water transmission and distribution facilities and one booster station. The District also owns approximately 103,000 lineal feet of sewer lines and six lift stations. Since Damon Run's water is supplied by IAWC and its sewage is treated by Portage, Indiana, Mr. Barko noted that the District does not own any water sources or sewage treatment facilities. Mr. Barko testified that the District's water and sewer facilities have sufficient capacity to meet the needs of the District's existing customers. He stated that the District has sized its facilities to meet a reasonable level of future growth as well. Mr. Barko testified that the District's facilities are in excellent condition and the District has experienced no service quality issues to date.

Mr. Barko also noted that Damon Run authorized Umbaugh to prepare an accounting report (the "Accounting Report") to calculate the District's costs, revenues, and expenses that demonstrate the reasonableness of the District's existing rates. Mr. Barko confirmed that the inputs used in Mr. Walsh's analysis are true and accurate, and based upon his analysis. Mr. Barko indicated he believes the District's rates are just and reasonable.

(2) **Eric J. Walsh.** Mr. Eric J. Walsh is a Certified Public Accountant and a manager in the firm of H.J. Umbaugh and Associates, Certified Public Accountants LLP ("Umbaugh"). Mr. Walsh testified that Umbaugh was retained to assist Damon Run with the development of a rate study to be used as a basis to make recommendations regarding the approval of its schedule of rates and charges for service.

Mr. Walsh testified that Damon Run issued Bond Anticipation Notes ("BANs") in 2005 and 2006 to finance the purchase of the District's initial infrastructure. He stated that the DLGF reviewed and approved the District's bond issue via Order No. 05-089 dated September 25, 2005. Mr. Walsh indicated that the BANs were repaid via the issuance of long-term debt in 2010. Mr. Walsh also indicated that the District recovers the cost of the bonds from the District's customers located within the District's boundaries via a Special Benefits Tax that is established annually by the DLGF. He explained that the District recovers the cost of the bonds from the Benefitted Properties via a PILT that is based on the Special Benefits Tax rate established by the DLGF and from sewer connection fees from new customers.

Mr. Walsh sponsored the Accounting Report, which was identified as Exhibit EJW-1, showing supporting information for Damon Run's water and sewer rates. Mr. Walsh explained that the District does not account for water and sewer revenue and expenses separately, but operates the District in the aggregate. He stated that in order to fully understand how the District's water rates were developed, it is necessary to see the District's aggregate expenses and revenues. Mr. Walsh testified that when the District was established, it did not initially segregate the books and records because the operations were small and a unified accounting approach was simple and appropriate. He stated that the unified accounting approach remains in place today; however, the District is aware of the possible need to separate its water and sewer financial activity. Mr. Walsh stated that the Accounting Report shows how and why various expenses and

revenues are attributed to the water and sewer operations, respectively. Mr. Walsh then described the components of Damon Run's water and sewer rates.

The components of the District's sewer rates are as follows:

1. Sewage Treatment. Damon Run passes on to its customers the charges it pays to the City of Portage for sewage treatment.
2. User Fees. Damon Run charges the customers a monthly \$12.00 charge for operations and administrative expenses.
3. Special Benefits Tax. Customers located within the District's boundaries ("In-District Properties") are charged a special benefits tax based on the assessed valuation of the customer's property. This special benefits tax is used to pay Damon Run's debt service and is approved annually by the DLGF.
4. PILT. Benefitted Properties pay a PILT based on the special benefits tax rate charged to In-District Properties.
5. Sewer Connection Fee. There is a one-time connection fee for new customers connecting to the sewage collection system. The fee is comprised of a \$2,200 charge that is remitted directly to Portage and \$2,500 that the District retains (total connection fee is \$4,700).

Mr. Walsh explained that Damon Run established rates that include a Special Benefits Tax and PILT in order to repay the debt Damon Run incurred to purchase the water and sewer infrastructure, as well as other expansion costs. Mr. Walsh explained that the difference between the rates charged to In-District Properties and Benefitted Properties relates to the tax element of the rate. For In-District Properties, the tax element is called a Special Benefits Tax, and the amount of the annual tax a customer pays equals: a) the tax rate established by the DLGF multiplied by b) the assessed value of the property. The tax element for Benefitted Properties is called a Payment-in-Lieu of Tax and is calculated based on the Special Benefits Tax rate and applied to the Benefitted Properties via an equivalent dwelling unit ("EDU") in order to assign proportional rate responsibility to the Benefitted Properties for the repayment of debt. Mr. Walsh stated that the result is that the total amount a Benefitted Property will pay for service is proportional to what In-District sewer customers will pay for service.

Mr. Walsh offered an example of how the PILT of Porter Hospital, one of the Benefitted Properties, is calculated. The District's contract with Porter Hospital provides that "Upon the District learning of the average single family residential tax bill for the tax year 2010 payable in 2011, the District shall notify the Hospital in writing of the annual payment amount which amount shall be the product of the Initial Hospital EDU and the average single family residential tax bill." The contract provides that once the hospital facility has been open and operating as a hospital for a period of one year, the number of EDUs used for the PILT will be based on actual flow figures determined through the water meter(s) for the project. The number of EDUs is adjusted annually based on the twelve month average flow for the Hospital with one EDU being equal to 310 gallons of water per day for a single family residential dwelling unit. Mr. Walsh testified that the District's contract with the School calculates the PILT in a similar fashion as the Hospital. He indicated that contract with the Park had not been finalized, but expected it to follow the same formula.

In discussing Damon Run's rates, Mr. Walsh explained that the \$12.00 monthly user fee recovers the costs associated with the District's day-to-day administrative activities performed

by Indiana Utilities Management, LLC, its maintenance and after hours service agreement with Utility Services Corp., insurance, testing, and the District's expenses for accounting, legal and engineering services. Mr. Walsh stated that the District does not have any direct employees. He explained that due to its small size, the Board has determined that for now, the most economic choice is for the District to contract for the management, maintenance and service needs of the District on an as-needed basis.

Mr. Walsh testified that the DLGF reviews Damon Run's budget on an annual basis and approves or makes changes to the budget. Based on the debt service portion of the approved budget, the DLGF calculates a tax rate for the District's customers. This tax rate is billed to the In-District Properties by the county auditor based on property assessed values.

Mr. Walsh explained how the Special Benefits Tax rate is applied to calculate the PILT. He stated that the tax rate used to calculate the PILT in the Accounting Report dated April 10, 2012 is the pay 2011 tax rate of \$1.0135 per \$100 of net assessed valuation as established by the DLGF. Mr. Walsh offered an example whereby an In-District customer with an assessed property value of \$150,000 will pay \$1,520 in annual Special Benefits Tax to the District. This annual bill is split into two semiannual installment payments.

