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STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

VERIFIED PETITION OF THE BOARD OF DIRECTORS )  
FOR UTILITIES OF THE DEPARTMENT OF PUBLIC )  
UTILITIES OF THE CITY OF INDIANAPOLIS, ACTING )  
IN ITS CAPACITY AS TRUSTEE OF A PUBLIC )  
CHARITABLE TRUST FOR THE PROVISION OF )  
ENERGY SERVICES, D/B/A CITIZENS THERMAL, FOR )  
(1) AUTHORITY TO INCREASE ITS RATES AND )  
CHARGES FOR STEAM UTILITY SERVICE, (2) )  
APPROVAL OF A NEW SCHEDULE OF RATES AND )  
CHARGES APPLICABLE THERETO, AND (3) APPROVAL )  
OF CHANGES TO ITS GENERAL TERMS AND )  
CONDITIONS FOR STEAM SERVICE )

CAUSE NO. 44349

APPROVED: MAY 21 2014

ORDER OF THE COMMISSION

**Presiding Officers:**  
**Angela Rapp Weber, Commissioner**  
**Aaron A. Schmoll, Senior Administrative Law Judge**

On June 3, 2013, the Board of Directors for Utilities of the Department of Public Utilities of the City of Indianapolis, as trustee of a public charitable trust, d/b/a Citizens Thermal (“Petitioner” or “Citizens Thermal”), filed its Verified Petition (“Petition”) with the Indiana Utility Regulatory Commission (“Commission”) seeking: (i) authority to increase its rates and charges for steam utility service; (ii) approval of a new schedule of rates and charges applicable thereto; and (iii) approval of certain changes to its general terms and conditions for steam service.

On June 4, 2013, Petitioner filed its case-in-chief consisting of the direct testimony and exhibits of Carey B. Lykins, William A. Tracy, John R. Brehm, Christopher H. Braun, P.E., Aaron D. Johnson, Sabine E. Karner, LaTona S. Prentice, Korlon L. Kilpatrick II, and Kerry A. Heid. Also on June 4, 2013, Petitioner filed a *Motion for Protective Order with Respect to Customer Specific Information Included in Petitioner’s Exhibits LSP-1, LSP-2 and Certain Workpapers*. On August 15, 2013, the Presiding Officers by Docket Entry found sufficient basis for a determination that the designated information included in Exhibits LSP-1, LSP-2 and certain workpapers should be held confidential by the Commission on a preliminary basis.

In accordance with 170 IAC 1-1.1-15 and pursuant to proper notice given as provided by law, a Prehearing Conference was held in Room 224 of the PNC Center, 101 West Washington Street, Indianapolis, Indiana at 11:00 a.m. on Tuesday, July 23, 2013. Proof of publication of notice of the Prehearing Conference was incorporated into the record and placed in the official files of the Commission. Counsel for Petitioner and the Indiana Office of Utility Consumer Counselor (“OUCC”) appeared and participated in the Prehearing Conference. On August 14,

2013, the Commission issued a Prehearing Conference Order, which set forth certain determinations with respect to the conduct of this Cause based upon the stipulations of Petitioner and the OUCC at the Prehearing Conference.

On July 26, 2013, Petitioner filed the substitute testimony of Kerry A. Heid, along with Petitioner's Substitute Exhibits KAH-2, KKK-3 and KKK-4. On the same date, Petitioner filed a *Motion for Protective Order with Respect to Customer Specific Information Included in Petitioner's Substitute Exhibit KAH-2*, and on August 7, 2013, the Presiding Officers by Docket Entry found sufficient basis for a determination that the information should be held as confidential by the Commission on a preliminary basis.

On August 1, 2013, Citizens Industrial Group (the "Industrial Group") filed a Petition to Intervene. Eli Lilly & Company was listed as a member of the Industrial Group. The Presiding Officers granted the Industrial Group's Petition to Intervene by Docket Entry dated August 7, 2013. On September 12, 2013, the Industrial Group advised the Commission that Indiana University and IU Health had been added as members of the Industrial Group.

On October 1, 2013, the OUCC filed the direct testimony of Michael D. Eckert. Also on October 1, 2013, the Industrial Group filed the direct testimony and exhibits of Michael P. Gorman. On October 3, 2013, the Industrial Group filed its *Motion for Leave to File Certain Workpapers Under Seal*.

On November 5, 2013, Petitioner filed the rebuttal testimony and exhibits of Christopher H. Braun, P.E., John R. Brehm, Sabine E. Karner, LaTona S. Prentice and Korlon L. Kilpatrick II.

Pursuant to proper notice given as provided by law, an evidentiary hearing was commenced on December 10, 2013, at 9:00 a.m., EST, in Room No. 222 of the PNC Center, 101 W. Washington Street, Indianapolis, Indiana 46204. Petitioner, the OUCC and the Industrial Group (collectively, the "Parties") participated in the hearing. No members of the general public appeared. During the Evidentiary Hearing the direct testimony and exhibits of the Parties were offered and admitted into evidence without objection. The Industrial Group's Motion to Strike was denied and the rebuttal testimony of Petitioner's witness John R. Brehm was admitted into evidence over the Industrial Group's objection. The rest of Petitioner's rebuttal testimony and exhibits were also offered and admitted into evidence without objection.

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

**1. Legal Notice and Commission Jurisdiction.** Due, legal, and timely notice of the public hearings conducted in this Cause was caused to be published as required by law. Petitioner is a municipally-owned steam utility subject to the jurisdiction of this Commission in the manner and to the extent provided by the laws of the State of Indiana, including certain sections of the Public Service Commission Act, as amended. Pursuant to Ind. Code § 8-1-11.1-3(c)(9) and Ind. Code § 8-1.5-3-8, Petitioner is required to obtain Commission approval of changes in its schedule of rates and charges and terms and conditions for steam service. The

Commission has jurisdiction over the Petitioner and the subject matter of this proceeding.

**2. Petitioner's Organization and Business.** Petitioner is the Board of Directors for Utilities of the Department of Public Utilities of the City of Indianapolis, as trustee of a public charitable trust, d/b/a Citizens Thermal. Its principal office is located at 2020 North Meridian Street, Indianapolis, Indiana 46202. Through its Steam Division, Petitioner owns, operates, manages and controls plant and equipment used for the production, distribution and furnishing of steam utility service to the public. On average during the 12 months ended September 30, 2012, Petitioner provided steam service to 195 customers in the City of Indianapolis through steam production and distribution facilities. Petitioner also operates a Chilled Water Division, which provides cooling utility service to several customers within Indianapolis. However, the Chilled Water Division has not been subject to regulation by the Commission.

**3. Test Year.** Petitioner requested a test year using a 12-month period ended September 30, 2012, with a period for fixed, known, and measurable adjustments for the 12-month period following the end of the test year. In accordance with 170 IAC 1-1.1-9(b), the Prehearing Conference Order established the 12-month period ended September 30, 2012, as the test year used in this Cause to determine Petitioner's actual and *pro forma* operating revenues, expenses and operating income under its present rates and charges and the effect of its proposed rates. We find the September 30, 2012 test year, as adjusted during the subsequent 12-month period, is sufficiently representative of Petitioner's normal utility operations to provide reliable data for ratemaking purposes.

**4. Relief Requested.**

**a. *Base Rate Relief.*** On May 17, 2010, Petitioner placed into effect its Steam Service Tariff, Rates, Terms and Conditions for Steam Service within Marion County, Indiana, as authorized by the Commission in its May 11, 2010 Order in Cause No. 43821. In its case-in-chief, Petitioner sought approval of an increase in base rate revenues of \$8,537,822, or 12.91%. The OUCC proposed in its case-in-chief that Citizens Thermal's rates should be increased by \$7,470,850. The Industrial Group recommended the Commission find Petitioner's revenue deficiency was approximately \$3.68 million, which represents a 5.45% increase on the *pro forma* revenues based on current rates. In its rebuttal testimony, Citizens Thermal accepted certain adjustments recommended by the OUCC and proposed an increase in base rate revenues of \$7,946,320, which represents an 11.97% overall increase in *pro forma* operating revenues.

**b. *Terms and Conditions for Service.*** Petitioner proposed certain changes to its Terms and Conditions for Steam Service, originally set forth in Petitioner's Exhibits KKK-1 and KKK-2. In rebuttal, Petitioner agreed to make certain other revisions to its Terms and Conditions for Steam Service proposed by the Industrial Group. Those changes, as well as Petitioner's original proposed modifications, were set forth in Petitioner's Exhibit KKK-R1 and KKK-R2.

**c. *OPERA Mechanism.*** In Cause No. 44149, the Commission approved the terms of a Settlement Agreement entered into among Petitioner, the OUCC and the Citizens Thermal Industrial Group. Under the terms of the Settlement Agreement, Petitioner agreed to

implement an Operating Expense Rate Adjustment (“OPERA”) mechanism to track savings related to the conversion of the Perry K plant to natural gas. In Cause No. 44149, Petitioner agreed to use a base rate case filed in 2013 to establish a baseline for operational expenses for purposes of administering the OPERA mechanism. In accordance with the Settlement Agreement and Petitioner’s testimony in Cause No. 44149, Citizens Thermal proposed to use this proceeding to establish a baseline for operational expenses for purposes of administering the OPERA mechanism.

**5. Applicable Law.** Indiana Code § 8-1.5-3-8 establishes the revenue requirement elements which this Commission must apply in determining reasonable and just rates and charges for a municipally-owned utility. These elements include:

- (a) maintenance costs, operating charges, including the cost of purchased power, upkeep, and repairs;
- (b) taxes, including payments in lieu of taxes;
- (c) interest charges on bonds or other obligations, including leases;
- (d) a sinking fund for the liquidation of bonds or other obligations, including leases;
- (e) revenue needed to “provide adequate money for working capital; and
- (f) adequate money for making extensions and replacements (“E&R”) to the extent not provided for through depreciation expense.

**6. Operating Revenues.**

**a. *Evidence.*** LaTona S. Prentice, Petitioner’s Vice President, Regulatory Affairs, sponsored Petitioner’s proposed adjustments to test year operating revenues. Petitioner’s Exhibit LSP-1 shows on page 4 the adjustment to revenue derived from *pro forma* steam sales based upon normal weather. The impact of this adjustment is an increase in test year operating revenue of \$3,121,219, and an increase in fuel cost of \$1,521,992.

Ms. Prentice testified that Exhibit LSP-1, page 5, includes the adjustment needed to reflect the change from the test year number of customers to the *pro forma* number of customers and their associated steam usage. Ms. Prentice explained that in determining the *pro forma* number of customers, she identified customers whose service was disconnected or added during the test year. Ms. Prentice stated the test year revenue decreased by \$1,547,050 to reflect a decreased customer count.

The OUCC did not recommend any changes to Petitioner’s *pro forma* operating revenues.

Industrial Group witness Michael P. Gorman, a Managing Principal with Brubaker & Associates, Inc., disagreed with Petitioner's customer adjustment. Mr. Gorman stated that while Ms. Prentice's workpapers reflect the loss of three customers from the Rate 1 and 2 classes, there does not appear to be any recognition of potential customer growth. According to Mr. Gorman, the trending level of customers at the end of the test year is equal to the average number of customers that existed during the test year. Mr. Gorman also testified that Mr. Braun developed Petitioner's proposed E&R budget to reflect expected customer growth (one per year) through the *pro forma* period. Mr. Gorman added that the failure to recognize customer growth results in a mismatch between the components of the cost of service. Mr. Gorman proposed to maintain the same level of customers in the *pro forma* year as was included in the test year. This results in offsetting customer load losses with load produced by adding new customers to the system.

