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STATE OF INDIANA
INDIANA UTILITY REGULATORY COMMISSION

PETITION OF INDIANA-AMERICAN WATER)
COMPANY, INC. FOR COMMISSION)
DETERMINATION IN A SUBDOCKETED)
PROCEEDING OF THE FOLLOWING)
REQUESTS PRESENTED IN CAUSE NO.)
44450: (1) AUTHORITY TO ESTABLISH AND)
IMPLEMENT SYSTEM DEVELOPMENT)
CHARGES, (2) AUTHORITY TO ESTABLISH)
AND IMPLEMENT CERTAIN CONNECTION)
FEES AND POLICIES AND NEW RULES AND)
REGULATIONS APPLICABLE THERETO, (3))
AUTHORITY TO ESTABLISH AND)
IMPLEMENT A REVENUE STABILITY)
MECHANISM, AND (4) APPROVAL OF A)
FAIR VALUE INCREMENT ASSOCIATED)
WITH PETITIONER'S ACQUISITION OF)
NORTHWEST INDIANA WATER CO.)
("NORTHWEST") AND UNITED WATER)
WEST LAFAYETTE, INC. AND UNITED)
WATER INDIANA, INC. (COLLECTIVELY,)
"UNITED"))

CAUSE NO. 44450 S1

APPROVED: **JAN 28 2015**

ORDER OF THE COMMISSION

Presiding Officers:
Carol A. Stephan, Commission Chair
Carolene Mays-Medley, Vice Chair
Jeffery A. Earl, Administrative Law Judge

On January 24, 2014, Indiana American Water Company, Inc. ("Indiana American") filed its petition in Cause No. 44450. On March 19, 2014, the Commission issued a Prehearing Conference Order ("PHC Order") creating this Subdocket to consider Indiana American's requests for the following relief:

- Phase 1: The proposed system development charges, connection fees, and policies discussed in Paragraph 9 of the petition in Cause No. 44450;
- Phase 2: The proposed revenue stability mechanism discussed in Paragraph 11 of the petition in Cause No. 44450; and
- Phase 2: The reconsideration of our denial of a fair value increment discussed on pages 44-48 of the Direct Testimony of Gregory P. Roach, filed in Cause No. 44450 on January 24, 2014.

On May 21, 2014, the Commission issued a PHC Order in this cause, creating a bifurcated procedural schedule and taking administrative notice of relevant evidence that was filed in Cause No. 44450.

The Commission held an evidentiary hearing in this Cause at 9:30 a.m. on August 21, 2014, in Hearing Room 222, 101 W. Washington Street, Indianapolis, Indiana. At the hearing, Indiana American and the Indiana Office of Utility Consumer Counselor (“OUCC”) appeared by counsel and offered their prefiled testimony and exhibits which were admitted into evidence without objection. No members of the general public appeared.

On November 18, 2014, Indiana American filed a Stipulation and Settlement Agreement entered into with the OUCC (the “OUCC Settlement”). On December 8, 2014, Indiana American filed a Stipulation and Settlement Agreement entered into with the OUCC, the Industrial Group, Crown Point, and Schererville et al. (collectively “Settling Parties”) (“Comprehensive Settlement”). In this Order, the “Settlement” refers to the OUCC Settlement and the Comprehensive Settlement, collectively. Under the terms of the Settlement, Indiana American agreed to withdraw its proposed Phase 2 relief in this Subdocket. With respect to Phase 1 of the Subdocket, the only disputed issue is the proposal to eliminate developer refunds.

Based on evidence presented and the applicable law, the Commission finds:

1. Commission Jurisdiction and Notice. Notice of the hearings in this Cause was given and published as required by law. Indiana American is a public utility as that term is defined in Ind. Code § 8-1-2-1(a). Under Ind. Code § 8-1-2-42, the Commission has jurisdiction over Indiana American’s rates and charges for utility service. Therefore, the Commission has jurisdiction over Indiana American and the subject matter of this proceeding.

2. Indiana American’s Characteristics. Indiana American is a public utility corporation organized under the laws of the State of Indiana and engaged in the provision of water utility service in counties throughout the State of Indiana. Indiana American also provides sewer utility service in Wabash and Delaware Counties. Indiana American has charter power and authority to engage in the business of providing water and sewer utility service. Indiana American owns, leases, operates, manages, and controls utility plant, property, equipment, and related facilities that are used and useful for the convenience of the public for the provision of water utility service, public and private fire utility service, and sewer utility service.