Mr. Walsh testified that in his opinion, the District's rates and charges assign responsibility for costs of service in a non-discriminatory way. He explained that the rates for operations and administrative costs are the same for customers within the District and for the three Benefitted Properties. He indicated that the District pays its debt obligations through a property tax rate. For the Benefitted Properties, Mr. Walsh stated that a rate was established to reflect a proportionate allocation of the District's debt service obligations. To accomplish this, the District charges the Benefitted Properties a PILT that is calculated based on the same tax rate used to determine the tax bill for In-District Properties.

Next, Mr. Walsh explained that the Accounting Report is divided into two sections. The first section, pages 3 through 18, contains pro forma financial information and the second section, pages 19 through 25, contains additional unaudited financial information regarding the test year ended December 31, 2011, and comparative financial information for the calendar years 2009, 2010 and 2011.

Mr. Walsh explained that pages 5 and 6 of the Accounting Report represent the summary schedule of rates and charges for service to the Benefitted Properties and In-District Properties. These rates represent a monthly District user fee of \$12.00 per EDU; sewer treatment charge of \$5.22 per 1,000 gallons; and an annual PILT per EDU calculated in relation to the current In-District Property tax bill for an average single family residence. He noted that this schedule also allows for the sewer treatment charge rate to be adjusted via a sewage treatment tracker.

Mr. Walsh explained the District does not account for water and sewer expense separately, but records these expenses in aggregate. He stated that page 8 of the Accounting Report presents the adjustments made to allocate these costs to water and sewer and the basis for these allocations. Mr. Walsh also testified that adjustments to test year expenses have been made for fixed, known, and measurable items. Mr. Walsh stated that the test year cash operating disbursements have been adjusted to reflect the cost of various contractual services, purchased treatment costs, and purchased power costs. According to Mr. Walsh, the test year cash operating expenses for water of \$132,680 have been decreased by \$58,634 to arrive at pro forma

annual cash operating expenses for water of \$44,046. He noted that the test year cash operating expenses for sewer of \$230,008 have been increased by \$14,789 to arrive at pro forma annual cash operating expenses for sewer of \$244,797.

Mr. Walsh testified that the calculation of Damon Run's annual allowance for replacements and improvements is based on the District's water capital assets of \$4,392,016 and sewer capital assets of \$5,746,525. Mr. Walsh stated that a composite depreciation rate of 1.7% or \$74,664 for water and 2.2% or \$126,424 for sewer is used in this calculation.

Mr. Walsh explained that 43% of the asset purchase price is allocated to the water utility and 57% is allocated to the sewer utility. Mr. Walsh stated that the allocation percentages are based on the District Asset Purchase Agreements dated February 9, 2006 and October 1, 2006, as well as the underlying appraisals to these agreements. He testified that of the District's assets originally purchased, approximately 43% of the purchase price is related to water assets and 57% to sewer assets.

Mr. Walsh further explained that the composite annual depreciation rates are in line with those historically accepted by the Commission for utilities without a water source or sewage treatment facility. Specifically, Mr. Walsh referenced a December 28, 1987 Commission memorandum on depreciation rates that recommends the rates used in the Accounting Report. Mr. Walsh stated that the revenue requirements incorporate the District's pro forma operating disbursements and an allowance for replacements and improvements, resulting in total revenue requirements for operation, maintenance and replacements of \$118,710 for water and \$371,221 for sewer (\$489,931 total). He stated that the revenue requirements are then compared against the annual District user fees of \$143,770 and sewer tracking factor (sewage treatment charge) receipts of \$160,649, resulting in a receipt shortfall of \$46,825 for water and \$138,687 for sewer.

Mr. Walsh testified that the District is aware of the obligation to maintain rates sufficient to fund its legal obligations and at the same time the District is sensitive to increasing rates and charges to its customers. Mr. Walsh observed that during its short history, the District has been successful in growing its customer base, but this growth is not guaranteed to continue to occur at a predictable pace. For these reasons, Mr. Walsh testified that the District will monitor its revenues and expenses, and to the extent that revenues do not materialize in an amount sufficient to pay costs, District management will curtail its spending in the areas they can control. He noted that this includes spending on replacements and improvements at a level less than the depreciation allowance shown in the Accounting Report.

Mr. Walsh testified that Damon Run's revenue requirements are based on the average annual debt service on the outstanding bonds of \$1,304,270. Mr. Walsh explained that the revenue requirements are then compared against the annual net sewer connection fees and Benefitted Properties' PILT. The net sewer connection fees are based on the District's estimated residential growth and the District's current sewer connection fee. He stated that the PILT is based on the District's PILT tracking factor per EDU and each Benefitted Property's EDU count. Mr. Walsh stated that the estimated receipts for debt service costs total \$484,456, resulting in a shortfall of \$819,814 (\$389,140 for water and \$430,674 for sewer). He explained that this \$819,814 shortfall will be funded via the District's property tax rate imposed upon the taxpayers within the District's boundaries.

Mr. Walsh testified that the second section of the Accounting Report displays unaudited supplemental financial information. He explained that included in this section is a comparative schedule of selected financial information arising from cash transactions as of December 31, 2009, 2010, and 2011. Mr. Walsh also testified that the amortization schedules of the outstanding Series 2010A (“Series A”) Bonds and Series 2010B (“Series B”) Bonds are displayed on pages 23 and 24, respectively and page 25 shows the schedule of combined bond amortization.

Mr. Walsh opined that the District has satisfied the requirements of the 43966 Order. Mr. Walsh concluded that the District’s rates proposed in his Accounting Report are fair, just, non-discriminatory, reasonable and necessary to meet the pro forma revenue requirements of the utility.

## **B. OUCC’s Testimony.**

(1) **Scott Bell.** Mr. Scott Bell is the Director of the Water/Wastewater Division of the OUCC. Mr. Bell testified that, in compliance with the Commission’s 43966 Order, Damon Run filed its annual reports as required and initiated this proceeding for a review of the District’s rates and charges for water and sewer service to the Benefitted Properties. Mr. Bell noted that prior to the Commission’s 43966 Order, Damon Run was notified through written comments of Ms. Leslie A. Hitchman, Assistant General Counsel for the Commission, dated September 17, 2003, which stated in part that “...Indiana law provides that conservancy districts electing to provide public water supply under I.C. 14-33-20 ‘shall file the initial schedule of rates and charges to patrons of the district with the Commission.’ I.C. 14-33-20-14.”<sup>1</sup> The last page of the report states that a copy was sent to David L. Hollenbeck, attorney for Damon Run, on November 4, 2003.

Mr. Bell provided background information on how the District purchased the water and sewer utility infrastructure from Olympia Development, LLC (“Olympia”). He noted that Mr. Bernard M. Madej was the Manager/Owner of Olympia and Chairman and President of the Damon Run Board of Directors at the time the purchase agreements were executed. He also noted that Mr. Madej filed a Uniform Conflict of Interest Disclosure Statement, dated October 27, 2010, with the Indiana State Board of Accounts after the transactions were completed. Mr. Bell testified that the total purchase price paid by Damon Run to Olympia was \$10,138,541.