Mr. Gorman also addressed Citizens Thermal's proposed adjustment of the sales included in the test year for the effects of abnormal weather. Mr. Gorman agreed, for the most part, with Petitioner's method of weather normalization, but testified that he did not agree with Petitioner's determination of base usage for Rate 2 customers. Mr. Gorman indicated that Petitioner's weather normalization calculation established a base level of monthly sales, which it determined was not weather sensitive, and that this base level was subtracted from the total monthly sales to determine the portion that varies with changes in temperature. This weather sensitive usage was normalized based on the variation in the number of degree days actually experienced compared to the 30-year normal.

Mr. Gorman stated, however, that Petitioner used the average of the actual sales during the months of May through August to establish the base usage. According to Mr. Gorman, this is not an appropriate period to use to establish the base sales volume since the normal level of degree days that exist in May and June represent 3% of the total number of normal degree days. Mr. Gorman therefore eliminated May and June from the period used to establish the base level of sales for Rate 2 customers.

In rebuttal, Ms. Prentice stated that she believes Petitioner's proposed *pro forma* reduction in customer numbers is appropriate. She explained that, during the preparation of Petitioner's direct testimony, Citizens Thermal was aware of two customers who were scheduled to be disconnected from Citizens Thermal's system, and another customer whose facility was scheduled for demolition. At the same time, she noted, Petitioner was unaware of any new customers to be added to its steam system during the 12 months following the end of the test year. Ms. Prentice indicated that Petitioner now has customer information for the 12 months following the end of the test year, and that it is a fact that Petitioner lost a total of 3 customers from Rates 1 and 2 (as indicated on Petitioner's Exhibit LSP-R3).

Ms. Prentice noted that in her view Mr. Gorman's proposal to maintain the same level of customers in the *pro forma* year is not fixed, known and measurable. She specifically addressed Mr. Gorman's reference to Petitioner's witness Braun's testimony regarding "typical customer growth" as it relates to extensions and replacements as support for the Industrial Group's recommendation. Ms. Prentice observed that Mr. Braun's testimony indicates an average increase of one additional customer per year, which is hardly an indicator of a groundswell of new customers to be added to the Citizens Thermal system. Ms. Prentice recommended that the

Commission accept Petitioner's negative \$1,547,050 customer growth revenue adjustment and reject the Industrial Group's proposed customer growth adjustment.

Ms. Prentice also disagreed with Mr. Gorman's weather normalization adjustments. She noted that when Mr. Gorman determined his weather normalization adjustment, he erroneously included in his calculation the 3 customers that appropriately should be excluded from *pro forma* revenue and related fuel cost. Ms. Prentice stated that this error in Mr. Gorman's weather normalization adjustment results in gross margin (revenue less fuel cost) that is approximately \$100,000 greater than Petitioner's revised gross margin. Ms. Prentice observed, however, that after re-examining the usage characteristics of Rate No. 2 steam customers, she agrees that only the 2 months of July and August should be used to determine the Rate No. 2 base usage. Ms. Prentice testified that this change to the weather normalization adjustment resulted in a \$233,835 net increase in *pro forma* at present rates revenue and gross margin.

**b. Discussion and Findings.** Industrial Group witness Gorman proposed *pro forma* revenues driven by two primary factors: (1) customer growth, and (2) a weather normalization adjustment. Mr. Gorman proposed that Petitioner's *pro forma* revenues be based on the test year level of customers. Petitioner derived its customer growth adjustment based on information that two customers were scheduled to be disconnected from the Citizens Thermal system, and another customer's facility was scheduled for demolition.

Actual customer information for the 12 months following the end of the test year reflects that Petitioner lost three customers from Rates 1 and 2. Accordingly, there is no evidence of any customer growth that is fixed in time, known to occur, and measurable in amount during the 12-month period following the test year. Thus, the Commission accepts Petitioner's adjustment.

The Commission also finds that Petitioner's weather normalization adjustment as modified in Petitioner's rebuttal testimony provides an accurate picture of Citizens Thermal's operations during the three-year period in which the proposed rates likely will be in effect. Mr. Gorman included in his weather normalization calculation the three customers that we determined above should be excluded from *pro forma* revenue and related fuel cost – given that they are no longer connected to Petitioner's system. This error results in gross margin that is approximately \$100,000 greater than Petitioner's revised gross margin. We note that, in response to Mr. Gorman's testimony, Petitioner refined its weather normalization adjustment, using only the 2 months of July and August to determine the Rate No. 2 base usage.

Based on the evidence presented, the Commission accepts Petitioner's negative \$1,547,050 customer growth revenue adjustment. The Commission additionally accepts Petitioner's change to the weather normalization adjustment. Accordingly, the Commission finds that Petitioner's *pro forma* operating revenues at present rates are \$66,378,967.

## **7. Petitioner's Statutory Cash Revenue Requirements.**

**a. Cost of Fuel.** Petitioner's witness Prentice also described the adjustments to Petitioner's fuel costs. Ms. Prentice stated that Petitioner had projected a \$557,310 reduction from test year fuel costs to reflect an overall decrease in therm usage by new customers. Based

upon the evidence of record, our acceptance of Petitioner's *pro forma* adjustments and methodology for calculating test year total operating revenues and the reasons set forth in above, it is appropriate to use Petitioner's *pro forma* adjustments to its test year fuel costs. Accordingly, we find Petitioner's *pro forma* cost of fuel is \$32,466,486.

**b. Extensions and Replacements ("E&R").**

i. *Evidence.* Christopher H. Braun, P.E., Petitioner's Vice President, Energy Operations, described Citizens Thermal's steam utility business. Mr. Braun explained that Citizens Thermal began providing steam utility service in November 2000 when the Board of Directors for Utilities purchased the Perry K steam production plant (the "Perry K Plant") and other thermal energy assets from Indianapolis Power & Light Company. Mr. Braun noted the Commission approved that purchase in its October 4, 2000 Order in Cause No. 41716.

Mr. Braun described the major components of Citizens Thermal's ongoing E&R program. He noted the three major categories of the annual E&R program for Citizens Thermal consist of capital expenditures for Steam Production Plant, Steam Distribution Plant, and Steam General Plant. Mr. Braun described the process Petitioner used to determine the amount of E&R expenditures Citizens Thermal will make on an ongoing basis, as well as the types of expenditures that Citizens Thermal makes for Production Plant, Distribution Plant, and General Plant E&R on an ongoing basis.

Mr. Braun sponsored Petitioner's Exhibit CHB-1: *Pro Forma* Extensions & Replacements. This Exhibit depicts planned E&R expenditures for production, distribution and general plant for FY 2013-FY 2015 based on approved budgets. The exhibit attempts to separate the major, non-recurring projects like the natural gas conversion, Wishard plant construction, and the re-tubing of boilers 13 and 14 from on-going expenditures. Petitioner's Exhibit CHB-1 also includes all planned Corporate Shared Services ("CSS") E&R and all planned Shared Field Services ("SFS") E&R, and also shows the amounts related to the cost to achieve the synergies of the Water and Wastewater acquisitions. Petitioner proposed using the average of the 2013, 2014 and 2015 approved budgets to determine Petitioner's *pro forma* E&R expense because according to Mr. Braun these figures are most reflective of the ongoing investment in E&R, after the conversion of steam production from coal to natural gas.

Mr. Braun stated that the annual revenue requirement for E&R to be included in rates and charges for services should be \$3,888,950. According to Mr. Braun, this amount is reflective of ongoing operations and the amount the Petitioner reasonably needs to invest annually in E&R in order to maintain its plant in a sound physical condition to render safe, reliable, and efficient steam service.

On CHB-1, Mr. Braun also calculated the total E&R for financing. This calculation included all of Citizens Thermal's E&R requirements, recurring or not, for FY 2013 through FY 2015. The figures were \$8.9 million, \$7.4 million and \$6.5 million respectively. Mr. Brehm included these full amounts in determining the amount of 2013 debt issuance.

Michael D. Eckert, OUCC Senior Utility Analyst, testified that the OUCC recommended an overall E&R amount of \$3,466,899, which is \$422,051 less than Petitioner's requested E&R revenue requirement. Mr. Eckert indicated that the OUCC expects Petitioner to file a base rate case in the summer of 2015 and projects Petitioner's rates to be in effect for approximately two years on the basis that the Perry K conversion should be completed in April 2014, and that Petitioner agreed in Cause No. 44149 to file a base rate case with a test year ending 12 to 16 months following completion of the Perry K Natural Gas Conversion Plan.

Mr. Eckert testified that a two-year average for E&R is more appropriate than a three-year average because the amount Petitioner budgeted for E&R in FY 2013 is approximately \$1,100,000 and \$1,400,000 higher than the amounts budgeted for fiscal years ended September 30, 2014 and 2015, respectively. Mr. Eckert stated that by including the budgeted amount for FY 2013, Petitioner has overstated its E&R requirement. His opinion is that a two-year average better represents the expected ongoing level of this requirement.

Industrial Group witness Gorman stated that Citizens Thermal's proposed level of rate revenue funding of its E&R program is not reasonable. Mr. Gorman indicated Citizens Thermal has included significant amounts of non-recurring capital projects in its proposed E&R annual rate revenue funding proposal, and that this is true for both steam utility, CSS and SFS capital projects.

Mr. Gorman also testified that after the CSS Information Technology ("IT") capital costs are completed, the amount of IT capital projects should decrease significantly, and the allocated share to the steam unit will materially decline. He noted additionally that the SFS capital budget allocated to steam nearly goes away in FY 2015 after the Langsdale facility improvements are completed. Mr. Gorman therefore recommended greater amounts of debt funding for these non-recurring major capital programs. In his view, E&R funding in rates should be limited to only annual recurring capital programs. Mr. Gorman ultimately recommended an amount of rate revenue funding for the E&R program of \$3.35 million, which is a \$540,000 reduction to Citizens Thermal's proposed \$3.89 million annual rate revenue funding amount.

In rebuttal, Petitioner's witness Braun disagreed with Mr. Eckert's use of the average of the estimated costs for 2014 and 2015 to determine Petitioner's E&R revenue requirement. Mr. Braun specifically disagreed that eliminating 2013 from the calculation results in the calculation of a representative ongoing level of the E&R revenue requirement. While acknowledging Mr. Eckert's observation that the amount budgeted for E&R expense for FY 2013 is higher than the amounts budgeted for the fiscal years ending September 30, 2014 and 2015, Mr. Braun pointed out that Citizens Thermal has identified numerous additional projects that must be completed over the next three years that further support the use of a three-year average to determine a representative level of steam system E&R needs going forward.