3. Indiana American’s Evidence. Mr. Stacy S. Hoffman, Director of Engineering for Indiana American, testified on behalf of Indiana American.

A. System Development Charge. Mr. Hoffman first discussed Indiana American’s proposal to implement system development charges (“SDCs”). The American Water Works Association’s *Principles of Water Rates, Fees and Charges*, AWWA M1 Manual (hereinafter, the “AWWA M1”) describes an SDC as:

A one-time charge paid by a new water customer for system capacity. It is also assessed to existing customers requiring increased system capacity. The receipts of this charge are used to finance the development of capacity-related water

facilities and are an important funding/financing source for growth-related or capacity-related water facilities.

Mr. Hoffman stated that Indiana American is proposing to implement SDCs because it is appropriate that capacity related costs be equitably distributed between existing and future customers. He explained that currently Indiana American's rate design without SDCs allocates all capacity costs to existing customers and no costs to future customers. Therefore, implementation of SDCs will equitably distribute capacity costs to future customers at the time they connect to the system.

Mr. Hoffman testified that after the Commission's approval, Indiana American proposes to implement the SDCs for all new customer connections. This would be achieved by requiring customer representatives to pay specified SDCs at the time service is requested. The AWWA M1 describes the costs included in the proposed SDCs as follows:

In general, SDCs are based on the costs for major backbone infrastructure components that are necessary to provide service to all customers including source of supply facilities, raw water transmission, treatment facilities, pumping facilities, storage tanks, and major treated-water transmission mains.

Mr. Hoffman stated that Indiana American has used this description for identifying costs to be included in the SDCs.

Mr. Hoffman explained that Indiana American has calculated SDCs using the buy-in calculation method and the reproduction cost new less depreciation ("RCNLD") valuation method as outlined in the AWWA M1. This calculation and a schedule of the proposed SDCs by meter size are included in Petitioner's Exhibit 2. The proposed SDC for 5/8-inch meter size is \$500. Mr. Hoffman stated that the SDC calculations include a tabulation of Indiana American's RCNLD with productivity adjustment factor for backbone plant infrastructure, a tabulation of Indiana American's capacity in terms of firm plant capacity, and the water use per residential customer. He explained that this information is used to calculate the SDC for residential 5/8-inch meter service connections. SDCs for larger size meters are calculated by multiplying the SDC for the 5/8-inch meter size by the ratio of the capacity of the larger meter size to capacity of the 5/8-inch meter as published in the AWWA M22 Manual, "Sizing Service Lines and Meters."

Mr. Hoffman testified that Indiana American proposes to treat received SDCs as contributions in aid of construction ("CIAC") and that Indiana American estimates that CIAC due to implementing the SDCs will be in the range of \$600,000 annually.

Mr. Hoffman also discussed how existing Indiana American customers will benefit from implementing the proposed SDCs. He explained that after implementing the SDCs for new service connections, these capacity costs, accounted for as CIAC, will offset Indiana American's existing rate base, thereby equitably distributing the capacity costs between existing and new customers. Reduction of Indiana American's rate base from received SDCs will result in a reduction in capacity costs for existing customers.

Given this reduction in costs for existing customers, Mr. Hoffman stated that Indiana American proposes to implement SDCs as soon as possible.

B. Connection Fees. Mr. Hoffman stated that Indiana American proposes to implement connection fees in order to pay for the cost of installing new service line connections and related meter settings for new customers (“developers”). Currently, developers neither pay for the cost to install any size domestic service line nor the cost of installing new service meter pits and related appurtenances for meter sizes less than two inches in diameter. Rather, existing customers pay for all of these developer connection costs because these costs are incorporated into Indiana American’s rate base.

Mr. Hoffman explained that Indiana American proposes to implement these connection fees because it is appropriate for developers to pay for the costs of new service connections they request, rather than existing customers paying rates to cover the costs of these connections. Additionally, he stated that Indiana American will implement the new service connection fees for all new customer connections after the Commission’s approval of this proposal by requiring customer representatives to pay the specified connection fee at the time service is requested.

The costs included in the proposed connection fees include the cost of tapping the water main, installing the service line, and installing the meter pit, meter, and related appurtenances, for all service connection sizes. However, connection fees would not include the costs of meter pits and vaults, and related appurtenances for meter sizes of two inches in diameter and larger because the developer already directly manages construction and costs for these assets in conformance with Indiana American’s existing Rules and Regulations. Mr. Hoffman explained that costs are structured in this way because construction of these larger meter pits often require site specific considerations that are more efficient for developers to manage. He stated that connection fees also include administration of the work.