Mr. Bell testified that Damon Run retained two engineering companies to estimate the value of the infrastructure or improvements to be purchased from Olympia. He explained that John M. Sturgill, General Manager of McMahan Associates, Inc. (“McMahan”), estimated the value of the Eagle Ridge Subdivision’s Phases I & II improvements to be \$3,957,100 and estimated the value of the total infrastructure costs to be \$9,250,000, plus \$925,000 for a BAN fee, which results in \$10,175,000 of Total Applicable Project Costs. See OUCC Exhibit SAB-6. He further explained that Steve Henschen, P.E., of Bonar Group estimated the total cost of infrastructure was \$9,800,000 and included the sanitary sewer system, the water distribution system and the stormwater system. Mr. Bell stated that the OUCC did not do an in-depth analysis of the valuations associated with the purchase of utility infrastructure since it appears that the Commission does not have regulatory authority over Damon Run’s Special Benefits

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<sup>1</sup> *Recommended Report of the Natural Resources Commission with Respect to the Petition for Creation of the Damon Run Conservancy District*, (Administrative Cause No. 03-135C, Ind. Nat. Res. Comm’n Jul. 31, 2003.)

Property Tax and PILT. He noted that rather than purchasing infrastructure from a developer, it is more common for a developer to donate the infrastructure to a utility, and the utility records the property as a Contribution in Aid of Construction. Mr. Bell observed that by purchasing the infrastructure from Olympia, the District has significantly increased the debt that it must pass on to its customers.

Mr. Bell opined that the District's rates and charges are relatively expensive when compared with other regulated water and sewer utilities in Indiana. Mr. Bell provided an overview of the rates and charges for the District's customers and the Benefitted Properties. He testified that if a customer using 5,000 gallons of water was charged on a monthly basis the Special Benefits Property Tax, a water bill of \$126.19 and a monthly sewer bill of \$146.40 would be the highest bills in the State based on the Commission's Bill Surveys in its 2011 IURC Annual Report. He also testified that Damon Run charges the Benefitted Properties the same monthly user fee, sewer treatment charge, and sewage connection fees as the In-District Properties. However, rather than charging the Special Benefits Property Tax, Damon Run charges a PILT to the customers it serves outside of the district boundaries. The PILT is \$1,300 per EDU for sewer service. Mr. Bell indicated that the majority of the District's rates and charges are attributable to the Special Benefits Property Tax for In-District customers and the PILT for the Benefitted Properties, but concluded that the Commission does not have jurisdiction over the District's taxes.

(2) **Richard Corey.** Richard J. Corey is a Utility Analyst for the OUCC. Mr. Corey's testimony provided an overview of Damon Run's rate structure. He indicated that Damon Run did not provide a rate study or propose a new set of rates, but instead provided analysis as support for its existing rates and charges. He noted the analysis revealed the current revenues generated by Damon Run do not exceed total annual operation, maintenance, replacement costs and the amount of funds needed for debt service. The calculations indicate that the annual revenue requirements for operation, maintenance and replacements exceed the annual receipts for District user fees and sewage tracking factor receipts by \$185,512, and that the annual debt service requirements exceed sewer connection fees and the PILT tracking factor receipts for the benefitted properties by \$819,814. He stated that it appears Damon Run's existing rates and charges may be insufficient to pay its expenses. He explained that Damon Run has taxing authority and has collected the majority of its revenue requirements through property taxes and PILT. He testified that if the District's revenues are insufficient to cover its revenue requirements the DLGF will allow the District to adjust its Special Benefits Tax rate so it can collect sufficient revenues and continue the operation of the utility. He also noted that the Commission has jurisdiction over the \$12.00 per month user fee for sewer accounts and the \$4,700 one time sewer connection charge for Benefitted Properties.

Mr. Corey raised concern for Damon Run's continued financial stability citing a large amount of debt, which will likely result in Damon Run's customers paying higher amounts of property tax and PILT when the debt service costs become incorporated in the property tax rates. Mr. Corey indicated the OUCC did not have any specific recommendations to address the concerns since the District issued the debt long ago and the debt was acquired to maintain the District's stability. He recommended the Commission require Damon Run to provide cost-based support for its \$12.00 per month administrative fee and the \$4,700 one time sewer connection charge for Benefitted Properties.

(3) **Edward Kaufman.** Edward R. Kaufman is a Senior Analyst with the OUCC. Mr. Kaufman discussed Damon Run's debt and the cost of that debt to its customers. He noted Damon Run has two outstanding loans: \$12,000,000 in Series A Bonds, and \$2,000,000 in Series B Bonds. He explained that the District's customers pay for the annual debt service on Damon Run's long-term debt through a property tax assessment and through connection fees. Mr. Kaufman explained that customers pay \$2,280 per year in Special Benefits Taxes based on average assessed property value. \$1,300 per year is allocated to wastewater customers. He noted that the tax assessments are in addition to Damon Run's tariffed monthly rates for wastewater service. Mr. Kaufman testified that the District's current level of taxes do not provide sufficient revenue to pay for the District's long term debt.

Mr. Kaufman testified that conservancy districts are able to issue tax exempt debt. Damon Run Conservancy District issued its Series A Bonds at an average interest rate of approximately 5.6% and its Series B Bonds at an average interest rate of approximately 5.77%, noting the interest rates appear high for tax exempt debt. Mr. Kaufman testified that typically when a utility borrows funds to build plant, it is relatively easy to compare the amount borrowed to the specific use of the funds, but there is insufficient evidence to tie the cost to construct Damon Run to the amount it borrowed. He also testified that the District's debt as a ratio to customers is quite high when compared to other water/wastewater utilities, but made no recommendations to the Commission.

C. **Damon Run's Rebuttal Testimony.** Eric Walsh provided rebuttal testimony on behalf of Damon Run. Mr. Walsh testified that the OUCC appeared to suggest that Damon Run should have secured a lower interest rate to finance the infrastructure when it acquired the utility assets necessary to serve the District's customers. Mr. Walsh testified that while BANs are short-term in nature and typically result in lower interest rates than long-term financing, the reasonableness of the interest rate needs to be measured against the risk the market perceived for the borrowing. He explained that at the time the BANs were issued (2005 and 2006) the District was a new conservancy district that would rely on future development and growth for the BANs and subsequent long-term debt to be repaid. As future growth is never certain, the borrowing included additional risk, which resulted in interest rates reflecting that risk. Mr. Walsh went on to note that three (3) institutions were contacted in regards to the District's borrowing in 2005 and 2006. The lowest interest rate offered from proposals submitted by the contacted lenders was chosen. Mr. Walsh also stated that as a tax supported financing, the BANs' issuance was approved by the DLGF.

