ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

IN THE MATTER OF THE COMMISSION'S INVESTIGATION INTO THE ADOPTION OF ALTERNATIVE REGULATORY PROCEDURES FOR RATE ADJUSTMENTS INVOLVING SMALL WATER AND SEWER UTILITIES	)))))	CAUSE NO. 44203 APPROVED: JUN 06 2012

ORDER OF THE COMMISSION

Presiding Officers:
Carolene Mays, Commissioner
Loraine L. Seyfried, Chief Administrative Law Judge

Based upon a request received by the Director of the Water/Wastewater Division of the Indiana Utility Regulatory Commission ("Commission") and pursuant to Ind. Code § 8-1-2-61.5, the Commission hereby commences an investigation to consider possible alternative regulatory procedures for the filing of rate adjustments by small water and sewer utilities.

1. **Commission Jurisdiction.** The Commission is authorized to enter, without a formal public hearing, an order affecting the rates of service of any public or municipally owned utility that:

(1) serves less than five thousand (5,000) customers;
(2) primarily provides retail service to customers; and
(3) does not serve extensively another utility.

Ind. Code § 8-1-2-61.5(a). The statute further authorizes the Commission to "issue an order…providing for the development, investigation, testing and use of regulatory procedures and generic standards with respect to water or sewer utilities described in subsection (a) or their services." Ind. Code § 8-1-2-61.5(d). The Commission may enter such an order only if it finds, after notice and hearing, the regulatory procedures or standards are in the public interest and promote at least one of the following:

(1) Utility cost minimalization to the extent that a utility's quality of service or facilities are not diminished.
(2) A more accurate evaluation by the commission of a utility's physical or financial conditions or needs.
(3) A less costly regulatory procedure for a utility, its consumers, or the commission.
(4) Increased utility management efficiency that is beneficial to consumers.

Ind. Code § 8-1-2-61.5(e).

2. **Background and Procedural History.** On May 25, 2012, the Director of the Water/Wastewater Division of the Commission requested an investigation be commenced to consider alternative regulatory procedures for small water and sewer utilities. *See* attached letter. The Water/Wastewater Division notes that small water and sewer utilities face numerous challenges, especially those related to capital needs and small size, and that costs associated with Commission regulation can affect small systems more adversely than larger systems. The Water/Wastewater Division proposes the development of an alternative regulatory program for small water and sewer utilities that will provide for annual rate increases based on a cost index and improvements in financial, managerial and technical capacities.

3. **Investigation.** In accordance with Ind. Code § 8-1-2-61.5, the Commission hereby initiates this investigation to consider alternative regulatory procedures for the filing of requests related to rates by small water and sewer utilities. Notice of this investigation shall be given to the Indiana Office of Utility Consumer Counselor and all water and sewer utilities described in Ind. Code § 8-1-2-61.5(a).

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

1. An investigation pursuant to Ind. Code § 8-1-2-61.5 is hereby commenced.

2. A Prehearing Conference and Preliminary Hearing is hereby scheduled in this Cause for July 5, 2012 at 11:00 a.m. in 222, PNC Center, 101 West Washington Street, Indianapolis, Indiana.

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

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

APPROVED: JUN 06 2012

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

Brenda A. Howe

Brenda A. Howe
Secretary to the Commission

STATE of INDIANA

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May 25, 2012

Mr. James D. Atterholt, Chairman
Indiana Utility Regulatory Commission
101 W. Washington Street, Suite 1500 E.
Indianapolis, Indiana 46204-3407

Subject: Request for Investigation to Consider an Alternative Regulatory Procedure for Small Water and Wastewater Utilities

Dear Chairman Atterholt:

The Water/Wastewater Division respectfully requests the Indiana Utility Regulatory Commission ("IURC" or "Commission") commence an investigation to consider an Alternative Regulatory Procedure for Small Water and Wastewater Utilities. The water and wastewater industries continue to face numerous challenges especially those related to capital needs and small size. Because they serve a relatively small percentage of the population, the small size of these organizations limits the savings that can be achieved from economies of scale. The characteristics of small utilities result in additional challenges for systems that are regulated by the Commission.

Commission regulated systems face additional costs associated with rate increase approvals along with the costs of regulatory lag or revenues lost from the delay of implementing the rate increase while approval is obtained. These costs affect small systems more adversely than larger systems because these costs represent a larger proportion of a small utility's total costs. Small systems also typically lack the financial resources to bear the time period required to obtain rate increase approvals. When Office of Utility Consumer Counselor ("OUCC") and IURC staff costs are considered, significant expenses may be incurred relative to the revenue increases approved, and in some instances, the total costs can be substantial relative to the utility's total revenues.

The Water/Wastewater Division proposes an alternative regulatory program for small water and wastewater systems that will provide for annual rate increases based on a cost index while motivating the utility to improve its financial, managerial and technical capacities. While

such a program may result in less regulatory oversight, it is unlikely that a mistake related to less oversight will cost the ratepayers more than the cost of maintaining the current regulatory regime. In addition to other safeguards, limits will be placed on the amount of increases allowed and the number of increases allowed before a full rate case will be required.

For instance, a utility can only receive five rate increases under this program and no increase can occur more frequently than every twelve months. After five increases, a utility will be required to undertake a general rate case before it can resume participation. Also, the cost index will not be applied to all elements of revenue requirements such as debt service which are not affected by inflation. Additionally, the cost index will be applied to amounts approved in the utilities last rate case rather than the utility's actual operating expenses. This protects ratepayers because the expenses that will be increased have been audited as part of the most recent rate case and insures that capital items such as backhoe purchases are not included in operating expenses.

In addition to these safeguards, customers will benefit as utilities build and maintain their financial, managerial and technical capacities that are required to be developed and maintained as part of this program. Customers may also benefit from lower rates associated with rate case expense savings.

Further, existing state statutes provide for such a program to be developed. Indiana Code § 8-1-2-61.5 provides the Commission with the ability to approve a rate order without a formal public hearing for utilities that serve less than 5,000 customers. A number of years ago, the Commission established the Small Utility Rate Application via a rulemaking to implement a process where a rate order could be issued without a hearing. However, the Commission has not developed a process or procedure to implement an alternative form of regulation for small water and wastewater utilities as outlined in Section (e). This provision of the statute was passed by the General Assembly in 2001 and is duplicated below:

(e) The commission may adopt a rule or enter an order under subsection (d) only if it finds, after notice and hearing, that the proposed regulatory procedures or standards are in the public interest and promote at least one (1) of the following:

(1) Utility cost minimalization to the extent that a utility's quality of service or facilities are not diminished.

(2) A more accurate evaluation by the commission of a utility's physical or financial conditions or needs.

(3) A less costly regulatory procedure for a utility, its consumers, or the commission.

(4) Increased utility management efficiency that is beneficial to consumers.

I believe the proposed program meets items one, three, and four. As the statute indicates, the Commission must find that the proposed regulatory procedure is in the public interest after notice and hearing. It is anticipated that the investigation requested will result in the hearing and order required by the statute to implement the proposed alternative regulatory procedure if the investigation determines the procedure is in the public interest and meets at least one of the four items listed.

Sincerely,

E. Curtis Gassert
Director, Water/Wastewater Division