Mr. Braun testified that Mr. Eckert's use of a shorter and lower two-year time frame inappropriately reduces Citizens Thermal's *pro forma* E&R revenue requirement to a level that would jeopardize Petitioner's ability to complete necessary upgrades to the system. Mr. Braun observed, additionally, that elimination of the budget amount for FY 2013 simply because it is higher than the budgets for years 2014 and 2015 results in a revenue requirement that ignores the

normal variation in year-to-year amounts of E&R due to system needs, environmental conditions, and customer needs in the longer term. According to Mr. Braun, by eliminating all of Citizens Thermal's 2013 capital spending, it is less likely that the OUCC's *pro forma* amount of E&R reflects a representative ongoing level of future spending for capital purposes. Mr. Braun expressed his opinion that the use of a three-year average (2013 through 2015) better reflects the representative ongoing level of capital spending Citizens Thermal will experience.

Mr. Braun also disagreed with Mr. Eckert's statement regarding the timing of Petitioner's next base rate case. Mr. Braun noted that although Mr. Eckert is correct that Petitioner agreed to file its next base rate case with a test year of 12 to 16 months following completion of the Perry K conversion, Petitioner's estimated completion date for the conversion is actually June 2014. Referencing Ms. Prentice's rebuttal testimony, Mr. Braun noted that a conversion completion date of June 2014 would likely result in Citizens Thermal obtaining an order in its next base rate case in early 2017. In Mr. Braun's view, given that the order would be received three years from when the rates from this proceeding are expected to be effective, Petitioner's estimated three-year life of rates from this proceeding is appropriate.

Mr. Braun also disagreed with Mr. Gorman's determination of the E&R revenue requirement for Citizens Thermal. He explained that although Petitioner expects certain aspects of its on-going capital improvement projects may be completed over the next several years, additional projects are identified that further support the inclusion of these projects as representative of steam system E&R needs going forward. Because new capital projects are added on a continuous basis as others are completed, the use of a three-year average more appropriately reflects the on-going level of capital spending that Petitioner will experience.

Mr. Braun also disagreed with Mr. Gorman's suggestion that Petitioner's IT upgrade and SFS capital expenditures are non-recurring and should be excluded. He explained that the IT field is one which is constantly changing and evolving, and Petitioner must regularly upgrade its computer system and software to better serve customers as software providers issue new versions and phase out the support of older versions. Mr. Braun presented examples of computer and software upgrades planned over the next three years.

Mr. Braun testified that the proposed level of funding in the amount of \$3,889,950 for the E&R revenue requirement allows Citizens Thermal to maintain the safety, reliability, and viability of the steam system. He noted that if the amount included in rates is inadequate to fund actual requirements for E&R, the shortfall in cash will need to be overcome with additional debt and that, consequently, the next rate case will not only require rates to be increased to reflect the appropriate higher level of E&R, but they will need to increase even further to reflect additional debt service costs. He cautioned that, over time, if the funds available for E&R are not adequate, customers may experience more frequent episodes of steam outages and losses of system pressure, and ultimately, if the steam system is not properly maintained and invested in, it may become infeasible to operate the steam system due to excessive maintenance costs, safety concerns, and the inability to operate obsolete equipment.

ii. *Discussion and Findings.* Petitioner proposed to use a *pro forma* amount for extensions and replacements as being most reflective of its ongoing investment

needs. Petitioner, the OUCC and Industrial Group have presented three competing alternatives for Petitioner’s on-going E&R revenue requirements. Those competing alternatives, and the manner in which they were derived, are summarized in the tables below:

	<b><u>Proposed Revenue Requirement</u></b>	<b><u>Method of Determining</u></b>
<b>Petitioner</b>	\$3,889,950	Average of budgets for FY 2013, 2014 and 2015
<b>OUCC</b>	\$3,466,899	Average of budgets for FY 2014 and 2015
<b>Industrial Group</b>	\$3,350,000	Average of budgets for FY 2013, 2014 and 2015, with non-recurring expenses removed

The Commission finds that the OUCC and Industrial Group’s respective approaches understate the on-going level of Petitioner’s E&R requirement. The Commission notes initially that the E&R budget amount for FY 2013 should not be eliminated from averaging simply because it exceeds the budgeted amounts for 2014 and 2015. Variation in Petitioner’s year-to-year amounts of E&R are to be expected and elimination of the 2013 budget amount has the effect of making the *pro forma* amount of E&R less, rather than more representative of Petitioner’s future capital spending. At the hearing, Mr. Braun identified two additional 2013 projects that were not budgeted, totaling approximately \$1.7 million. Tr. at B-29 to B-30.

We have used capital expenditures in historical periods as the basis for establishing the E&R revenue requirement. *See, e.g., Citizens Gas & Coke Utility*, Cause No. 42767 at 66 (IURC Oct. 19, 2006) (approving an E&R revenue requirement based on a four-year historical average of fiscal years 2001, 2002, 2003 and 2004). The fiscal year budgets presented in this case differ from those presented in the Citizens Water rate case in Cause No. 44306. In that case, we determined that a two-year average was appropriate, because the 2013 E&R budget included projects that had been deferred from FY 2012, and therefore inappropriately skewed the average budget higher. Here, no party suggested the 2013 fiscal budget was inappropriately skewed due to deferred projects.

Mr. Gorman testified Citizens Thermal has included significant amounts of non-recurring capital projects in its proposed E&R funding proposal. However, to some extent, any E&R project is non-recurring. Petitioner indicated that it adds new capital projects on a continuous basis as other projects are completed. The issue is not whether projects are recurring or non-recurring, but whether a project is appropriate to be included in capital planning. Mr. Gorman’s testimony appears to recognize that the budgeted projects are capital projects that benefit utility operations.

Finally, we note that under the municipal ratemaking statute, a utility can opt to seek recovery of E&R to the extent not provided through depreciation. As set forth below, Petitioner’s *pro forma* depreciation expense, which no party opposed, is \$4,561,570. Petitioner is not seeking recovery of depreciation expense, however, and has only sought to include its

lower E&R proposal in its revenue requirement. While it is still Petitioner's burden to show its proposed amount is reasonable, we believe a lower E&R request should be considered in determining the reasonableness of a utility's proposal.

Based on the evidence of record, we find Petitioner's proposed level of funding for the E&R revenue requirement best reflects the on-going level of capital spending that Petitioner will experience. Accordingly, the Commission finds that Petitioner's \$3,888,950 proposed annual revenue requirement for E&R to be included in rates and charges for services should be approved.

**c. Debt Service Revenue Requirement.**

**i. Evidence.**

A. Petitioner's Direct Evidence. John R. Brehm, Petitioner's Senior Vice President and Chief Financial Officer, testified in support of the *pro forma* revenue requirement for debt service. Mr. Brehm stated the *pro forma* amount of debt service Petitioner is proposing for determining the revenue requirement is the *pro forma* debt service for FY 2015, which is \$9,847,357. The reason Mr. Brehm proposed to use *pro forma* debt service for FY 2015 is due to the fact Petitioner's debt service obligations will increase substantially from the test year level. This will occur in part, he explained, because of the need to issue long-term debt to fund the conversion of certain coal and oil fired boilers at Petitioner's Perry K plant to natural gas. Mr. Brehm noted that the Natural Gas Conversion Plan was approved by the Commission in its Order in Cause No. 44149, and that the capital expenditures for this conversion project currently are occurring and will continue until the project is completed. Mr. Brehm stated that the *pro forma* amount of debt service for FY 2015 is appropriate for determining the revenue requirement for the proposed rates, because it is virtually the same amount as the *pro forma* annualized debt service of Citizens Thermal for FY 2014, and is representative of the annualized debt service Petitioner will be incurring while the proposed rates are in place.

Mr. Brehm stated he understands it is an accepted practice for the Commission to use projected debt service costs to determine the debt service portion of revenue requirements of municipal utilities under its jurisdiction. He noted use of projected debt service to establish the *pro forma* debt service component of revenue requirements is especially important for Petitioner because it must issue new debt to finance capital spending requirements. Referencing Petitioner's Exhibit JRB-2, Mr. Brehm explained that in addition to the \$31.2 million of net funds required in FY 2013, \$8.8 million of net funds are required in FY 2014 and an additional \$2.7 million of net funds are required in FY 2015 to finance a portion of Petitioner's capital spending requirements. Consequently, if projected debt service is not used to establish the *pro forma* debt service component of revenue requirements, the rates established in this rate case would deliberately be based on a debt service amount that is less than the annualized debt service amount Petitioner would be incurring when the rates are actually in effect. Mr. Brehm believes such an approach to ratemaking for Petitioner would be unfair, unjust and unreasonable.

Mr. Brehm further noted that the Settlement Agreement the Commission approved in Cause No. 44149 requires Petitioner to make every reasonable effort to recover debt service

costs directly related to the Natural Gas Conversion Plan through base rates. According to Mr. Brehm, since the debt funding required for the Natural Gas Conversion Plan construction extends until the project is completed in 2015, it is necessary to use projected debt service through FY 2015 to establish the *pro forma* debt service component of revenue requirements for Petitioner in this rate case in order to fulfill the referenced Settlement Agreement obligation.

Mr. Brehm described the debt structure of the thermal energy system and indicated the system's debt is secured by the net revenues of the system, which includes both Petitioner and the chilled water system. He noted the methodology that has been consistently used since formation of the thermal energy system to apportion the debt between Petitioner and the chilled water system has been based on specific identification of the use of the proceeds of each series of debt at the time the debt is issued.

Mr. Brehm further observed this methodology for apportioning debt has always been used by Citizens Energy Group ("CEG") in preparing the respective books and records of Petitioner and the chilled water system, for funding every debt service payment that has ever been made on thermal energy system debt and for Petitioner's two rate cases since CEG acquired the Steam Division and Chilled Water Division from IPL in 2001: Cause No. 43201 (2007) and Cause No. 43821 (2010).

Mr. Brehm sponsored Petitioner's Exhibit JRB-1, which details the actual test year debt outstanding and debt service, as well as *pro forma* debt outstanding and debt service for Petitioner. Summarizing Petitioner's debt outstanding at September 30, 2012, Mr. Brehm observed that the total principal amount of Citizens Thermal's portion of the outstanding debt of the thermal energy system at September 30, 2012 was \$84,975,039. That amount, he explained, was made up of long-term debt in the amount of \$60,016,108, current maturities of long-term debt in the amount of \$3,092,931, the Wishard Construction Loan balance of \$7,866,000 and borrowings under a bank revolving credit agreement of \$14,000,000.

In his testimony and exhibit JRB-2, Mr. Brehm detailed his development of the amount of the 2013 bond issue that he proposed to allocate 100% to Petitioner. Mr. Brehm outlined his allocation of the total Wishard Construction Loan between the Chilled Water and Steam Divisions. The Wishard Construction Loan matured on September 15, 2013. He testified that the Chilled Water Division could retire its share of the loan with cash, but the steam system did not have available cash. Mr. Brehm also included the \$14 million balance of line of credit in the amount of this 2013 bond issue and allocated the amount entirely to the Steam Division. His justification was based on a claim that the Steam banking transactions show that the Steam Division used this funding.

In determining the amount of the 2013 bond issuance, Mr. Brehm also included the amount of E&R for financing determined by Mr. Braun. Mr. Brehm testified that Citizens Thermal would draw on the 2013 bond issuance to fund \$8.9 million in E&R in FY 2013, \$7.4 million in FY 2014 and \$6.5 million in FY 2015.

Mr. Brehm stated that the entire principal amount of the Series 2013 bonds on line 22 of Exhibit JRB-2 will be apportioned to Petitioner and that, likewise, the entire amount of the annual debt service on line 10 of that Exhibit will be apportioned to Petitioner.