Mr. Walsh testified, in response to Mr. Kaufman's statement that there is insufficient evidence to tie the cost to construct the District to the amount the District borrowed, that Damon Run issued long-term debt in 2010 to repay the outstanding BANs issued in 2005 and 2006. He noted that Damon Run had not audited the claims related to the disbursement of the \$12,000,000, but offered an accounting for the use of the BANs proceeds in accordance with the Hearing Information Sheet filed with the DLGF on July 8, 2005.

With regard to Mr. Bell's statement that the District's overall cost for water and sewer service is relatively expensive compared to other regulated Indiana utilities, Mr. Walsh testified that he is aware of no comprehensive rate comparison report that tries to add property tax to the calculation of average water and sewer bills because the amount of property taxes paid has no relationship to the amount of water used. Mr. Walsh concluded that Mr. Bell's analysis is not an apples-to-apples comparison as the District's monthly cost calculated by Mr. Bell includes the

District's tax rate and generally property taxes are not included in such a comparison as the amount of property taxes paid has no relationship to the amount of water used.

In addressing Mr. Corey's conclusion that Damon Run's existing rates and charges may be insufficient to pay its expenses, Mr. Walsh indicated that he agreed with Mr. Corey's computation of the \$185,512 shortfall in user fees and sewage tracking factor receipts. He also agreed with Mr. Corey's computation of the \$819,814 shortfall in sewage connection fees and the PILT for the Benefitted Properties. He disagreed, in part, with Mr. Corey's statement that the DLGF will allow the District to adjust its property tax rate to allow it to collect sufficient revenues to pay their annual revenue requirements and continue the operation of the utility. Mr. Walsh explained that the DLGF will allow the District to adjust its property tax rate to allow it to collect sufficient revenues to pay their annual debt service revenue requirements. However, revenues generated from the tax rate cannot be used to fund the District's day-to-day operations or pay for replacements and improvements. Mr. Walsh testified that the District plans to manage the \$185,512 shortfall by spending less on replacements and improvements than allowed by the depreciation calculation.

Mr. Walsh testified, concerning cash flow, that the District monitors its revenues and expenses daily and to the extent revenues do not materialize in an amount sufficient to pay costs, the District will need to curtail its spending in areas that it can control, such as replacements and improvements. Mr. Walsh stated that to the extent these cost controls do not allow for the District's current revenue stream to be sufficient, the District may need to look at increasing its monthly user fee per EDU from the current \$12.00 per month. Mr. Walsh indicated that the District's management is aware of the burden the District's Special Benefits Tax places on its customers and has tried to keep the District monthly user fee as low as possible. However, Mr. Walsh stated that the District may need to increase its monthly user fee per EDU in the future.

Mr. Walsh indicated the District's annual debt service requirement comes into full effect beginning with the pay 2013 budget year. He testified that Mr. Corey is correct in that at that time the average monthly debt service requirement will be approximately \$1,304,000. The District customer's tax rate relates directly to the assessed value of the District, not EDU count. Mr. Walsh disagreed with Mr. Kaufman's observation that the current level of anticipated taxes is insufficient to pay the District's annual debt service. He testified that the District's annual debt service is to be repaid from revenues generated from the Benefitted Properties' PILT as well as the District's Special Benefits Tax revenue. To the extent PILT from the Benefitted Properties is not sufficient to cover the District's annual debt service, the District's tax rate will be set at a level to cover the shortfall. Mr. Walsh noted that it will be the pay 2013 property taxes where the District customers' tax rate will be set at a level that revenues meet the \$1,304,000 revenue requirement. Mr. Walsh also testified that as the District's assessed value grows, the tax rate can be reduced.

Mr. Walsh explained that the reasonableness of any interest rate for debt financing is a direct result of the market's interpretation of the risk for the financing. He noted that since the District will depend on future development and growth to repay its debt, the interest rate for the 2010 financing takes into account that risk. Mr. Walsh testified that at the time of the 2010 financing, the District took the necessary steps to qualify for the lowest interest rate possible. That included a bond rating from Standard & Poor's Corporation, as well as funding a reserve with bond proceeds. He stated that it is also important to note that as the District matures it will have the ability to refinance its debt if savings opportunities develop.

Mr. Walsh noted in discussing the District's ratio of gross plant investment per customer that the District's initial infrastructure was sized at a level to allow for future growth and development. He testified that the District's current customers pay for the size of this collection system. He explained that as growth and development do occur, the District's ratio of gross plant investment will be reduced.

Mr. Walsh opined that the rates proposed in the Accounting Report are fair, just, non-discriminatory and reasonable and necessary to meet the pro forma revenue requirements of the utility.

**5. Commission Discussion and Findings.** The Commission authorized Damon Run to provide water and sewer service to the Benefitted Properties through its 43966 Order. The 43966 Order also authorized Damon Run, on an interim basis, to apply its proposed rates and charges for water and sewer services to the Benefitted Properties and directed Damon Run to file a rate proceeding within 90 days of the issuance of the Order. The Commission directed Damon Run to provide records that support the use and disbursement of the utility's bond proceeds as part of its filing. Damon Run filed this Cause seeking approval of its existing rates and charges in compliance with the 43966 Order.

**A. Water Service.** Pursuant to Ind. Code § 14-33-20-4(a), a conservancy district must make an election in its district plan or in an amendment to the district plan to furnish water supply under Ind. Code ch. 14-33-20 to come within the jurisdiction of the Commission. As previously discussed, the record is clear that Damon Run never elected in its district plan or any amendments to its district plan to provide water service under Ind. Code ch. 14-33-20. Therefore, we find the Commission does not have jurisdiction over Damon Run's rates and charges for water service.

**B. Sewer Service.** Ind. Code § 14-33-1-2 provides the Commission with jurisdiction to determine the rates and charges that a conservancy district may make for sewer services to territory outside of the boundaries of the district. Consequently, the Commission's jurisdiction is limited to the rates and charges of sewer service for the Benefitted Properties outside Damon Run's territorial boundaries.

**(1) Books and Records.** Damon Run does not account for its sewer and water revenues and expenses separately. Mr. Walsh explained that initially Damon Run's operations were small and a unified accounting approach was simple. The unified accounting system remains in place today. In Damon Run's analysis of its rates, it allocated revenues and costs between the water and wastewater utilities using various allocation factors, including allocation of the stormwater utility assets to the wastewater utility. Mr. Walsh's testimony indicated the District recognizes the need to separate its water and sewer financial activity. We agree. Based on the evidence, we find it appropriate that Damon Run maintain separate books and records for its utilities.

The Commission notes that the Indiana State Board of Accounts ("SBoA") has oversight of conservancy districts and provides guidance on how districts are to maintain their books and records through its Special Districts Manual ("Manual"). The Commission directs Petitioner to maintain separate books and records for its wastewater utility from its water and stormwater utilities, using double-entry accounting utilizing the SBoA's Manual for guidance. Within ninety

(90) days of the date of this Order, Petitioner shall certify with the Commission that it has separated its books and records for its wastewater utility from its water and stormwater utilities.

