

ORIGINAL

[Handwritten initials]
[Handwritten initials]
[Handwritten initials]

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

IN THE MATTER OF THE PETITION OF) CAUSE NO. 44352 U
PLEASANTVIEW UTILITIES, INC. FOR A)
NEW SCHEDULE OF RATES AND) APPROVED: MAR 12 2014
CHARGES.)

ORDER OF THE COMMISSION

Presiding Officers:
David E. Ziegner, Commissioner
Gregory R. Ellis, Administrative Law Judge

On June 13, 2013, Pleasantview Utilities, Inc., (“Petitioner“ or “Pleasantview“) filed its Small Utility Rate Application for a change in rates and charges (“Application“) with the Indiana Utility Regulatory Commission (“Commission“) pursuant to the provisions of Ind. Code § 8-1-2-61.5 and 170 IAC 14-1. Pleasantview is seeking an increase of 51.04% or \$32,039 above its current water rates. On July 3, 2013, the Commission’s Water and Sewer Division issued a Memorandum stating that Pleasantview’s application was incomplete. On July 8, 2013, Pleasantview filed additional information in support of the application, including proofs of the notice it had published describing the filing of its Application as required by 170 IAC 14-1-2(b). On July 10, 2013, the Commission determined that the Application was complete.

Pursuant to Ind. Code § 8-1-2-61.5, a formal public hearing is not required in rate cases involving small utilities with fewer than 5,000 customers, unless a hearing is requested by at least ten customers, a public or municipal corporation, or by the Indiana Office of Utility Consumer Counselor (“OUCC“). On August 29, 2013, the OUCC filed a request for a public field hearing in response to a communication it received from 23 customers of Pleasantview. The Commission granted the request on September 11, 2013. Pursuant to notice duly published as required by law, proof of which was incorporated into the record by reference and placed in the official files of the Commission, a public field hearing was held in this Cause on September 25, 2013 at 6:00 P.M., in the Connersville City Hall Council Chambers, 500 N. Central Avenue, Connersville, Indiana. Approximately 14 people out of a customer base of 194 connections attended the field hearing.

On October 7, 2013, the OUCC filed its report (“Report“) with the Commission as required by 170 IAC 14-1-4(a). The Report detailed its review of the Application and made several recommendations to the Commission concerning the relief requested by Pleasantview. On November 25, 2013, Pleasantview filed its response to the OUCC’s Report pursuant to 170 IAC 14-1-4(c). On February 26, 2014, Pleasantview responded to questions asked by the Presiding Officers in a docket entry dated February 18, 2014.

Based upon the applicable law and the evidence presented herein, the Commission now finds as follows:

1. **Commission Jurisdiction and Notice.** Petitioner is a public utility as defined in Ind. Code § 8-1-2-1(a). The evidence presented by Pleasantview in this Cause establishes that legal notice of the filing of the Application was published in accordance with applicable law and that Pleasantview gave proper notice of the nature and extent of the relief it is seeking to its customers. The Commission thus finds that due, legal, and timely notice of this matter was given and published as required by law. Further, the Commission finds Pleasantview is an Indiana public utility, provides water service to fewer than 5,000 retail customers and does not extensively serve another utility. The Application satisfies all of the requirements of Ind. Code § 8-1-2-61.5 and 170 IAC 14-1 for treatment as a small utility. Therefore, the Commission has jurisdiction over the Petitioner and subject matter of this case.

2. **Petitioner's Characteristics.** Petitioner is an investor-owned public utility that provides water utility service to approximately 194 customers in Fayette County, Indiana. Pleasantview is an S corporation whose common stock is owned in its entirety by Mr. Matthew Sherck. Mr. Sherck also serves as President of the utility. Petitioner purchases all of its water from the City of Connersville, Indiana via 4-inch connection at the edge of the Pleasantview subdivision. Petitioner's water system consists of approximately 13,400 feet of transmission PVC main and 11,000 feet of distribution PVC main.