Mr. Brehm also addressed credit rating matters. He noted that Petitioner necessarily must rely on having working capital and short-term sources of funds such as bank debt available to meet current obligations in the event of operating at a cash deficit with the expectation that any working capital depleted and bank debt utilized ultimately will be replaced with permanent financing, such as long-term bonds. He noted that these risks of operating at a cash deficit are among the reasons why it is essential at a minimum to maintain the current credit rating so that Petitioner can always have reasonable assurance of access to both the short-term and long-term debt markets. He added that sufficient and timely rate increases to support an adequate debt service coverage ratio are essential in achieving and maintaining the credit rating.

Mr. Brehm sponsored Petitioner's JRB-3, which is a computation of Petitioner's stand-alone debt service coverage ratios for fiscal years 2013 through 2015 on a *pro forma* basis at present rates and at the proposed rates and charges for steam service requested in this case. Mr. Brehm testified that from both an operational and a credit rating perspective it is essential to sustain debt service coverage levels, not at the minimum level required by the bond indenture, but at levels significantly above minimum levels.

B. OUCC's Evidence. OUCC witness Eckert recommended that Petitioner utilize a two-year average of Debt Service (January 2014 through December 2015) because Petitioner's rates will be in effect for approximately two years. The two-year average is \$9,848,457, and the OUCC therefore is recommending an increase of \$1,100 to Petitioner's proposed debt service requirement.

C. Industrial Group's Evidence. The Industrial Group proposed several adjustments to Petitioner's *pro forma* debt service revenue requirement. Mr. Gorman recommended a different structure of the 2013 bond debt service cost. His proposed structure for the 2013 bond issue is similar to Citizens Thermal's actual 2008 debt service structure. According to Mr. Gorman, the amount of debt service for the 2013 bond issue should reflect interest-only payments for the first 11 years of the bond term, and principal and interest payments for the last nine years of this bond term.

Mr. Gorman stated that a more balanced structure of the 2013 debt service cost would mitigate the rate increase in this proceeding. He suggested that modifying the debt service structure of the 2013 bond issue to be more consistent with Citizens Thermal's 2008 bond issue can produce a more level and stable annual debt service cost structure over the next 20 years. Mr. Gorman stressed that the restructuring of the Citizens Thermal debt service is not only appropriate to levelize debt service costs over the next 20 years, but also that the bonds are being used to support assets that have at least 20 years of expected operating life. He stated that to the extent the capital investments supported by the 2013 bond issue will have expected useful lives of at least 20 years, then his proposed levelization of the annual debt service cost would be a balanced approach to match the repayment of the debt with the life of the asset.

Mr. Gorman also testified that Petitioner did not need to issue as much debt as it planned. He specifically disputed Petitioner's claim that \$14 million of short-term line of credit should be refinanced with 2013 bond issue and allocated 100% to the Steam Division. Mr. Gorman disputed whether the \$14 million short-term line was devoted entirely to Petitioner's steam systems. Mr. Gorman noted that the line of credit is available to both Petitioner (Steam) and the Chilled Water business unit.

Mr. Gorman testified that Petitioner did not prove it needed the \$14 million of additional cash from the line of credit entirely for the Steam Division. Mr. Gorman asserted that Mr. Brehm's allegation that the Company's banking transactions prove it should be allocated to the Steam Division is without merit and is not a reliable basis for establishing that this Thermal System short-term borrowing balance should be allocated 100% to Steam (a regulated entity) and 0% to Chilled Water (an unregulated entity).

Mr. Gorman recommended a cash flow methodology be used to allocate the short-term balance between Steam and Chilled Water. This cash flow study measures the operating cash flows for the Steam Division during the time period the short-term borrowing line was drawn upon. The Steam Division's operating cash flow shortfall establishes how much of the short-term borrowing facility draws were needed to cure its cash deficiencies. Mr. Gorman noted that cash can easily be moved between Citizens Thermal and other members of the Citizens affiliate structure. This concern about free movement of cash within the Citizens affiliates is shared by credit rating agencies such as Moody's Credit Rating Group. The Industrial Group offered CX-1 to show that Moody's recently downgraded CEG because of the lack of transparency in its movement of cash between affiliates. Mr. Gorman argued that there should be clear proof that the entire \$14 million of short-term borrowing facility is needed to support the cash deficiencies at the Steam Division. The Petitioner's proposal to allocate this for only the regulated Steam Division based on bank transactions is not sufficient proof that it should be included in its cost of service. Mr. Gorman stated that he performed a cash flow study for Petitioner, and he estimated approximately \$9.6 million of the \$14 million line of credit was necessary to cure cash deficiencies at Citizens Thermal. Mr. Gorman therefore adjusted Mr. Brehm's projected debt service cost for the Steam Division to include only \$9.6 million for line of credit to be allocated to the steam system.

Industrial Group offered IG-CX 5 to show that account reflects cash decline driven by under-recovered fuel expenses. The second item, for FY 2012, related to "Prepayments and Deposits" in the amount of \$2.26 million. IG CX-6 was offered to show that expense largely consisted of a prepayment the Steam Division made to Citizens' affiliate companies for CCS expenses related to the acquisition by CEG of the water and wastewater utilities, i.e. Citizens Water and CWA Authority, Inc.

D. Petitioner's Rebuttal Evidence. Petitioner's witness Brehm agreed with the debt service revenue requirement recommended by Mr. Eckert. Mr. Brehm disagreed, however, with Mr. Eckert's statement that the debt service revenue requirement should be determined based on a two-year average of debt service from January 2014 through December 2015 because Petitioner's rates will be in effect for approximately two years. Mr. Brehm noted that the rebuttal testimony of Ms. Prentice corrects Mr. Eckert's statement

regarding the length of time the rates established in this case are likely to be in effect by showing such rates are likely to be in effect until early in 2017. Mr. Brehm stated the \$9,847,357 amount of debt service cost he recommends is a representative ongoing level of debt service costs and should be used for the debt service revenue requirement in this case.

Mr. Brehm stated that Mr. Gorman's recommended *pro forma* debt service revenue requirement amount is so materially below the level recommended by Mr. Eckert and himself because Mr. Gorman's analysis is deficient and incomplete, resulting in multiple errors. Mr. Brehm criticized Mr. Gorman's cash flow study because it omitted transactions recorded on the Petitioner's balance sheet. Mr. Brehm also pointed out that Petitioner's Exhibit JRB-R1 demonstrates that the entire \$14 million amount of the bank revolving line of credit not only was properly recorded on Petitioner's books, it was needed to satisfy Petitioner's cash requirements. Additionally, Mr. Brehm testified that Mr. Gorman reduced the amount of E&R used to determine the amount of debt funding required by eliminating Petitioner's share of costs-to-achieve ("CTA") full utility integration that are part of total CSS E&R expenditures in FY 2013 and FY 2014. Mr. Brehm explained that this reduction is an error because such CTA actually will be spent in FY 2013 and FY 2014 and consequently must be funded.

Mr. Brehm noted the Series 2013 bonds have been issued and stated that he believes the amount of *pro forma* debt service he calculated in his case-in-chief testimony for the Series 2013 bonds remains a reasonable estimate of going-level debt service for the Series 2013 bonds when the entire bond issue is converted to 20-year fixed rate bonds. Accordingly, Mr. Brehm indicated that Mr. Gorman's proposed debt service structure for the Series 2013 bonds should be rejected.

Mr. Brehm stated that the Series 2013 bonds are providing funding for *new* investments in 2011 through 2015. The Series 2013 bonds are not refunding old bonds that were issued years ago. He explained that the equitable way to allocate capital costs on new investments "across the generation of customers that will be served by the investments over the next 20-year period" is by providing a level amount of debt service revenue requirement each year on the debt issued to finance such investments, which he noted is precisely what the levelized debt structure he presents for the Series 2013 bonds does.

Mr. Brehm noted that Mr. Gorman's proposed structure moves all responsibility for the debt service revenue requirement for paying back the principal on the Series 2013 bonds that were issued to fund capital investments that will serve current customers to the generation of customers on the steam system during the final 8 years of the 20-year term of the Series 2013 bonds. Mr. Brehm sponsored Petitioner's Exhibit JRB-R3, which he indicated further illuminates the intergenerational inequity of Mr. Gorman's proposed debt service structure and the intergenerational equity and consistency of the debt service structure he presents for the Series 2013 bonds.

Mr. Brehm observed that the actual principal amount of the Series 2013 bonds issued on August 20, 2013 was \$47,825,000, whereas the principal amount Mr. Gorman recommended for the Series 2013 bonds was \$38,494,807. Mr. Brehm also suggested that because the actual amount of cash on hand of Citizens Thermal as of September 30, 2013 (the end of its 2013 fiscal

year) was less than what Petitioner would need to draw down in future years, Petitioner demonstrated that the \$47,825,000 principal amount of the Series 2013 bonds was not excessive.

Finally, Mr. Brehm indicated the methodology that has been consistently used since formation of the Thermal Energy System to apportion the debt and related debt service between the Steam Division and the Chilled Water Division has been based on specific identification of the use of proceeds of each series of debt at the time the debt is issued. Mr. Brehm testified that Mr. Eckert and Mr. Gorman each, in effect, used that methodology for apportioning debt service in this case, and he respectfully requested that the Commission make a finding in this case that the methodology for apportioning the debt and related debt service between the two divisions is specific identification of the use of proceeds of each respective series of debt at the time the debt is issued. Mr. Brehm testified that this results in an apportionment percentage to Petitioner for each series of debt as follows: Series 2008 – 43.41%; Series 2010A – 100%; Series 2010B – 43.41%; and Series 2013 – 100%. Mr. Brehm believes this will reduce the potential for unnecessary controversy in future rate cases and allow the record in future rate cases to be somewhat shorter because it will enable the Citizens Thermal witness sponsoring the *pro forma* debt service revenue requirement to avoid repeating the lengthy explanations of how the apportionment percentages for each of the above series were derived.

ii. *Discussion and Findings.* Indiana Code § 8-1.5-3-8 requires Petitioner’s rates and charges for steam service to produce sufficient revenues to “(1) pay all the legal and other necessary expenses incident to the operation of the utility, including: . . . (F) interest charges on bonds . . . (2) [p]rovide a sinking fund for the liquidation of bonds . . . (3) provide a debt service reserve for bonds . . . not to exceed the maximum annual debt service on the bonds . . . .” Petitioner and the OUCC are in substantial agreement regarding the appropriate amount of the debt service revenue requirement (\$9,847,357 and \$9,848,457, respectively). The Industrial Group recommends a *pro forma* debt service revenue requirement amount of \$7,922,307, which is approximately \$1,925,050 less than the level recommended by Petitioner and the OUCC.

In its proposed order, Industrial Group makes an initial argument that debt service, to the extent not reflected in test year or the adjustment period, cannot be included in the utility revenue requirement. We reject this position from the outset. We have previously stated that municipal debt service is not subject to the adjustment period limitation. *Dept. of Waterworks*, Cause No. 43645, at 53 (IURC Feb. 2, 2011). Industrial Group’s argument also fails to recognize that municipal debt service may reflect the funding of capital plans that extend well beyond the 12-month adjustment period. In this case, Petitioner’s E&R request, which we addressed above, utilized FY 2013 through FY 2015 budgets for capital items.<sup>1</sup> Petitioner’s test year debt service does not provide for funding of the future capital needs of Petitioner.