(2) **Rates and Charges.** Ind. Code § 14-33-1-2(b) specifies that the Commission shall determine the rates and charges a conservancy district may make for wastewater services outside of the district boundaries. However, the statute is silent on how the reasonableness of these charges is to be determined. Although Damon Run issued Ad Valorem Special Benefits Property Tax Bonds to finance the purchase of infrastructure, we note that Ind. Code § 14-33-5-21 may provide limited guidance on rates and charges. Ind. Code § 14-33-5-21 establishes that if a conservancy district board issues revenue bonds for the collection, treatment and disposal of sewage and liquid waste, the board may establish just and equitable rates and charges and use the same basis for the rates as provided in Ind. Code § 36-9-23-25 through Ind. Code § 36-9-23-29. We also note that the Commission has previously looked to Ind. Code § 8-1-2-125 for guidance in determining the reasonableness of a conservancy district's wastewater rates. See *Petition of Merrillville Conservancy District*, Cause No. 39159, 1992 Ind. PUC LEXIS 39, at \*11 (IURC 1992). Notwithstanding that Ind. Code § 8-1-2-125(d) applies to not-for-profit utilities and not to conservancy districts, it provides that a reasonable and just charge for sewer service is a charge that will produce sufficient revenue to pay all legal and other necessary expense incident to the operation of the utility's system. The revenue requirements of a not-for-profit utility are very similar to the provision for rates and charges allowed under Ind. Code § 36-9-23-25. Both provisions allow for recovery of: operation and maintenance expenses; payment of the principal and interest on the bonds or debt service; working capital; and adequate funds for extensions and replacements. Therefore, we find it appropriate to consider these costs and expenses in determining whether Damon Run's sewer rates and charges for the Benefitted Properties are just and reasonable.

Damon Run's existing rates and charges to the Benefitted Properties are collected through user fees, commodity charges and a semi-annual PILT fee. To determine the reasonableness of these fees, the Commission was required to review and analyze the revenue requirements of both the water and wastewater utilities in determining whether Damon Run's existing rates for sewer service to the Benefitted Properties are just and reasonable. The review was necessary because Damon Run's books are comingled as described above. The District's evidence indicated that it allocated revenues and costs between the water and wastewater utilities using various allocation factors. Petitioner allocated the stormwater utility assets to the wastewater utility as well.

**a. Initial Infrastructure Purchased.** In the 43966 Order, the Commission directed Damon Run, as part of this Cause, to file the appropriate rate studies or other analyses to support its existing rates and charges or a proposal for new rates and charges with supporting documentation, and to provide information that supports the use and disbursement of the bond proceeds. The evidence of record demonstrates that, after its formation as a conservancy district in 2004, Damon Run purchased water, wastewater and stormwater infrastructure from Olympia in 2006 and incurred approximately \$12,000,000 of debt to purchase the infrastructure. Damon Run issued bonds in 2005 and 2006 that were approved by the DLGF in order to finance the purchase. Damon Run recovers the cost of the bonds or its debt service revenue requirement through either the Special Benefits Tax for the In-District customers or PILT for the Benefitted Properties. The evidence indicated that when Damon Run elected to purchase the infrastructure and issue approximately \$12,000,000 of debt for the acquisition, Damon Run petitioned the DLGF to approve issuance of special taxing district bonds not to exceed \$12,000,000. As part of this process, the District filed a Hearing Information Sheet with

the DLGF on July 8, 2005. The DLGF approved the issuance of the special taxing district bonds via Order No. 05-089 on September 23, 2005. Thereafter, in the fall of every year, the District files its budget with the DLGF for the following year for approval of its Special Benefits Tax rate. The DLGF reviews this filing and approves a tax rate. The Benefitted Properties pay a PILT for sewage service that is equivalent to \$1,300 per EDU. Damon Run indicated it has designed the PILT so that the Benefitted Properties are on equal footing with the Special Benefits Tax paid by In-District customers.

Damon Run and the OUCC maintained throughout the course of this proceeding that the Commission did not have jurisdiction over the Special Benefits Tax because it was reviewed and established by the DLGF. Nonetheless, Petitioner's debt issuances must be reviewed to determine whether or not the debt incurred is just and reasonable and should be allowed to be recovered in rates to the Benefitted Properties.

In the 43966 Order, the Commission directed Petitioner, as part of this case, to provide support for the use and disbursement of \$14,000,000 in bond proceeds.<sup>2</sup> Damon Run submitted workpapers in support of the testimony of Eric J. Walsh that contained a copy of an estimate from McMahon, dated October 5, 2006, as to the value of the infrastructure purchased from Olympia. At hearing, the OUCC offered into evidence a copy of the estimate from McMahon (See Public's Exhibit 1, Attachment SAB-6). Based on the McMahon study the following valuation was assigned as follows:

Water	\$ 3,855,198
Wastewater	4,395,414
Stormwater	999,488
Total Infrastructure Cost	<u>\$ 9,250,100</u>

The McMahon study also included \$925,000 as an estimate for fees associated with the BANs issued by the District. In its September 24, 2012 response to a docket entry question regarding what method McMahon used to determine the value of the assets purchased, Damon Run indicated (at p.7) it did not know what method McMahon and the Bonar Group used for valuation of the infrastructure. Nonetheless, Damon Run did include in its September 24, 2012 responses (at p. 17) to docket entry questions from the Commission, copies of purchase agreements, the first executed on February 9, 2006 and the second executed on October 1, 2006, for the infrastructure in the amounts of \$3,850,275 and \$6,288,266, respectively. The purchase agreements include spreadsheets of actual and estimated costs of the assets and associated costs that totaled \$10,138,541. Although Mr. Sturgill of McMahon expressed concerns about inconsistencies in the data reviewed, the Commission accepts the McMahon report as the basis for review of the reasonableness of Petitioner's purchase price. However, we do not accept the \$925,000 McMahon included in its report for estimated BAN fees. Since the BAN fees do not increase the value of the assets the District purchased, it is unreasonable to include the financing costs in the valuation of the assets being purchased.

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<sup>2</sup> Damon Run issued bonds in 2005 and 2006 to finance the purchase of water, wastewater and stormwater infrastructure from Olympia and incurred approximately \$12,000,000 of debt. The BANs issued in 2005 and 2006 were repaid via the issuance of long-term debt in 2010. This increased Damon Run's total bonded indebtedness to approximately \$14,000,000: \$12,000,000 in Series A Bonds and \$2,000,000 in Series B Bonds.