3. **Existing Rates and Relief Requested.** Pleasantview's existing rates and charges were established in the Commission's April 12, 2000 Order in Cause 41591 U. Pleasantview is requesting an across-the-board increase of 51.04% in its rates and charges. The proposed increase would generate an additional \$32,039 in annual revenues.

4. **Test Period.** The test period selected for determining Pleasantview's revenues and expenses reasonably incurred in providing water utility service to its customers includes the twelve (12) months ending December 31, 2012. With adjustments for changes that are fixed, known and measurable, the Commission finds that this test period is sufficiently representative of Pleasantview's normal operations to provide reliable data for ratemaking purposes.

5. **Application.** In its application, Pleasantview indicated the proposed rate increase is to be used principally to pay for water rate increases from the City of Connersville that went into effect on July 1, 2013. The City of Connersville increased the flow rate from \$4.72 to \$5.07 per 1,000 gallons. Pleasantview indicated in the Application that it has experienced net income losses in the past years.

A. **Revenue Adjustments.** Pleasantview has no proposed revenue adjustments in the Application.

B. **Expense Adjustments.** Pleasantview proposed the following *pro forma* adjustments to test year expenses:

- i. **Salaries and Wage Expense:** An increase of \$13,950, which includes a proposed annual salary of \$12,000 for the President and an allowance of \$1,950 for 130 hours of work by a part-time billing clerk.

- ii. Purchased Water Expense: An increase of \$6,212.
- iii. Insurance Expense: An increase in insurance premiums of \$202.
- iv. Rate Case Expense: An increase of \$500 per year, which reflects a total rate case expense of \$2,500 over five years.
- v. Depreciation Expense: An increase of \$414, based on utility plant in service of \$24,341 and a 1.70% composite depreciation rate.
- vi. Payroll Taxes: An increase of \$1,067 to reflect increases in Salaries and Wage expense.
- vii. Property Taxes: A decrease of \$718.
- viii. IURC Fee: Increases of \$11 and \$39 to reflect *pro forma* present and proposed adjustments.
- ix. IDEM Penalty: A decrease of \$600 to remove penalty imposed by the Indiana Department of Environmental Management.
- x. Non-recurring Expense: A decrease of \$625 to remove non-recurring construction fee permit.
- xi. Utility Receipts Tax: Increases of \$77 and \$449 to reflect *pro forma* present and proposed adjustments.

C. Rate Base. Pleasantview's Application shows an original cost rate base of \$2,816 using utility plant in service of \$24,341 and accumulated depreciation of \$24,341. Pleasantview also proposes a 100% common equity capital structure, with a cost of equity rate of 12.00%.

6. OUCR Report. The OUCR filed its Report, which was prepared by Richard Corey, Harold Rees and Edward Kaufman. The Report recommended several adjustments to Petitioner's revenue and expense calculations. The OUCR Report recommended the Commission grant Petitioner an increase in rates of 1.58% or \$1,109.

A. Revenue Adjustments. The OUCR proposed the following adjustments to *pro forma* test year revenues:

- i. Tracker Revenue: An increase of \$2,556, which reflects an additional tracking factor of \$0.28 per 1,000 gallons approved by the Commission on August 14, 2013.

- ii. Accrued Water Revenue: An increase of \$2,078 to reflect billed, but uncollected water revenue.
- iii. Accrued Penalty Revenue: During the test year Pleasantview billed \$3,112 in penalties for both water and wastewater services. The OUCC's calculations added 53% of the \$3,112 total penalty revenues, or \$1,641 to *pro forma* present water revenues.
- iv. Revenue Normalization: An increase of \$1,143 for rate revenues to normalize residential growth within the test year.