The Industrial Group’s recommended debt service revenue requirement rests on certain suppositions, including: (i) a portion of the \$14 million that had been drawn on the bank revolving line of credit as of September 30, 2012 had been used by entities other than Petitioner;

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<sup>1</sup> We note that Industrial Group did not argue that Petitioner should use the adjusted test year capital budget, i.e. FY 2013, for determining E&R expense, but should use FY 2014 and FY 2015 capital budgets.

(ii) Citizens Thermal's share of CTA that are debt financed can simply be excluded from Petitioner's financing requirements; (iii) the actual principal amount of the Series 2013 Bonds in the amount of \$47,825,000 is overstated; and (iv) a proposed restructuring of the Series 2013 Bonds to delay repayment of the principal amount of the bond issuance to the final 8 years.

Petitioner's Exhibit JRB-R1 demonstrates, contrary to Mr. Gorman's assertion, the entire \$14 million amount of the bank revolving line of credit was properly recorded on Petitioner's books and was needed by Petitioner to satisfy its cash requirements. Mr. Brehm testified at the hearing: "[t]hose dollars were needed by steam; they were drawn down by steam. Every dollar was deposited in steam, and every dollar was used by steam." (Tr. at A-78.) Accordingly, we find there is no basis for reducing Petitioner's debt service revenue requirement with respect to the bank line of credit, as proposed by Mr. Gorman.

The CTA are costs that actually will be spent in FY 2013 and FY 2014 and consequently must be funded with debt. Mr. Gorman's proposal to eliminate these costs from the amount of debt funding required would result in rates and charges for service that produce insufficient revenues for Petitioner to pay its debt service. Accordingly, Mr. Gorman's proposed reduction to the debt service revenue requirement related to debt service costs incurred to fund Citizens Thermal's portion of the CTA full utility integration that are part of total CSS extensions and replacements expenditures in FY 2013 and FY 2014 is rejected.

Mr. Gorman's recommendations with respect to the amount and suggested structure of the 2013 Bonds are inconsistent with the record evidence related to those bonds. The Series 2013A Bonds were issued on August 20, 2013 as 20-year fixed rate bonds in an amount sufficient, after funding the debt service reserve fund and paying the costs of issuance, to pay off the Wishard Construction Loan and finalize construction of the steam project to serve the new Eskenazi Health facility. Bonds designated as Series 2013B on Petitioner's Exhibit JRB-2 were issued as put bonds with a mandatory purchase feature pursuant to which, on August 1, 2014, the holder thereof must tender its bond back to the bond trustee in exchange for payment and the bond is remarketed as a 20-year fixed rate bond. Taken together, the par amount of the Series 2013 bonds is \$47,825,000.

Petitioner's witness Brehm testified that the entire \$47,825,000 was or will be used to fund Citizens Thermal needs. Mr. Brehm stated:

It's clear in this case, one only has to look at a bank statement to validate it, that the entire \$47 million of proceeds of the debt issuance went to the steam system. . . [T]hat money doesn't leave steam. It turns – It's turned around and is invested in steam assets which is exactly what has happened here either directly or indirectly by paying off prior loans that were invested in steam assets, and the residual dollar amount that remains is going to be invested in steam assets in 2014 and 2015. 100 percent of that debt issuance was used by steam; none of it was used by chilled water.

(Tr. at A-72.)

Finally, Mr. Gorman proposed that debt service should be reduced based on his proposal that Petitioner should have pursued debt issuances that would have only required interest only payments during a portion of the issuance. Unlike other municipal utilities, Petitioner is not required to receive Commission approval to issue debt. The 2013 notes have already been issued under the terms of the issuance, which include principal and interest payments over the entire term. While we encourage Petitioner to consider the rate impacts of its debt issuances, we do not find that the terms of its 2013 debt issuance were unreasonable.

Based on the evidence presented, we find the *pro forma* amount of debt service for determining the revenue requirement for the proposed rates in this Cause should be \$9,847,357. The Commission further finds reasonable Petitioner's proposal that the methodology for apportioning the debt and related debt service between Citizens Thermal and the chilled water system is specific identification of the use of proceeds of each respective series of debt at the time the debt is issued. This will reduce the potential for unnecessary controversy in future Citizens Thermal rate cases. The Commission finds this methodology, which has consistently been used in each rate case subsequent to Citizens Thermal's acquisition of the Steam Division, is reasonable and shall be employed in Petitioner's future rate cases.

**d. *Operations and Maintenance ("O&M") Expenses.***

**i. *Rate Case Expense.***

A. Evidence. In its case-in-chief, Petitioner proposed to amortize its estimated rate case expense of \$428,539 over three years, thus seeking to include \$142,846 in its annual revenue requirements. OUCC witness Eckert stated that Petitioner's rate case expense consists of three parts: OUCC/Commission fees, \$154,000; *pro forma* consulting costs, \$235,581; and 10% contingency fee, \$38,958. Mr. Eckert proposed a total rate case expense of \$220,000, amortized over two years, which would reflect to be the estimated life of Petitioner's rates, arriving at a total annual rate case amortization expense amount of \$110,000. Mr. Eckert explained that this amount is \$32,846 less than the amount requested by Petitioner.

Mr. Eckert further explained that Petitioner's estimate of OUCC/Commission fees consisted of three items: consultants for the OUCC, \$60,000; OUCC Staff and Attorneys, \$92,000; and Commission charges, \$2,000. Mr. Eckert explained that as of September 27, 2013, the OUCC had incurred approximately \$18,200 of expense related to this case. He recognized that there is a significant amount of time and effort to finalize the case and prepare for hearing, but still reduced Petitioner's estimated expense for OUCC consultants, staff and attorneys and Commission expense from \$154,000 to \$50,000. He added that a main component of this amount was estimated costs for a cost of service consultant. The OUCC did not retain a cost of service consultant for this case. Finally, Mr. Eckert also eliminated the 10% contingency fee component of rate case expense because this case does not appear to be very controversial at this time.

In rebuttal, Petitioner's witness Prentice disagreed with the proposed exclusion of \$66,000 in legal and consultant costs, and noted that Mr. Eckert did not describe the adjustments he made to Petitioner's estimated legal costs and its expenses for the cost-of-service ("COS")

consultant. Ms. Prentice stated that Mr. Eckert based his adjustments on the COS consultant invoiced amount as of August 31, 2013 and the legal invoices paid through July 2013. Ms. Prentice pointed out, however, that additional work will be necessary from the COS consultant, who at a minimum will need to finalize rates after a Final Order is issued. Ms. Prentice added that a great amount of work is yet to be performed with respect to legal costs, as the invoices paid through July would not have included any time spent reviewing testimony, rebuttal case preparation, evidentiary hearing preparation and litigation, post-hearing briefs, settlement discussions, etc., all of which will result in additional legal fees for Petitioner. Ms. Prentice, however, indicated that she can agree with Mr. Eckert's removal of Petitioner's estimated \$60,000 in OUCC consultant costs, as well as the proposed OUCC fee expense reduction of \$44,000, if the OUCC is willing to limit its billed charges to no more than \$48,000.

Ms. Prentice also disagreed with Mr. Eckert's proposed amortization of Petitioner's rate case expenses. Ms. Prentice explained that, leaving time for case preparation and litigation, she estimates an order in the next rate case will be issued early in 2017, approximately three years from when the rates from this proceeding are likely to be effective. Her opinion is that Petitioner's estimated three-year life of rates from this proceeding is appropriate.

After reducing the *pro forma* OUCC/Commission costs to \$50,000, eliminating the contingency, and amortizing over three years, Ms. Prentice proposed that the *pro forma* Rate Case Amortization Expense adjustment be \$59,231. Ms. Prentice added, however, that should the OUCC not be willing to limit its billed charges to no more than \$48,000, the proposed revenue requirement reflected in Petitioner's Exhibits LSP-R1 and LSP-R2 would need to be revised to reflect her original proposed amortized regulatory expense.

B. Discussion and Findings. Based on the evidence presented, we find Petitioner's rate case expense, amortized over three years, results in an adjustment of \$59,231 to test year rate case expense.

ii. *Payroll Expense.*

A. Evidence. OUCC witness Eckert testified that, based on Petitioner's responses to OUCC data requests, Citizens Thermal employee levels decreased by 6, SFS employees increased by 9, and CSS positions remained the same. Mr. Eckert testified that Petitioner indicated that three of the positions will not be replaced and three of the positions will be replaced in mid-October 2013. Mr. Eckert eliminated all six positions because three of them are not being replaced and the other three are to be replaced in October 2013. Mr. Eckert stated that the three positions to be replaced in October 2013 are outside the adjustment period. Mr. Eckert ultimately proposed to reduce Petitioner's *pro forma* payroll adjustment by \$326,913.

Sabine E. Karner, Director of Strategic Finance for CEG, agreed that costs associated with three of the positions should be removed from the revenue requirement because they were vacated after Petitioner filed its case-in-chief and these three positions will not be replaced. According to Ms. Karner, the remaining three positions, however, were filled by employees during the test year, simply happened to be vacated as of the point in time for which the OUCC requested a new employee count, and remain a necessary cost to Petitioner.

Ms. Karner characterized as faulty the OUCC's argument that the three positions intended to be replaced should be removed from operating expenses because the replacements may have fallen outside the *pro forma* adjustment period ending September 2013. Ms. Karner stated Petitioner must replace these positions according to business needs and schedules and cannot reasonably hurry the process in order to meet regulatory proceeding timelines. She added the three positions in question were filled by employees during the test year, which is fixed, known and measurable, and that these positions remain necessary for the operation of Citizens Thermal despite the fact that the positions were vacant as of July 31, 2013 and may not have been filled until after September 30, 2013.

According to Ms. Karner, subtracting from the case-in-chief *pro forma* count the three eliminated positions that were vacated after Petitioner filed its case-in-chief, and which will not be replaced, yields 71 positions, which she believes is reasonably representative of normal and ongoing costs. Ms. Karner recommended a *pro forma* decrease to payroll costs of \$135,329 compared to test year to account for the three eliminated positions.

B. Discussion and Findings. Petitioner and the OUCC agree that costs associated with three vacant positions, which will not be replaced, should be removed from Petitioner's revenue requirement. Petitioner and the OUCC disagree, however, as to whether the costs associated with three additional positions that were vacant at the time the OUCC conducted its review in this proceeding, but will be replaced, should be removed from Petitioner's operating expenses. The OUCC proposes to remove these additional positions on the basis that they were to be replaced outside the adjustment period.

The Commission agrees with the OUCC that expenses incurred after the 12 month adjustment period cannot be included in Petitioner's rates in this proceeding. However, the payroll expenses and benefits of the three positions that will be filled in the future were included in Petitioner's test year expenses, as employees occupied those positions during a portion of the test year. The question we must answer is whether sufficient evidence exists to make an adjustment to test year expenses based on the fact that those positions were vacant during the 12 month adjustment period. Although Petitioner did not fill the positions, the OUCC did not challenge Citizens Thermal's claim that those position are not necessary going forward. Accordingly, the Commission adopts Ms. Karner's adjustment of (\$135,329), which reflects the removal of the three positions that will not be filled, but includes the three positions that will be filled. We similarly adopt her adjustment of \$8,121 for payroll taxes and (\$402,164) for payroll benefits.

iii. *Miscellaneous Expenses.* Mr. Eckert proposed to eliminate \$6,000 in Christmas party expenses. Mr. Eckert also testified that Petitioner included an invoice from MJK DBA Brown Refractory twice in its books and records in the amount of \$10,120.90. Finally, Mr. Eckert stated that Petitioner booked 14 months of expense from Astbury Water when it should have booked only 12 months of expense. Ms. Karner agreed with Mr. Eckert's recommended removal of \$17,621 in miscellaneous expenses.