Mr. Hoffman testified that Indiana American calculated the proposed connection fees by utilizing contract pricing for service line and meter related construction work in all service areas except the Northwest service area, where Indiana American crews perform this work. He stated that the average cost for the service connections across Indiana American’s service areas for services requiring 5/8-inch meters is \$800. A schedule of the Company’s proposed connection fees by meter service size was presented in Petitioner’s Exhibit 3. The connection fees are calculated as the current average costs of these connections across Indiana American’s service areas.

He further stated that Indiana American proposes to treat received connection fees as CIAC for accounting purposes and that Indiana American estimates it will accrue approximately \$1,000,000 CIAC annually. Mr. Hoffman testified that after implementing the proposed connection fees for new service connections, these future costs will no longer be included in Indiana American’s rate base. Therefore, these costs will not be included in costs to existing customers, but rather will be costs paid for by developers.

C. Developer Refunds. Mr. Hoffman stated that Indiana American proposes to cease existing customer funding of new developer installed water mains and testified that this currently occurs via refund provisions in main extension agreements with developers. He explained that, in essence, when a new customer connects to a developer-installed main, Indiana American refunds three times annual revenue for that customer to the developer not to exceed the cost of the main extension. The provisions enable refunding the cost of developer installed

main extensions and these refund payments are included in Indiana American's rate base by reducing CIAC.

Mr. Hoffman stated that Indiana American proposes to eliminate these refunds to developers for main extension agreements executed after the Commission's approval of this proposal. However, Indiana American proposes to continue honoring funding of developer installed mains via the refund provisions in existing main extension agreements that were fully signed by all parties prior to the Commission's approval of this proposal. He stated that Indiana American proposes to eliminate these developer refunds because it is appropriate for developers to pay for the costs of main extensions for properties they develop. Indiana American will implement this change by removing refund provisions from future main extension agreements.

Mr. Hoffman further discussed how eliminating developer refunds would impact Indiana American's capital or operating expenditures. He explained that if approved by the Commission, this change would reduce Indiana American's capital expenditures in developer main extensions via refunds, and thereby reduce future increases to rate base associated with developer main extensions. This will enable Indiana American to focus more investment where it is needed in replacing infrastructure, not for developers, but to maintain reliable, quality for all customers. Given this benefit, Indiana American proposes to implement this change as soon as feasible in 2014.

Mr. Hoffman projected capital expenditures associated with refunds for developer main extensions and included an exhibit detailing these projections in his testimony. Indiana American expects refunds to remain near existing levels for a few years due to continuing build-out of developments under existing main extension agreements, but Indiana American expects refunds to then begin to taper as older agreements expire.

4. OUCC's Evidence. Margaret A. Stull, Senior Utility Analyst in the OUCC's Water/Wastewater Division, testified on behalf of the OUCC.

A. System Development Charge. Ms. Stull testified that the OUCC accepts the system development charge amount proposed by Indiana American. The OUCC also accepts Indiana American's proposal to assess and collect its SDC when land is subdivided and platted or at the time building permits are issued. In addition, although Ms. Stull testified that amortizing CIAC would be more appropriate, the OUCC does not oppose Indiana American's proposal to simply record its received SDCs as CIAC without any amortization.

Ms. Stull also identified concerns with Indiana American's calculation of its proposed SDC. First, she stated that Indiana American's valuation of water system backbone infrastructure includes capitalized tank painting costs and general plant that is not properly classified as water system backbone infrastructure. She stated general plant does not consist of assets that provide for the transmission, storage, and treatment of water and therefore it is not appropriate to include general plant in the costs to be recovered through a system development charge. Ms. Stull testified that the OUCC disagrees with Indiana American's inclusion of capitalized tank painting costs in the calculation of the proposed SDC because such costs are generally considered to be maintenance expenses and are not typically capitalized. She also stated that Indiana American's

valuation of its water system backbone infrastructure could include contributed plant, which she asserted should not be used to justify a system development charge.

Second, Ms. Stull testified that in order to accurately and fairly distribute the costs of capacity to current and new customers, for purposes of establishing its SDC, Indiana American should have considered peak demands in its assumed level of residential customer use.