B. Expense Adjustments. The Report indicated that Pleasantview proposed several operation and maintenance expense adjustments yielding *pro forma* operating and maintenance expense of \$91,509. The OUCC accepted Pleasantview's proposed adjustments to insurance expense, rate case expense, disallowed expense, non-recurring item, depreciation expense and property tax. However, the OUCC disagreed with Pleasantview's remaining proposed adjustments, including: wages and salaries, the Public Utility Fees under Ind. Code ch. 8-1-6 ("IURC Fee"), postage expense and bad debt expense. The OUCC also proposed an adjustment to purchased water to reflect its extensive lost water problem. The following adjustments proposed by the OUCC yield *pro forma* operating and maintenance expense of \$69,468:

- i. Salary and Wage Expense: An increase of \$1,950 for billing services of 130 hours per year at \$15 an hour. The Report also stated a proposed \$12,000 annual salary for Pleasantview's President has not been justified and the OUCC recommended disallowing the \$12,000 salary.
- ii. Lost Water Adjustment to Purchased Water Expense: A decrease of \$11,129 to adjust purchased water to reflect a 20% water loss. The Report indicated that Pleasantview had a lost water rate of 32.9% for the test year, but Pleasantview has not taken steps to address its historical water loss problem.
- iii. IURC Fee Expense: An increase of \$28 to reflect IURC fee rate of .001329888% for fiscal year 2013-2014.
- iv. Postage Expense: An increase of \$17 reflects the OUCC's Revenue Normalization Adjustment.
- v. Bad Debt Expense: An increase of \$1,053 reflects an estimated bad debt of 1.5%.
- vi. Payroll Taxes: An increase of \$149 based on the OUCC's proposed salary and wage expense of \$1,950.

- vii. Utility Receipts Tax: An increase of \$181 based on the OUCC's water revenue adjustments discussed above.

C. Rate Base. The OUCC Report noted that Pleasantview's Application reflected utility plant in service of \$24,341 and accumulated depreciation of \$24,341 for net utility plant in service of \$0, which the OUCC agreed with. Pleasantview proposed an annual working capital revenue requirement of \$2,816. However, the OUCC proposed working capital of \$1,452 based on the changes to operating expenses discussed above.

The OUCC Report indicated Pleasantview proposed a cost of equity and weighted cost of capital of 12.00% because Pleasantview uses a capital structure that is 100% equity. The OUCC noted that Pleasantview did not provide a study to support its proposed cost of equity, but agreed with Pleasantview's decision not to incur the expense necessary to perform such a study. The OUCC does not oppose Petitioner's proposed cost of equity of 12.00%.

Taking into account Pleasantview's customer deposits, the OUCC proposed a capital structure of 53.73% equity and 46.27% debt. The OUCC also proposed a weighted cost of capital of 9.23%.

D. Lost Water. The OUCC indicated Pleasantview has had a serious water loss problem since 2001 as exhibited in Pleasantview's Annual Reports filed with the Commission. The OUCC believes there are at least three potential reasons for Pleasantview's lost water: possible error in the Connersville's source meter, aging customer meters causing low readings, or leakage in Pleasantview's water system.

The Report noted that Connersville hired M.E. Simpson Company to perform a full test on its source meter in the last few years to verify its accuracy. The OUCC made a recommendation that Pleasantview discuss with the City of Connersville the possibility of testing the source meter again.

The Report indicated Pleasantview has installed 40 newer Neptune water meters in recent years. The majority of Pleasantview's customers have older Rockwell units installed in meter pits located in the front yards of homes, some of which may have been in service for 30 years. The OUCC noted these units are known to run slower over time causing inaccurate readings. The OUCC recommended Pleasantview install 80 new Neptune units in the coming year at a cost of about \$70 each for a total of \$5,600. The following year the utility could install Neptune units at the remaining locations with approximately the same amount of investment, thereby eliminating the older obsolete water meters. The OUCC also recommended Pleasantview develop a plan for an analysis of its entire distribution system to check for leakage.

7. Pleasantview's Response. Petitioner filed a response to the OUCC's Report on November 25, 2013. The response disagreed with two items in the Report: adjustment to salary and wage expense and the lost water adjustment.

A. Salary and Wage Expense. Pleasantview stated the OUCC does not provide any rationale for denying Pleasantview's proposed salary of \$12,000 for its President,

other than Pleasantview purchases its water. Pleasantview argued the President performs all daily operations, billing, accounting and maintenance for the utility, and should be compensated. Pleasantview makes no other type of payment to the President or Owner and no dividends are paid to the President or Owner.