Based on Petitioner's and the OUCC's agreement, the Commission accepts the OUCC's proposed \$17,621 adjustment to Petitioner's revenue requirement for miscellaneous O&M expenses.

iv. CTA.

A. Evidence. Industrial Group witness Gorman testified that as a result of acquiring the water and wastewater systems of the City of Indianapolis, CEG has argued that all of its utilities will realize savings. Mr. Gorman stated that to achieve these acquisition savings, CSS incurred additional capital and O&M costs in the test year. Citing life-to-date numbers in CEG's semi-annual savings reports to the Commission, Mr. Gorman testified that CSS incurred \$4,097,000 of CTA in O&M expenses. Mr. Gorman alleged that these costs, along with realized savings associated with these costs, were reflected in the test year and allocated across all CSS utility companies including Petitioner.

Mr. Gorman testified that it is not appropriate to include the test year amount of cost to achieve in the CEG CSS allocations to the Steam Division in the *pro forma* period. Mr. Gorman testified that the test year costs associated with this merger integration should be reflected as a non-recurring test year CSS cost. Mr. Gorman stated that the CSS total test year CTA are approximately \$4,097,000, and that CEG's reallocation of total CSS cost is 8.26%, resulting in a *pro forma* adjustment to Petitioner of approximately \$338,000.

In rebuttal, Petitioner's witness Karner initially noted that Mr. Gorman recycled the same argument he made in Cause No. 44306. According to Ms. Karner, Mr. Gorman incorrectly makes an assumption that the O&M CTA shown on Petitioner's semi-annual savings report are included in Petitioner's proposed revenue requirement. Ms. Karner stated that this assumption is incorrect for multiple reasons. Ms. Karner noted first that Mr. Gorman incorrectly characterizes the CTA as having been incurred during the test year. Ms. Karner stated that the savings report for the period from October 1, 2011 to September 30, 2012 clearly indicates that the CTA is a life-to-date number. She testified that the vast majority of all CTA expense (\$3.4 million) was incurred prior to the test year. Second, Ms. Karner noted that Mr. Gorman jumps to the conclusion that all CTA were charged to CSS, which also is incorrect. Third, Ms. Karner stated that Petitioner already removed any residual CTA expenses in its case-in-chief.

Ms. Karner sponsored Petitioner's Exhibit SEK-R2, which is a high level summary of the more than 4,300 transactions pertaining to O&M CTA as reported on the second semi-annual savings report. She stated that Petitioner's Exhibit SEK-R2 reflects that there are no CTA included in Petitioner's proposed revenue requirement. Accordingly, Ms. Karner recommended the Commission reject Mr. Gorman's proposed removal of \$338,000 of O&M CTA from the revenue requirement, because there are no O&M CTA costs included in Petitioner's revenue requirement.

B. Discussion and Findings. We found in Cause No. 43306, for Citizens Water, the evidence showed that there were no costs to achieve included in Citizen Water's proposed revenue requirement. We reach the same conclusion here, based on Ms.

Karner's testimony that CTA expenses were not included. Based on the record evidence, the Commission rejects the Industrial Group's proposed *pro forma* adjustment.

v. *Corporate Cost Redistribution.*

A. Evidence. Industrial Group witness Gorman testified that, in Cause No. 43936, the parties stipulated that the wastewater utility would only receive a 10% allocation of CSS costs and that, as a result, when CEG determined the allocation of CSS costs for Petitioner's rate case, only 10% was allocated to CWA Authority, Inc.<sup>2</sup> Mr. Gorman testified that according to the normal allocation method, 19.83% of the CSS cost would have been allocated to CWA Authority, Inc., absent the stipulation. Mr. Gorman stated that Petitioner proposes to redistribute the additional 9.83% of CSS cost among the other regulated utilities and unregulated entities, resulting in an additional \$0.7 million of CSS cost being allocated to Petitioner.

Mr. Gorman disagreed with a portion of this redistribution of CSS cost. Mr. Gorman stated that the stipulation in the last rate case does not specifically address Petitioner's proposal to have the non-wastewater regulated utilities and unregulated entities absorb any CSS cost which would have been allocated to CWA Authority, Inc., absent the 10% limit. Mr. Gorman testified it is inappropriate to ask Petitioner's customers to subsidize CWA Authority, Inc.'s operations and, as a result, he recommends elimination of the \$0.7 million redistribution of CSS costs to Petitioner.

Mr. Gorman acknowledged that the Commission's Order in Cause No. 43936 refers to an exhibit prepared by Witness Brehm showing a redistribution of the excess wastewater allocation to the other CEG entities. However, he stated that exhibit reflects an allocation of 5.7% of CSS costs to Petitioner before the redistribution of any excess CWA Authority, Inc. CSS costs, which results in a total CSS allocation to Petitioner of 6.6% after the redistribution. In this case, the allocation of CSS costs has increased from what was proposed in Cause No. 43936 by approximately 1.66% to 8.26%. Mr. Gorman further testified that after the acquisition of the water and wastewater systems, SFS was established for the centralized operation and maintenance of various plant facilities. Mr. Gorman stated that Petitioner's allocation of these costs is 1.79% and that, therefore, in addition to the increased reallocation of 1.66% of CSS costs, plus a redistribution of approximately 1% of CWA Authority, Inc. CSS costs, Petitioner is absorbing additional shared costs through the SFS allocation.

Mr. Gorman finally noted that one of the other agreements in the stipulation addresses adherence to the Affiliate Guidelines and Cost Allocation Guidelines. Mr. Gorman stated that seeking to have the non-wastewater regulated utilities and unregulated entities absorb any CSS cost which would have been allocated to CWA Authority, Inc. using the normal allocation method does not comply with these guidelines.

In rebuttal, Petitioner's witness Karner testified that, at its core, Mr. Gorman's recommendation appears to be based on the notion that the CSS redistribution equates to an

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<sup>2</sup> CWA Authority, Inc. is the entity associated with CEG that provides wastewater service.

unauthorized subsidization of the wastewater utility operated by CWA Authority, Inc. Ms. Karner noted, however, that the CSS redistribution methodology was addressed and authorized in Cause No. 43936, and that it is simply false to assert otherwise. She noted that in Cause No. 43936, Petitioner's witness Brehm described both the reason behind the CSS redistribution and the methodology of accomplishing it at length in his case-in-chief testimony. Ms. Karner also noted that Mr. Brehm's testimony also included an exhibit demonstrating the methodology.

Ms. Karner also noted that other details about the CSS Redistribution methodology were provided to the Commission in Cause No. 43936. She explained that the Presiding Officers issued a docket entry requesting information about the details of the proposed redistribution methodology, and that CEG provided a simple example that clearly illustrated the approach. Ms. Karner also noted that the CEG docket entry response includes an illustration of the redistribution calculation. Ms. Karner stated that CEG provided ample evidence regarding the CSS redistribution, including the fact that the redistributed costs would necessarily need to be absorbed by CEG's other regulated and unregulated entities.

Ms. Karner concluded that: (i) the settling parties agreed to the proposed CSS redistribution methodology described by Mr. Brehm and in response to the Presiding Officers' docket entry; (ii) the OUCC reviewed and accepted the CSS redistribution methodology; and (iii) the Order in Cause No. 43936 addressed the fact that the redistributed CSS costs would be borne by other CEG entities.

Ms. Karner stated that the methodology of redistributing the CSS costs allocated to the Wastewater Utility in excess of 10% was specifically approved by the Commission in Cause No. 43936 after clear evidence was presented that the reallocation would result in increased allocations to all remaining CEG entities, including Citizens Thermal. Accordingly, Ms. Karner ultimately expressed her view that Mr. Gorman's recommendation for the disallowance of a portion of the CSS redistribution costs to the Petitioner should be rejected.

B. Discussion and Findings. The Commission approved the methodology to be applied to redistribute CSS costs allocated to CWA Authority, Inc. in excess of 10% in Cause No. 43936. Our Order in Cause No. 43936 provides:

Through the Settlement Agreement, the Settling Parties recommend that the Commission approve Citizens's proposal to allocate ten (10) percent of shared corporate support services ("CSS") costs to the Authority. [ ... ] Based upon the Settlement Agreement and the evidence presented, the Commission finds that Citizens's proposed methodology for allocating CSS costs among the affected utilities and non-utility affiliates should be approved. The agreed-upon methodology allows all customer stakeholders to benefit from the proposed transactions. *The Commission further finds that the proposed methodology and the corresponding percentage allocation of CSS costs should be used by all of the regulated Citizens utilities for ratemaking purposes in their next rate case.*

*Joint Petition of the Board of Directors, et al.*, Cause No. 43936, at 35-36 (IURC July 13, 2011) (Emphasis added.) Following the issuance of our Order in Cause No. 43936, this approach was

applied by CEG in Cause Nos. 44305 and 44306, which involved requests for rate relief by CWA Authority, Inc. and Citizens Water, respectively. We reviewed and accepted the proposed CSS Redistribution methodology in both Causes.

To the extent that the Industrial Group is attempting to argue that the approved CSS Redistribution methodology is somehow unreasonable as applied to Petitioner in this proceeding, we find no reason for deviating from the part of our Order in Cause No. 43936 which requires that “the proposed methodology and the corresponding percentage allocation of CSS costs should be used by all of the regulated Citizens utilities for ratemaking purposes in their next rate case.” *Id.* at 36. Industrial Group’s proposal would cause Petitioner to under-recover costs allocated to it in accordance with the terms of our Order in Cause No. 43936. The Commission accordingly rejects the Industrial Group’s proposal to disallow CSS Redistribution costs to the Petitioner.

*vi. Other Payroll Expenses.* In our Order in Cause No. 44306, we found that the level of incentive compensation paid to CEG executives was an inappropriate expense for a municipal utility to charge its ratepayers. Petitioner’s *pro forma* payroll includes allocated short term incentive pay (“STIP”) paid to CEG executives and non-executives, as well as allocated executive incentive pay (“EIP”) paid exclusively to CEG executives.

In Cause No. 44306, we found that executive level STIP compensation should be based on the same percentage as non-executive employees. Here, using Petitioner’s workpaper 302S1, the percentage of STIP compensation for non-executive employees was calculated to be 8.39%. Based on Petitioner’s workpaper 302S1, line 812, the percentage of STIP paid to executives and non-executives can be calculated by dividing the total STIP payout (\$5,988,162) by the total base compensation for all CEG employees (\$48,565,142). This results in a percentage of 12.33%. Petitioner proposed an adjustment of (\$177,502) to reduce *pro forma* STIP allocated to Petitioner to \$665,047. Thus, the appropriate *pro forma* STIP should be approximately 68.01% (i.e., 8.39/12.33) of the proposed STIP amount of \$665,047. Accordingly, we find that an additional salary expense adjustment of (\$212,513) is appropriate.