In rebuttal testimony, Petitioner provided the estimated use of funds for the 2005 and 2006 BAN proceeds taken from the Hearing Information Sheet:

Acquisition of District infrastructure, including architect fees	\$ 10,701,000
Cost of issuance	130,000
Underwriter's fee	180,000
Capitalized interest	989,000
Total	<u>\$ 12,000,000</u>

The Commission declines to rely on the cost estimates for the \$12,000,000 included in the Hearing Information Sheet as the basis for the District's purchase prices for the assets purchased from Mr. Madej and his affiliated companies. The estimated acquisition cost of \$10,701,000 is significantly more than the engineering estimate of \$9,250,100 contained in the McMahon report and the \$10,138,541 in the purchase agreements. Moreover, Petitioner did not provide sufficient evidence to support the \$10,701,000. As explained further below, we approve the inclusion of an allocated portion of the 2005/2006 BAN issuance costs and capitalized interest.

Mr. Walsh testified that the BANs issued in 2005 and 2006 to finance the purchase of the initial infrastructure of Damon Run were repaid via the issuance of long-term debt in 2010. This increased Damon Run's total bonded indebtedness from approximately \$12,000,000 to \$14,000,000. The sources and uses of funds are shown below:

Sources of Funds:

2010 Bonds	\$ 14,000,000
Bond premium	159,910
District funds on hand	272,351
Total sources of funds	<u>\$ 14,432,261</u>

Uses of Funds:

Redeem BANs	\$ 12,000,000
Accrued interest on BANs	301,843
Reimbursements for project costs	223,172
Portage sewage capacity purchased	169,089
Engineering	161,692
Pipe relocation	39,951
Legal and accounting fees related to District expansion	32,225
Cost of issuance on 2012 bonds	114,700
Debt service reserve funding	1,233,266
Capitalized interest	16,373
Underwriter's discount	139,950
Total estimated uses of funds	<u>\$ 14,432,261</u>

We also note that the OUCC indicated in Mr. Kaufman's testimony that there is insufficient evidence to tie the cost to construct Damon Run's infrastructure to the amount it borrowed.

Public's Exhibit 3, Attachment ERK-1 contains a copy of the SBoA's July 22, 2010 Examination Report of the Damon Run Conservancy District. The Examination Report noted (at page 10 of 18):

“[n]either claims nor checks (funds were electronically transferred) were used to document \$10,138,541 of the net proceeds spent. These proceeds were used to repay the developer and his wife, personally, as well as his development company. The developer, who serves as the District Board President was reimbursed \$4,594,353 of the \$10,138,541. The remaining \$5,544,188 retired a loan taken out by Olympia Development, LLC, a development company which is wholly owned by the District Board President and his wife. The only documentation provided to support any of the disbursements was a ‘Commercial Promissory Note’ documenting the full amount of the line of credit between the bank and Olympia Development, LLC. All of these amounts were posted to the records as ‘principal paid on bonds.’”

The Commission is concerned that Petitioner has kept virtually no records of the transactions that surround the District's significant debt issuances. Moreover, we agree with the OUCC that the actual costs should have been known by Mr. Madej, therefore a valuation study should have been unnecessary. Finally, it is Petitioner's burden of proof to support the reasonableness of the purchase price and associated debt issuances for this utility. The assets acquired through the executed purchase agreements (See Public's Exhibit 1, Attachment SAB-2) were for infrastructure installed inside the Eagle Ridge and Timberland subdivisions, along with the main extensions to interconnect the subdivisions to the District's wholesale wastewater treatment and water providers. In addition, it is not common practice for a utility to purchase the collection systems for wastewater service or a distribution system for water service installed in a subdivision. Utilities typically require developers donate these assets to the utility as a Contribution in Aid of Construction because the developer would have already recovered the cost of the infrastructure through charges to the residents of the subdivision, the same residents that will be paying the utilities' rates.

In Damon Run's September 24, 2012 response to the Presiding Officers' docket entry questions, it provided a list (at pp. 5-6) that identified which users in the District Plan have connected to the Damon Run system and who funded the infrastructure costs. With the exception of one unidentified commercial customer, all other customers paid for the funding of their infrastructure. We find Damon Run's decision to purchase the assets within the Eagle Ridge and Timberland subdivisions along with the main extensions thereto, was unreasonable and discriminatory as discussed below. Therefore, recovery of these costs should not be allowed in rates charged to the Benefitted Properties.

**b. Main Extension and Oversizing Costs.** Consistent with standard main extension practices, the Commission finds that any oversizing of the initial purchases and any expansion costs should be recovered through rates. The Commission questioned Petitioner regarding the oversizing of its system. Question 18 of the Presiding Officers' August 17, 2012 docket entry requested information defining by what means and how much the various systems are oversized. In Damon Run's September 6, 2012 response (at p. 4), Mr. Walsh stated that the entire capacity of the sewage system is roughly 1,800 EDUs and the system is currently committed to serving 870 EDUs. However, the response did not provide the build out conditions or planning calculations needed to fully define by how much the system is

oversized. In order to better understand the size of Damon Run’s sewage system, it is necessary to break down the actual and committed capacity during initial installation. Based on the initial District Plan, the Timberland subdivision was the only subdivision within the District’s initial boundaries to be constructed. The District Plan reflected the Timberland subdivision includes 162 EDUs. The Plan identified the Eagle Ridge Subdivision as a Future User, but the evidence indicates it was the first subdivision actually constructed. Therefore, it is appropriate to allow an additional 112 EDUs as committed capacity during initial installation given the aforementioned purchase agreements were for the purchases of the Eagle Ridge and Timberland subdivisions. Therefore, the amount of “oversizing” can be calculated as follows:

	<u>EDU</u>	<u>Gal/EDU</u>	<u>Total Gallons</u>
Total Build-out Capacity	1,800	310	558,000
Initial Demand	274	310	84,940
Capacity for Future Use			<u>473,060</u>
% Oversized			<u>84.78%</u>

As indicated above, reasonable oversizing of the main extensions should be allowed in rates. Thus, based on the 84.78% oversizing as computed above, the Commission approves \$2,430,596 ( $\$2,866,945 * 84.78\% = \$2,430,596$ ) of the Offsite Improvements as identified in the McMahon report to be recovered in rates.

**c. Subdivision Infrastructure.** As discussed above and based on the evidence presented, Damon Run’s decision to purchase the assets within the Eagle Ridge and Timberland subdivisions along with the main extensions was unsupported and found to be unreasonable. The decision was discriminatory because other developments connecting to Damon Run’s system were required to pay their own infrastructure and main extension costs in order to obtain service, while Eagle Ridge and Timberland subdivisions were not required to pay the same costs. The Benefitted Properties should not be required to pay for infrastructure within the Eagle Ridge and Timberland subdivisions. Therefore, \$666,543 for the purchase of wastewater assets in the Eagle Ridge Subdivision and \$861,926 for the purchase of wastewater assets in the Timberland subdivision are disallowed. Excluding the infrastructure costs for the Eagle Ridge and Timberland subdivisions from rates has the effect of treating this infrastructure as a contribution to the utility.