Pleasantview's response to docket entry questions from the Commission indicated the President of Pleasantview performs billing services, including entering meter readings, calculating and preparing bills, entering payments, and collections. Pleasantview explained that the utility's board secretary assists with the billing and the \$1,950 allowance is for her work. Pleasantview also indicated the duties of the President include being available to its customers 24 hours a day, 7 days a week. Pleasantview further explained the President spends an average of 30 hours per work week answering telephone calls, entering payments, driving, reading meters, depositing payments, balancing accounts, managing funds, preparing reports, responding to State agencies, monitoring water usage, water testing, paying bills, updating meters, and other duties. Pleasantview argued in its response that the President deserves to be paid for the time spent performing these duties.

B. Lost Water Adjustment. Pleasantview noted it conducts regular inspections of the entire system and any leaks are repaired. Pleasantview asserted that water loss is not due to leaks in the system, but because its meters are older and therefore slower. Therefore, customers are paying for less water than they are using. Pleasantview further noted the last two rate trackers reflected water loss.

8. Commission Discussion and Findings.

A. Salaries and Wages. Pleasantview requested an increase of \$13,950 in its Application, which includes an annual salary for the President of \$12,000 and a \$1,950 allowance for billing services. The OUCC agreed with the \$1,950 allowance for billing services, but recommended no salary for Pleasantview's President citing the fact that Pleasantview has no wells, storage or treatment facilities, and has purchased its water from Connersville Utilities since 1998. Pleasantview's President performs all daily operations, billing, accounting, and maintenance services for the utility. The Commission finds the utility's President should be compensated for these services. Pleasantview's proposed Salaries & Wages expense adjustment of \$13,950 is reasonable and is hereby approved. Pleasantview's Payroll Tax Expense shall reflect a *pro forma* increase of \$1,097 as a result of the Salaries & Wages expense adjustment.

B. Lost Water. The evidence of record demonstrates that Pleasantview has had a high water loss percentage since 2001, ranging from 23.7% to 44%. Its lost water was 32.9% for the test year. We note that the Commission has reduced Pleasantview's last two water trackers to a maximum of 20% water loss. Pleasantview opined that its high amount of water loss is due to older meters and not leaks. The OUCC proposed an \$11,129 reduction to purchased water expense due to Pleasantview's persistent high level of lost water. In addition, the OUCC proposed Pleasantview implement a meter replacement capital improvement plan, which would reduce Pleasantview's lost water percentage. The OUCC estimated it would cost \$10,780 to replace Pleasantview's older meters with newer Neptune meters (154 remaining

meters at \$70/Neptune meter). The OUCC recommended Pleasantview replace 80 meters within one year of this Order and replace the remaining meters within the subsequent year.

The Commission finds the OUCC's proposal that Pleasantview take action to reduce its high amount of lost water reasonable and appropriate. Given the rate of \$5.07/1,000 gallons of water charged by Connersville Utilities, Pleasantview has no incentive to correct the problem if the utility is simply allowed to pass the cost related to lost water to its customers. While we understand the OUCC has proposed a reduction in the utilities purchased water expense, we find Pleasantview should be provided an opportunity to correct the situation before limiting the amount of purchased water it is permitted to recover from its ratepayers. Accordingly, we find that the entirety of Petitioner's purchased water shall be included in customer rates. We also find that Pleasantview shall implement a meter replacement program of its remaining 154 meters to be completed within one year of the issuance of this Order. Therefore, a \$10,780 meter replacement capital improvement project shall be included in this rate case.

Further, based on Pleasantview's assertion that its current 32.9% water loss is due to its older and slower water meters, Pleasantview should earn approximately 26% more in revenue once the old meters are replaced due to the accuracy of the newer meters. This percentage increase in revenues equals \$21,941 of additional revenue and assumes the utility will continue with 15% water loss. The additional revenue would eventually cause Pleasantview to over earn. Therefore, the Commission finds a two-phase rate adjustment is appropriate. Pleasantview shall complete its meter replacement program within one year of this Order in Phase I and Pleasantview shall adjust its rates downward by 17.15% in Phase II to offset its expected increase in revenues. Phase II rates shall take effect upon notification by Petitioner that the meter replacement project is complete, but in any event no later than one year after the issuance date of this Order.