Similarly, the pushdown of EIP allocated to Petitioner would result in the allocation of excessive executive compensation to the municipal utility. Petitioner proposed an adjustment of (\$57,683) to reduce *pro forma* EIP to \$140,888. Removing EIP from labor expense creates an additional adjustment of (\$140,888) for the Steam Division.

*e. Depreciation.* Petitioner’s witness Karner sponsored Exhibit SEK-2 setting forth certain *pro forma* adjustments to depreciation expense relating to asset retirements and capital projects that are reasonably certain to be in service during the *pro forma* adjustment period. Ms. Karner stated that the Steam Division and CSS are using group depreciation rates that vary by asset class. The overall effective depreciation rate for the test year, calculated as depreciation expense divided by depreciable plant, was approximately 3.9% for the Steam Division and 19.1% for CSS.

No party proposed any adjustments to Petitioner’s *pro forma* depreciation expense.<sup>3</sup> The Commission, therefore, finds that Petitioner’s *pro forma* depreciation expense is \$4,561,570. Since Petitioner did not seek recovery of depreciation expense, this amount is not included in Petitioner’s revenue requirements.

**8. Discussion and Findings Regarding Aggregate Annual Revenue Requirements.**

Based upon the above discussion and findings, the Commission concludes that Petitioner’s total aggregate annual cash revenue requirement is \$73,860,639, as detailed below:

Fuel Costs	\$32,466,486
Debt Service Requirement	\$9,847,357
Extensions and Replacements	\$3,888,950
Operations and Maintenance Expense	\$26,718,876
Taxes	<u>\$939,562</u>
Total Revenue Requirement	\$73,861,231
Less: Other Income	\$592
<b>Net Revenue Requirement</b>	<b>\$73,860,639</b>
Less: <i>Pro forma</i> Present Rate Revenue	<u>\$66,378,967</u>
Deficit	\$7,481,672
Plus: Incremental Indiana Utility Receipts Tax	\$106,231
<b>Revenue Increase Required</b>	<b>\$7,587,903</b>
Percentage Increase Required	11.43%

We find that Petitioner’s current rates and charges, which produce annual operating revenue of \$66,378,967 are insufficient to provide for Petitioner’s aggregate annual cash revenue requirement and, therefore, are unjust and unreasonable. Petitioner’s rates and charges for steam service need to be increased by \$7,587,903, which includes revenues associated with increased Indiana Utility Receipts Tax, in order to meet its aggregate annual cash revenue requirement.

**9. Cost of Service and Rate Design.**

a. **Evidence.** Kerry A. Heid, P.E., sponsored a cost of service study (“COSS”) based on Petitioner’s cost of providing steam service for the twelve months ended September 30, 2012. Mr. Heid stated that working with Petitioner’s management and staff, he prepared an embedded COSS based on Petitioner’s accounting costs per books, adjusted for

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<sup>3</sup> The Industrial Group’s Exhibit MPG-1 reflected only Petitioner’s test year amount of depreciation. However, Industrial Group witness Gorman did not contest the *pro forma* adjustments Ms. Karner made to account for asset retirements and additions.

known and measurable changes to test year operating results, for the test year. The COSS corresponds to the *pro forma* financial information included in the exhibits of Petitioner's witness, LaTona S. Prentice. Mr. Heid's objective in performing the cost of service study was to determine the rate of return on rate base that Petitioner earns from each customer class, which provides an indication as to whether its rates reflect the cost of providing service to each customer class.

Mr. Heid stated that the COSS contains two parts. First, the investment required to serve each rate schedule was determined. This was done by allocating total utility rate base at September 30, 2012 among the customer rate classes based on various assignment and allocation methods. Second the operating expenses incurred in providing service to each customer rate class was determined by allocating the *pro forma* costs of providing steam service among the customer rate classes based on various assignment and allocation methods. Cost data was taken from detailed property accounting information and various sources, including Petitioner's books and records.

Mr. Heid sponsored Exhibit KAH-2 Schedules 1-15, which presents the COSS and rate design he prepared in this proceeding based on the revenue requirement. Mr. Heid stated that his COSS is the foundation for determining the revenue allocations being proposed. The COSS was structured to provide revenue and operating income amounts and associated taxes to compute the rate of return on rate base for each rate schedule at both present and proposed rates. Mr. Heid stated that Exhibit KAH-2, Schedule 8 – Statement of Operating Income shows the current class rates of return compared to current overall system rate of return. It shows that Rate 1 is providing a subsidy to at least some of the remaining rate classes.

Mr. Heid explained the objective in the revenue allocation process is to reduce interclass subsidies while mitigating rate shock. To measure the movement in the subsidy levels, Mr. Heid considered two measures. First, Mr. Heid considered the dollar subsidy, determined as the difference in rate class revenues at equal rates of return compared to results at actual and proposed rates of return. Second, Mr. Heid considered the relative movement in the Earnings Indices toward equal rates of return, represented by an Earnings Index of 100%. Earnings Indices move toward the target Earnings Index of 100% in each rate class, representing a movement toward equal rates of return.

In this case, the Rate 3 customer class showed the need for a rate decrease, which was deemed undesirable from a rate stability objective. Therefore, the Rate 3 subsidy reduction percentage was adjusted slightly in order to produce a 0% increase in Rate 3 rates. The Rate 1 and Rate 2 proposed subsidy reductions were established to create a reasonable rate increase that is commensurate with the level of present subsidies and the desired movement in the elimination of subsidies. Mr. Heid stated that the Energy Charge for Rate 4 was increased consistent with the Eli Lilly Contract Steam Service.

Petitioner's Substitute Exhibit KAH-2, Schedule 14, contains the Calculation of Revenues at Present and Proposed Rates. This schedule summarizes the present and proposed rates and change in rates for each rate component, as well as contract customers. This schedule also provides a revenue proof demonstrating they generate the appropriate level of revenues.

OUCC witness Eckert testified that the OUCC reviewed Petitioner's COSS and did not make any adjustments. Neither the OUCC nor Industrial Group recommended changes to Petitioner's COSS.

**b. *Discussion and Findings.*** Petitioner conducted a COSS, which presented an accurate and equitable allocation of costs to Petitioner's customers based on the COS to those customers. No party objected to the methodology used to prepare Petitioner's COSS.

Petitioner's proposed rate design moves toward equal rates of return by class and thereby reduces cross subsidies. However, Petitioner concluded that an approximately 20% reduction in subsidies should be proposed in order to produce reasonable percentage increases to each schedule. However, the Rate 3 customer class showed the need for a rate decrease under the proposed subsidy reduction percentage. In order to promote rate stability, the subsidy reduction percentage was reduced to 19.24% reflecting a zero percent increase in Rate 3 rates.

The Commission often has been faced with the competing goals of cost-based rates and the minimization of excessive rate impact or "rate shock." *See Ohio Valley Gas Corp.*, Cause No. 40049, 1995 WL 809937, at \*9 (IURC Nov. 9, 1995). While we agree that utility rates should accurately reflect the cost of providing service to each customer class, we have frequently required a gradual movement toward such cost-based rates in order to strike a balance between the long-term benefit of cost-based rates and the short-term detriment of rate shock. *Id.*, citing *Southern Ind. Gas & Elec. Co.*, Cause No. 39871, at 58-61 (IURC June 21, 1995).

Consistent with this long-established Commission policy, Petitioner's proposed rate design reduces interclass subsidies to the extent practical, while mitigating rate shock. We find that Petitioner's proposed COSS and rate design are reasonable and should be approved.

#### **10. Acquisition Savings.**

**a. *Evidence.*** Petitioner's witness Aaron D. Johnson testified that in Cause No. 43936, CEG, with the assistance of Booz & Company, conducted an analysis to identify the synergies and associated cost savings that could be realized by transferring the operations of the water and wastewater utilities to combine the water, wastewater, gas, and steam utilities serving Indianapolis, and such analysis resulted in an estimated \$60 million of annual savings. Mr. Johnson stated that CEG has tracked the savings achieved and reported such findings in its "Semi-Annual Reports Regarding Savings and Other Matters." Mr. Johnson explained the methodologies used to determine the amount of O&M savings and capital expenditure ("Capex") savings.

Mr. Johnson stated that the acquisitions resulted in net first year savings through September 30, 2012 of approximately \$111.9 million and projected net second year savings of \$37.9 million. Mr. Johnson summarized the drivers behind some of the savings achieved by CEG. Mr. Johnson explained that attrition or the reduction in the total full time equivalent employee count by 191 as of September 30, 2012, resulted from individuals who were actively employed within CEG or CWA Authority, Inc. not being offered employment and naturally occurring attrition that is typical of any large scale reorganization. In addition, O&M savings

resulted from the elimination of duplicative general and administrative costs, such as back office functions, redundant positions, consolidation of telephone systems, information technology networks and data centers, and corporate shared services. Mr. Johnson noted that savings of approximately \$46.2 million of retiree health care expenses and \$3.4 million related to pension expenses resulted after most active employees retained by CEG were offered a benefit structure similar to that offered by CEG prior to the acquisition.

Mr. Johnson noted that these savings have lowered the revenue requirement that would otherwise be necessary. Mr. Johnson noted that many of the O&M expense savings cannot be attributed to specific lines of business since a functional operating model is used, but these savings are manifested in the form of reduced cost allocations from the common expense areas such as CSS.

Neither the OUCC nor Industrial Group provided any testimony in this proceeding relating to acquisition savings.

**b. *Discussion and Findings.*** Section 8-c of the Settlement Agreement in Cause No. 43936 provides: “In the first two (2) rate cases filed subsequent to the Closing by the Authority [i.e., CWA Authority] and each of Citizens’ regulated utilities, the Authority or Citizens, as applicable, will present testimony describing the savings achieved from the proposed transactions and how such savings have affected the proposed rate increase. Citizens shall continue to report such savings in future rate cases for all regulated entities until a steady state of annual savings has been achieved.”

No party provided any evidence with respect to Petitioner’s testimony regarding the savings achieved from the acquisitions approved in Cause No. 43936. Moreover, we note that in Cause No. 44305, which involved Citizens Water’s request for rate relief, CEG has agreed to further collaborate with the OUCC in a meeting or meetings to discuss the presentation of testimony to be included describing savings achieved from the acquisitions and how such savings have affected the proposed rate increase pursuant to Section 8-c of the Settlement Agreement approved in Cause No. 43936. Accordingly, we decline to make any further findings relating to the presentation of such evidence in this proceeding.

## **11. Miscellaneous Issues.**

**a. *FAC Issues.*** The OUCC requested that it continue to be allowed to file its testimony in Petitioner’s FAC proceedings 30 days after Petitioner files its testimony as ordered in Cause No. 43201. The OUCC also requested that if Petitioner must update its filing that it continue to file a clean version and a redline version and that Petitioner should continue to perform its FAC earnings test in the same manner as it does right now.

Petitioner did not object to the foregoing recommendations, which comport with our findings in Cause No. 43201. Accordingly, we find that the OUCC’s recommendations regarding Petitioner’s FAC proceedings should be approved.