**d. Expansion Costs and Stormwater Infrastructure.** Petitioner’s August 27, 2012 responses to the Commission’s docket entry questions showed expansion costs of \$626,129, as summarized below. This included \$169,089 for the costs associated with Portage sewage capacity, which is appropriately charged to the wastewater utility. Since there was not sufficient evidence to determine which utility incurred the charges, the remaining balance of \$457,040 was allocated 50/50 to the water and wastewater utilities.

<u>District Expansion Costs</u>	<u>Total</u>	<u>Water</u>	<u>Wastewater</u>
Portage Sewage Capacity Purchase	\$ 169,089	\$ -	\$ 169,089
Reimbursement for Project Costs	223,172	111,586	111,586
Engineering	161,692	80,846	80,846
Pipe Relocation	39,951	19,976	19,976
Legal	19,038	9,519	9,519
Accounting	13,187	6,594	6,594
<b>Total</b>	<b>\$ 626,129</b>	<b>\$ 228,520</b>	<b>\$ 397,609</b>

Consistent with our earlier discussion concerning the subdivisions' infrastructure, we deny the recovery of \$999,488 for stormwater infrastructure specific to the Eagle Ridge and Timberland subdivisions.

**e. Bond Issue Costs.** Based on the infrastructure costs for the wastewater utility allowed in rates, the Commission has allocated the bond issuance costs shown on page 3 of Petitioner's Exhibit 3 as follows:

<u>2005/2006 BANs and 2010 Bond Issuance Costs</u>		
Cost of issuance - 2005/2006 BANs		\$ 130,000
Underwriter's Fee - 2005/2006 BANs		180,000
Capitalized Interest		989,000
Bond premium		(159,910)
Cash on hand		(272,351)
Accrued interest on BANs		301,843
Cost of issuance on 2012 bonds		114,700
Capitalized Interest		16,373
Underwriter's discount		139,950
Sub-total		<u>1,439,605</u>
Amount of Wastewater Infrastructure Allowed in Rates	\$2,828,205	
Divided By: Infrastructure Value	<u>9,876,229</u>	
Percent Allowed in Rates		28.64%
Bond Issue Costs Allowed in Rates		<u>\$ 412,252</u>

**f. Debt Service Reserve.** Finally, consistent with Petitioner's method of funding its debt service reserve, we approve a maximum debt service payment of \$336,385 as the District's debt service reserve to be financed in its bond issue based on the bond amortization schedule explained below. Thus, we find \$3,575,000<sup>3</sup> of the \$7.98 million in existing debt Petitioner allocated to the wastewater utility should be approved for recovery in rates. The last column of the table below reflects the oversizing costs, expansion costs and bond issue costs that are reasonable and prudently incurred to be recovered in rates for the wastewater utility:

<sup>3</sup> Actual amount of \$3,576,842 was rounded up to nearest \$25,000 increment or \$3,575,000.

Description	McMahon Report	Percent of Value Estimate	Water		Wastewater	
			Direct Chg. or Allocation (information taken from McMahon Report)	Allocation	in Rates - Wastewater (84.78%)	
<i>Offsite Improvements Phases I &amp; II (wkp. 126)</i>						
Sanitary Sewer Improvements	\$ 2,588,225	55.19%		\$ 2,588,225	\$ 2,194,297	
Water System Improvements	2,101,725	44.81%	\$ 2,101,725			
Sub-Total	4,689,950					
Sedimentation Control	102,800		46,068	56,732	48,097	
Contract Administration and Misc.	402,250		180,262	221,988	188,202	
Sub-Total	5,195,000		2,328,055	2,866,945	2,430,596	
<i>Eagle Ridge Subdivision Phases I &amp; II (wkp. 127)</i>						
Sanitary Sewer Improvements	579,500	41.53%		579,500		
Water System Improvements	375,600	26.92%	375,600			
Storm Water Improvements	440,305	31.55%				
Sub-Total	1,395,405					
Sedimentation Control	22,320		6,008	9,269		
Contract Administration and Misc.	187,275		50,409	77,774		
Sub-Total	1,605,000		432,017	666,343	-	
<i>Timberland Subdivision Phases I &amp; II (wkp. 128)</i>						
Sanitary Sewer Improvements	760,650	35.18%		760,650		
Water System Improvements	966,450	44.70%	966,450			
Storm Water Improvements	435,115	20.12%				
Sub-Total	2,162,215					
Sedimentation Control	40,200		17,968	14,142		
Contract Administration and Misc.	247,685		110,708	87,134		
Sub-Total	2,450,100		1,095,127	861,926	-	
Total Initial Infrastructure Costs	9,250,100					
Value of Infrastructure to be Recovered in Rates from Original Purchase			\$ 3,855,198	\$ 4,395,414	2,430,596	
Add: Expansion Costs provided in Rebuttal	626,129				397,609	
Total Infrastructure Costs	\$ 9,876,229					
Total Value of Infrastructure to be Recovered in Rates					2,828,205	
Bond Issue Costs provided in Rebuttal	\$ 1,439,605				412,252	
Debt Service Reserve provided in Rebuttal	\$ 1,233,266				336,385	
Debt to be Recovered through Rates					\$ 3,576,842	

**g. Debt Service.** The evidence in this Cause shows Damon Run has two bond issues: \$12,000,000 (Series A) and \$2,000,000 (Series B) (see Petitioner's Exhibit 2, Attachment EJW-1 at page 27 and 28). The amortization schedules are both 18 years, but have different ranges of interest rates. To calculate the yearly debt service on \$3,575,000, the Commission finds it appropriate to apply the interest rates from the Series B bonds because it was closest to the amount allowed in rates. Using the same amortization formulas, but increasing the amount of the bond issue from \$2,000,000 to \$3,575,000, the five-year average debt service using the first five years of debt service payments is \$308,846.

**h. PILT Payment.** Damon Run has charged the Benefitted Properties PILT, which it based on the Special Benefits Tax rate charged to the In-District customers, since it does not have the authority to levy a Special Benefits Tax on the Benefitted Properties. The Commission notes that when wastewater fees are collected through PILT, there is no direct link between the service provided and the method for calculating the bill. Wastewater service should be paid with user fees so there is a direct relationship between cost to serve and the user fees. We find including the debt service revenue requirement in Petitioner's

user fee sends a better price signal to customers. The Commission further finds eliminating the semi-annual PILT charge for the Benefitted Properties and including debt service in Petitioner's user fee is a more appropriate approach than Petitioner's current approach of making a revised tariff filing each year after the District's assessment is completed. Eliminating the semi-annual PILT payment should also reduce customer confusion and will no longer require the District to send two additional bills. Therefore, Petitioner's \$1,300 per EDU semi-annual PILT payment from the Benefitted Properties shall be eliminated from Petitioner's rates.