C. Cost of Capital. In its Application, Pleasantview proposed a cost of equity of 12.00%. However, Pleasantview did not provide a study to support its cost of equity. While the OUCC accepted Petitioner's cost of equity of 12.00% because the costs to challenge Pleasantview's proposed cost of equity would typically exceed any benefit, the OUCC estimated that such a study would result in a cost of equity of less than 10%. The Commission notes that cost of equity is used to measure the general financial risk of a utility. When models are used to determine cost of equity they typically examine interest rates, growth of utility, the difference between equity returns and bond returns, and returns compared to market returns. General risk also looks at the size of the utility, debt-to-equity ratio, and rates of comparable utilities. In this Cause, Pleasantview's cost of equity of 12.00% does not correspond to the general risk it faces compared to other regulated utilities. From October 2007 to present, the Commission has determined cost of equity in twenty-four water/sewer utility cases. The cost of equity in those cases ranged from 9.50% to 12.00%, with only one case having a cost of equity above 11.00%. Pleasantview's evidence fails to support a 12.00% cost of equity.

Pleasantview uses a capital structure that is 100% common equity. The OUCC's proposed capital structure includes Applicant's customer deposits. The Commission finds the inclusion of customer deposits is a normal part of a utility's capital structure to be recovered from its customers through rates. Based upon the evidence, we find Pleasantview will have a

capital structure that is 53.73%% equity, 46.27% customer deposits, and 0.00% debt in Phase I and a capital structure in Phase II of 18.25% equity, 15.71% customer deposits, and 66.04% debt for the purchase of meters. Customer deposits are at 6.00% and the cost of debt is 8.00%.¹ The table below summarizes the cost of capital calculations:

Phase I				
	<u>Amount</u>	<u>Percent of Total</u>	<u>Cost</u>	<u>Weighted Cost</u>
Common Equity	\$2,979	53.73%	10.50%	5.64%
Customer Deposits	2,565	46.27%	6.00%	2.78%
Long -Term Debt		0.00%		0.00%
Total	<u>\$5,544</u>	<u>100%</u>		<u>8.42%</u>

Phase II				
	<u>Amount</u>	<u>Percent of Total</u>	<u>Cost</u>	<u>Weighted Cost</u>
Common Equity	\$2,979	18.25%	10.50%	1.92%
Customer Deposits	2,565	15.71%	6.00%	0.94%
Long-Term Debt	10,780	66.04%	8.00%	5.28%
Total	<u>\$16,324</u>	<u>100%</u>		<u>8.14%</u>

Given Pleasantview’s size, debt-to-equity ratio, and lack of service quality issues, we find a cost of equity of 10.50% to be more reasonable, appropriate and consistent with the cost of equity approved in other recent small utility rates cases.²

D. Authorized Rate Increase. An investor-owned utility calculates rates by first determining the return on rate base. This calculation determines what the net operating income (“NOI”) should be in order to provide an opportunity for a reasonable return to the shareholders. Next, a determination is made as to the amount of the adjusted or *pro-forma* operating income based on the utility’s current rates. The *pro-forma* amounts are based upon the known test year revenues and expenses updated to include changes that are fixed within the time period, known to occur and are recurring, and are measurable in amount. By subtracting the NOI determined through the adjustment process from the NOI required by the return on rate base, the dollar amount of the increase needed to achieve the NOI that is expected to provide a reasonable return to the shareholders can be determined. The increase in NOI is then adjusted for taxes and fees related to the increased revenue and income.

Petitioner originally proposed an across-the-board increase of \$32,039 or an increase of 51.04% in rates. The OUCC recommended an increase of \$1,108 or 1.58% increase in rates. Based upon the evidence presented and the discussion above, the Commission finds that an

¹ Pursuant to 170 IAC 6-1-15(f)(1), utilities are required to pay 6.00% on deposits held more than twelve (12) months.