**b. *Long Term Planning and Reporting.***

i. *Evidence.* OUCC witness Eckert recommended that Petitioner continue to produce and provide biennially (i.e., once every two years, in April) to the OUCC, the Industrial Group and Commission, a work plan highlighting and describing its production planning process per the Settlement Agreement in Cause No. 43201. Mr. Eckert stated that this informal process is less burdensome than a formal Integrated Resource Plan (“IRP”). Mr. Eckert stated that the OUCC also believes Petitioner should continue to report on an annual basis its environmental compliance efforts as described in paragraph II (e) of the Settlement Agreement approved in Cause No. 43201. Finally, Mr. Eckert recommended that Petitioner should report any new financing that it incurs and how that financing is split between its other operating divisions (i.e., Steam Division, Chilled Water Division, Citizens Water, etc.).

Petitioner’s witness Kilpatrick testified that the OUCC’s recommendation that Petitioner report any new financing it incurs in its biennial production planning report is unnecessary and therefore, should be rejected. Mr. Kilpatrick noted that the OUCC did not identify any need to support its recommendation. Given this lack of a stated rationale, Mr. Kilpatrick concluded that the OUCC’s recommendation would equate to a reporting requirement for the sake of reporting. Mr. Kilpatrick noted that information about CEG’s debt issuances is available in a variety of existing sources, including: (i) each of Petitioner’s rate cases and those of other regulated utilities of CEG; and (ii) CEG’s annual report.

ii. *Discussion and Findings.* Petitioner did not object to the OUCC’s proposal that it continue to: (i) provide biennially (i.e., once every two years, in April) to the OUCC, the Industrial Group and Commission, a work plan highlighting and describing its production planning process per the Settlement Agreement in Cause No. 43201; and (ii) report on an annual basis its environmental compliance efforts as described in paragraph II (e) of the Settlement Agreement approved in Cause No. 43201. Accordingly, we find that Petitioner should continue providing those reports it agreed to provide in Cause No. 43201.

With respect to the additional reporting requested by the OUCC, we do not find such reporting would provide any substantial burden on Petitioner, and given that the Commission does not preapprove Petitioner’s financing request, we find more timely reporting reasonable. Accordingly, Petitioner shall report its new debt issuances within 30 days of closing.

**c. *Debt Service True-Up.***

i. *Evidence.* Petitioner’s witness Korlon L. Kilpatrick II testified that following receipt of an Order in this rate case, Petitioner will make a true-up filing with the Commission within 30 days of closing on the long-term debt financing to reflect the actual principal amount of the bonds, the interest rate of the 2015 debt, the financing term, the actual average annual debt service requirements and the actual impact on Petitioner’s metered rates. Mr. Kilpatrick stated that if the actual impact on Petitioner’s metered rates is materially different than the increase approved by the Commission in this Cause, Petitioner will file amended schedules of rates and charges within 15 days of filing the true-up report.

OUCC witness Eckert recommended that within 30 days of closing on any long term debt

issuance, Petitioner file a report with the Commission and serve a copy on the OUCC, explaining the terms and purpose of the new loan, including the amount of debt service reserve. Mr. Eckert stated that because the precise interest rate and annual debt service will not be known until the debt is issued, Petitioner's rates should be true-up to reflect the actual cost of the debt. Petitioner's report should include a revised rate schedule and tariff.

In rebuttal, Mr. Kilpatrick testified that Petitioner agrees a true-up report is necessary to advise the Commission and the parties of the actual cost of debt, which will not be known until the put rate bonds are converted to a fixed interest rate. Mr. Kilpatrick stated that Petitioner further agreed with Mr. Eckert's recommendation to include revised rate schedules with the true-up report. This should streamline the process and allow revised rates, if necessary, to become effective more quickly.

ii. *Discussion and Findings.* The actual cost of Petitioner's proposed debt service will not be known precisely until after Petitioner issues its proposed bond issuances. Accordingly, within 30 days of closing on its proposed bonds, Petitioner shall file a true-up report with the Commission under this Cause, with service to all parties to this Cause. Each true-up report shall provide the following information: the actual principal amount borrowed, the interest rate, the term of the bonds, the actual average annual debt service requirements, the actual average annual debt service reserve requirement, the impact that any difference would have on Petitioner's rates and charges, and revised tariff sheets reflecting the impact.

After the true-up report is filed, any party may file an objection to the true-up report within 15 days. If no objections are filed, the new rates will go into effect upon approval by the Electricity Division. If an objection is filed, Petitioner shall have 10 days to respond, and the Presiding Officers shall issue a Docket Entry resolving the issue, or establishing additional proceedings if necessary.

d. *Perry K Conversion and OPERA Mechanism.* Petitioner's witness Korlon L. Kilpatrick II described the OPERA mechanism approved in Cause No. 44149. Mr. Kilpatrick stated that the OPERA mechanism is a tracker mechanism designed to track operating and maintenance cost savings realized as a result of the conversion of boilers at the Perry K plant to natural gas. Petitioner proposed that the OPERA baseline be established at \$13,996,677. Mr. Kilpatrick stated that this figure is comprised of \$4,258,220 in Other Cost of Goods Sold, and \$9,738,457 in O&M expenses. This baseline would represent a full 12 months of operating expenses by which future operating expenses will be compared.

OUCC witness Eckert testified that the Perry K conversion will create O&M expense savings for Petitioner. Mr. Eckert stated that some of the savings will occur in the short-term while the majority of the cost savings will occur in the 2nd and 3rd quarter of 2014. Mr. Eckert stated that Petitioner intends the OPERA mechanism track only net savings related to the conversion. The OPERA mechanism will not track net increases and should equal zero or be a credit. Mr. Eckert stated that this proceeding establishes the baseline for the OPERA mechanism. Mr. Eckert noted that Petitioner anticipates fuel prices, recovered through the FAC, will increase after the conversion. However, Mr. Eckert stated that the OPERA mechanism will help offset this increase in steam expense by tracking O&M cost savings.

Based on the evidence of record, the Commission finds that Petitioner's OPERA baseline should be established at \$13,996,677. This figure is comprised of \$4,258,220 in Other Cost of Goods Sold, and \$9,738,457 in O&M expenses.

**12. Terms and Conditions for Service.**

**a. *Evidence.*** Petitioner's witness Kilpatrick sponsored Petitioner's Exhibits KLK-1 and KLK-2 setting forth proposed changes to Petitioner's Terms and Conditions for Steam Service. Mr. Kilpatrick stated that the changes to Petitioner's Terms and Conditions for Steam Service generally included: (i) changes to the language in Rule 12.4 regarding meter testing to reflect an adjustment period not to exceed 12 months instead of six; and (ii) miscellaneous clean-up items. Mr. Kilpatrick stated that the modification to Rule 12.4 brings it in line with 170 IAC 4-1-14(A)(2).

No party objected to Petitioner's proposed changes to its Terms and Conditions for Steam Service. However, Industrial Group witness Gorman recommended the Commission should require Citizens Thermal to establish objective, equitable, criteria to be used in making decisions with respect to when the company can demand a deposit, when it must return a deposit, and how a customer can demonstrate that it is creditworthy and that no deposit is needed. Mr. Gorman stated that this should be easy to do as Citizens Water and the CWA Authority, Inc. already have in place provisions within their rules/terms and conditions for service that establish such criteria, and will help to provide a uniformity across Citizens' regulated utilities.

In rebuttal, Petitioner's witness Kilpatrick stated that CEG also desires greater consistency, where possible, across the terms and conditions for service of its multiple utilities. Accordingly, Mr. Kilpatrick stated that Petitioner proposes to change its deposit rules, to be consistent with the non-residential customer deposit rules in the Terms and Conditions of Citizens Water and CWA Authority, Inc. Mr. Kilpatrick stated that these rules were thoroughly vetted by representatives of both the OUCC and Industrial Group. The same rules were ultimately agreed upon in a Settlement Agreement entered into among Citizens Water, CWA Authority, Inc., the OUCC and Industrial Group and subsequently approved by the Commission in Cause No. 44163. Mr. Kilpatrick sponsored Petitioner's Exhibits KLK-R1 and KLK-R2, which were red-line and clean versions of Petitioner's Terms and Conditions for Steam Service reflecting this modification.

**b. *Discussion and Findings.*** The Commission finds that the changes proposed by Petitioner to its Terms and Conditions for Steam Service set forth in Petitioner's Exhibit KLK-R1 and KLK-R2 are nondiscriminatory, reasonable and just. The changes to Petitioner's deposit rules will make the rules consistent with the non-residential customer deposit rules of Citizens Gas, Citizens Water and CWA Authority, Inc. In addition to having been agreed upon by the OUCC and Industrial Group in Cause No. 44163, the modified deposit rules strike an appropriate balance between protecting the integrity of the system while protecting the interest of customers. For the foregoing reasons, we find the changes proposed by Petitioner to its Terms and Conditions of Steam Service, which were filed in this Cause as Petitioner's Exhibits KLK-R1 and KLK-R2, are approved.

its Terms and Conditions of Steam Service, which were filed in this Cause as Petitioner's Exhibits KLK-R1 and KLK-R2, are approved.

**13. Confidentiality.** Both Petitioner and the Industrial Group filed motions seeking protective orders, which were supported by accompanying affidavits, showing certain workpapers and exhibits to be submitted to the Commission contained confidential, proprietary and trade secret information of a third-party within the scope of Ind. Code §§ 5-14-3-4(a)(4) and (9) and Ind. Code § 24-2-3-2. The Presiding Officers issued Docket Entries making preliminary findings of confidentiality after which Petitioner and the Industrial Group submitted the information to the Commission under seal. We find that all information submitted under seal by Petitioner and the Industrial Group is confidential pursuant to Ind. Code § 5-14-3-4 and Ind. Code § 24-2-3-2, and shall continue to be exempt from public access and disclosure by the Commission.

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

1. Petitioner is hereby authorized to immediately increase its rates and charges for steam service so as to produce total annual operating revenues of \$73,860,639, representing an approximate \$7,587,903 increase in annual operating revenues.

2. Petitioner's proposed changes to its terms and conditions for steam service, as set forth in Petitioner's Exhibits KLK-R1 and KLK-R2, are hereby approved and Petitioner is authorized to implement its revised terms and conditions for steam service after filing the same with the Commission as set forth in paragraph 4 below.

3. Petitioner's OPERA baseline should be established at \$13,996,677.

4. Petitioner shall file with the Electricity Division of this Commission, prior to placing into effect the rates and charges and terms and conditions for steam service authorized herein, tariff schedules set out in accordance with the Commission's rules for filing utility tariffs. Said tariffs, when filed by Petitioner, shall cancel all present and prior rates and charges concurrently when said rates and charges herein approved are placed into effect by Petitioner.

5. The methodology employed by Petitioner for apportioning the debt and related debt service between Petitioner's Steam Division and the Chilled Water Division, which is specific identification of the use of proceeds of each respective series of debt at the time the debt is issued, is approved and shall be employed in each of Petitioner's future rate cases.

6. Petitioner shall pay the following itemized charges within twenty (20) days of the date of this Order to the Secretary of this Commission:

Commission charges:	\$ 5,101.50
OUCC charges:	\$ 25,178.41
Legal Advertising charges:	\$ <u>109.12</u>
Total:	\$ 30,389.03

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

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

**MAYS, WEBER, AND ZIEGNER CONCUR; STEPHAN ABSENT:**

**APPROVED: MAY 21 2014**

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

A handwritten signature in cursive script that reads "Brenda A. Howe". The signature is written in black ink and is positioned above a solid horizontal line.

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