**i. Operations and Maintenance Expenses and Extensions and Replacements.** Damon Run provided evidence that its existing sewer rates and charges include a \$12 monthly user fee per EDU for all sewer customers and a sewage treatment charge based on the cost for treatment paid by Damon Run to the City of Portage. The \$12 per EDU user fee covers operation, maintenance and administrative costs of Damon Run, as well as provides an allowance for extensions and replacements. The District's sewage treatment charge is a \$5.22 per 1,000 gallons of flow charge, which is the same rate the City of Portage charges Damon Run for treatment of the District's sewage. Both Damon Run and the OUCC submitted evidence that indicated Damon Run's annual revenue requirements are \$84,148 for operation and maintenance expenses of the wastewater utility. Therefore, we find \$84,148 should be approved for operation and maintenance expenses.

The Commission finds that Petitioner's depreciation expense calculation, which provides an allowance for extensions and replacements, is an acceptable practice for purposes of this proceeding. However, for purposes of going forward, we prefer to see a capital improvement plan in any proceedings involving Damon Run's rates and charges. The Commission finds that the amount of plant allowed for debt in rates is a good indicator of the cost of plant for which to compute depreciation expense. Therefore, an allowance for extensions and replacement is calculated below:

Allowance for Extensions and Replacements ("E&R")	
Plant Allowed for Debt	\$2,828,205
Times: Composite Depreciation Rate	2.20%
Estimated Annual E & R/Depreciation	\$ 62,221

Based on the evidence supporting Damon Run's operating and maintenance expense allocations, the Commission finds the following revenue requirements appropriate for operating and maintenance expenses and an allowance for extensions and replacements:

<u>Description:</u>	<u>Wastewater</u>
Operating and Maintenance Expense	\$ 84,148
O&M - Purchased Treatment	160,649
Depreciation Expense/ E&R	62,221
Sub-total O&M and E&R Requirements	<u>307,018</u>
Less: Amount Recovered through Sewage Treatment Chg.	<u>160,649</u>
Total O&M and E&R Revenue Requirements to be Recovered in User Fee	<u><u>\$ 146,369</u></u>

**j. Working Capital.** The Commission notes that although Damon Run did not include a working capital revenue requirement in its Accounting Report, it is a revenue requirement that should be included in rates and charges. Working capital is the amount of money needed to fund the day to day operations until the revenues from the utility service provided is collected. Based on Petitioner's non-restricted cash on hand balance as of December 31, 2011, we utilized the 45-day method to calculate Petitioner's working capital needs. The 45-day method assumes a 45-day lag between the time a percentage of operating expenses occur to the time revenues are collected. Since Petitioner's books are comingled, we allocated Petitioner's cash on hand 50% to water and 50% to wastewater:

<u>Working Capital Calculation:</u>	<u>Amount</u>
Operating Expenses (Pet.'s Ex. EJW-1, pg.11)	\$ 84,148
Less: Purchased Power	<u>5,737</u>
Sub-Total	78,411
Times: 45-Day Factor	<u>0.125</u>
Sub-Total	9,801
<i>Less: Cash on Hand as of 12/31/11</i>	<u>7,278</u>
Sub-Total	2,523
Divided By: 3 Years	<u>3</u>
Working Capital Revenue Requirement	<u><u>\$ 841</u></u>

**k. Revenue Requirements.** Based on the evidence and the discussion above, we find the total revenue requirements of \$456,056 for Damon Run's wastewater utility as summarized below to be appropriate:

<u>Revenue Requirements:</u>	<u>Wastewater Utility</u>
Operation & Maintenance Exp.	\$ 84,148
Depreciation Expense	62,221
Debt Service	308,846
Working Capital	841
Total Revenue Requirements	<u><u>\$ 456,056</u></u>

**I. Sewer Service Rate for the Benefitted Properties.**

Petitioner’s total revenue requirements of \$456,056 for its wastewater utility less current user fee receipts of \$71,885 results in a \$384,171 increase in user fee revenues or 534.42% to the Benefitted Properties.

Total Revenue Requirements	\$ 456,056
Less: Revenues from User Fees	71,885
Net Revenue Increase Required	<u>\$ 384,171</u>
Recommended Percentage Increase	<u>534.42%</u>

With the elimination of Petitioner’s PILT fee, the impact on Damon Run’s existing rates to the Benefitted Properties is as follows:

Wastewater:	<u>Current Rate</u>	<u>Approved Rate</u>
Monthly User Fee per EDU - Outside Customers	\$ 12.00	\$ 76.13
Sewage Treatment Charge per 1,000 gallons usage	\$ 5.22	\$ 5.22
PILT Monthly Average	\$ 108.33	\$ -

Damon Run is authorized to continue to bill the Benefitted Properties a sewer treatment charge of \$5.22 per 1,000 gallons usage in addition to Damon Run’s monthly user fee of \$76.13 per EDU.

We note that based on Petitioner’s Accounting Report, current revenues received from the Benefitted Properties for wastewater service is \$337,989. The approved 534.42% increase in user fee and the elimination of the PILT fee will result in revenue of \$160,056 or an overall decrease of 52.64% or \$177,933 in revenues from the Benefitted Properties:

Wastewater - User Fee	\$ 76.13
Times: Number of EDUs from Benefitted Properties	175.2
Sub-Total	<u>13,338</u>
Times: 12 months	12
Proposed Revenue to be Collected from Benefitted Properties	160,056
Less: Current Revenues from Benefitted Properties	337,989
Revenue Decrease from Benefitted Properties	<u>\$ (177,933)</u>
% Decrease in Revenues	<u>52.64%</u>

**(3) Non-Recurring Charges.** Damon Run provided evidence that it currently charges a one-time connection fee of \$4,700 for new customers connecting to the sewage collection system. The fee is comprised of a \$2,200 charge that is remitted directly to Portage and a \$2,500 charge that the District retains. In its August 27, 2012 response to docket entry questions from the Commission (at p.4), Damon Run explained that the \$2,500 sewer connection fee that it retains was designed to reduce the amount of debt needed to be borrowed and also to provide a reduction in the amount of property tax needed to cover annual debt

payment in the future. We find that Damon Run has failed to provide sufficient evidence that the \$2,500 charge was based on the cost to connect a customer to Damon Run's sewer system and therefore should be eliminated from the \$4,700 connection fee. We also note the Commission has included all the debt service requirements for the District's wastewater utility in its monthly user fee as calculated above.

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

1. Damon Run Conservancy District shall maintain separate books and records for its utilities and certify it is doing so within ninety (90) days of this Order in accordance with Finding Paragraph 5. B. (1).

2. Damon Run Conservancy District's existing rates and charges for sewer service outside the District's boundaries shall be adjusted in accordance with Finding Paragraph 5. B. (2).

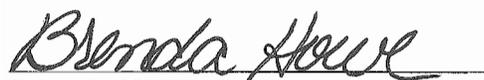
3. Damon Run Conservancy District shall file with the Commission's Water/Sewer Division within twenty-one (21) days of the date of this Order a new tariff setting forth the District's rates and charges consistent with this Order.

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

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

**APPROVED: JUN 19 2013**

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



**Brenda Howe  
Secretary to the Commission**