² The Commission most recently found a cost of equity of 10.50% was reasonable for a similarly sized small investor owned utility, Pioneer Water, LLC. See *Petition of Pioneer Water, LLC*, Cause No. 44309 U, 2014 Ind. PUC LEXIS 1 (IURC 2014).

across-the-board rate increase of 37.08% or \$26,026 for Phase I and an adjustment resulting in a decrease of 18.41% or \$21,941 for Phase II are approved for Pleasantview. Phase I rates shall become effective on the approval of Petitioner’s tariff to be filed in accordance with this Order and the Phase II rate adjustment shall become effective upon notification by Petitioner that the meter replacement project is complete, but in any event no later than one year after the issuance date of this Order. The revenue requirements approved by the Commission are shown below:

Revenue Increase	IURC Phase I	IURC Phase II
Rate Base	\$ 2,952	\$ 13,415
Times: Cost of Capital	8.42%	8.14%
Net Operating Income Required	249	1,092
Less: Pro-forma NOI at Present Rates	(24,988)	22,367
Increase in NOI Required	25,237	(21,275)
Times: Gross Revenue Conv. Factor	103.13%	103.13%
Recommended Increase	<u>\$ 26,026</u>	<u>\$ (21,941)</u>
Recommended Percentage Increase	<u>37.08%</u>	<u>-18.41%</u>
 Revenue Requirements		
Operations and Maintenance Expenses	\$ 93,022	\$ 93,008
Depreciation Expense	414	597
Taxes Other Than Income	2,534	2,548
Income Taxes	0	0
Return on Rate Base	249	1,092
Total Revenue Requirements	<u>\$ 96,219</u>	<u>\$ 97,245</u>

9. **Effect on Rates.** The results of a residential customer using 5,000 gallons per month would be an increase of \$13.09 per month from \$35.30 to \$48.39 for Phase I and a decrease of \$8.91 per month from \$48.39 to \$39.48 for Phase II based on the approved rate adjustments.

10. **Alternative Regulatory Program (ARP).** If Petitioner elects to participate in the Small Utility ARP Program in accordance with procedures approved in Cause No. 44203, the eligible operating expenses to which the Annual Cost Index will be applied for Phase I are \$24,045. This amount excludes \$68,977 approved for purchased water. Taxes Other Than Income of \$2,534 are also eligible expenses to which the Annual Cost Index will be applied. Similarly, the eligible operating expenses to which the Annual Cost Index will be applied for Phase II are \$24,031. This amount excludes \$68,977 approved for purchased water. Taxes Other Than Income of \$2,548 are also eligible expenses to which the Annual Cost Index will be applied. All other components of Petitioner’s revenue requirement will remain unchanged.

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

1. Consistent with the above findings, an increase of 37.08% or \$26,026 for Phase I and an adjustment resulting in a decrease of 18.41% or \$21,941 for Phase II of Pleasantview's water service rates and charges are hereby authorized.

2. Prior to placing into effect the rates and charges approved herein, Pleasantview shall file with the Water/Sewer Division of the Commission a schedule of rates and charges in a manner consistent with this Order and the Commission's rules for filing such schedules. When approved by the Commission's Water/Sewer Division, such schedule shall cancel all prior rates and charges.

3. Pleasantview shall implement a meter replacement program as discussed above in Finding Paragraph 8.B. Pleasantview shall notify the Water/Sewer Division of the Commission upon completion of the water replacement program at which time Phase II rates shall become effective. However, Phase II rates shall become effective no later than twelve months after the date of this Order. Upon completion of the water replacement program or twelve months after the date of this Order, whichever occurs earlier, Pleasantview shall also file a revised schedule of rates and charges with the Water/Sewer Division of the Commission reflecting the Phase II rates.

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

ATTERHOLT, MAYS, STEPHAN, AND ZIEGNER CONCUR; WEBER NOT PARTICIPATING:

APPROVED: MAR 12 2014

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



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