Finally, Ms. Stull recommended that Indiana American be required, at least once every five years, to review its system development charge calculation and provide the results of that calculation to the Commission and the OUCC.

B. Connection Fees. Ms. Stull testified that based on the supporting documentation provided, the OUCC does not oppose Indiana American's proposed connection fees.

C. Developer Refunds. Ms. Stull recommended the Commission reject Indiana American's proposal to eliminate refunds to customers for main extensions. She stated the effect of Indiana American's request is that Indiana American would be treated differently than all other water utilities in Indiana and would be the only water utility subject to the Commission's main extension rules that does not have to refund revenue allowances to developers for main extensions. She testified that fairness requires that all utilities be subject to the same rules and if the Commission determines that a change to the main extension rules is warranted, this should only be accomplished through a rulemaking that would apply to all Indiana water utilities, rather than through utility specific exceptions.

5. Indiana American's Rebuttal.

A. System Development Charge. Although the OUCC accepted Indiana American's proposed SDCs, Mr. Hoffman did respond in rebuttal to some of Ms. Stull's statements about the calculation of the proposed charges. He stated that Indiana American has long been permitted to capitalize tank painting costs and, accordingly, those costs should be included the same as any other capital costs in the calculation of the SDC. He also testified that the inclusion of contributed plant in the calculation of the SDC is appropriate, citing to an Indiana Court of Appeals decision upholding the trial court's approval of capacity and tap connection charges that were calculated based on inclusion of federal and state government grants. *Taylor v. Fall Creek Regional Waste Dist.*, 700 N.E.2d 1179, 1185 (Ind. Ct. App. 1998).

Mr. Hoffman stated that Indiana American will consider in the future Ms. Stull's suggestion regarding amortizing CIAC, though such a change will require significant study.

Mr. Hoffman defended Indiana American's inclusion of specific general plant accounts for land, structures, laboratory equipment, and related communication and miscellaneous equipment, stating that they are normally considered to be parts of backbone source of supply, treatment, pumping, and tank plant and therefore are properly included in backbone plant for the purpose of calculating SDCs.

With respect to Indiana American's use of the average use per residential customer in calculation of the SDC instead of peak demand, Mr. Hoffman cited the AWWA M1's discussion

calling for a “rational nexus” between the SDC amount and the capacity cost for new development. He stated that in Indiana American’s calculation of SDCs, a rational nexus exists between the cost of plant and the new customers’ use, which is the apportionment of the cost of plant based on the customers’ expected use over the course of an entire year, not the customer’s expected maximum use for a limited number of days during the summer.

Mr. Hoffman indicated that Indiana American is willing to submit a report to the Commission and the OUCC every five years regarding its review of the calculation of the SDC, but the Company would not expect a further docketed proceeding unless determined necessary by the Commission upon receipt of such a report.

B. Connection Fees. The OUCC did not oppose Indiana American’s proposed connection fees.

C. Developer Refunds. In response to the OUCC’s recommendation that the Commission reject Indiana American’s proposal to eliminate revenue refunds to developers for extending water main to their developments, Mr. Hoffman pointed out that the vast majority of water utilities in Indiana are not subject to the Commission’s main extension rules. He stated Indiana American’s proposal would result in the Company being able to act in a way that many other water utilities in the state already act with respect to not funding developers’ main extensions to their developments. He disagreed with the concerns raised by Ms. Stull regarding granting a change to Indiana American’s current practice under the main extension rules. He explained that waiting to grant Indiana American’s proposed change will divert limited capital to developers for their main extension to their developments while existing customers will continue to be required to pay for these developer main extensions in water rates. He reiterated his direct testimony that eliminating developer refunds will enable Indiana American to invest this capital in replacement of aging infrastructure that will inure to the benefit of all customers in reliable, quality service. He stated the need for infrastructure replacement is both urgent and significant.

Mr. Hoffman explained that a further purpose for the proposed change is to ensure that the appropriate person (i.e., the developer) pays for the costs that benefit them (i.e., the properties they develop). He testified this is more appropriate than requiring all existing customers to fund developer main extensions through rates. He concluded that Indiana American’s request would result in lower rates to existing customers than would otherwise be the case.

6. Commission’s Discussion and Findings.

A. System Development Charge. Although the OUCC raised concerns regarding certain aspects of the calculation of Indiana American’s proposed SDCs, to which Indiana American offered rebuttal, the OUCC ultimately accepted Indiana American’s proposed SDC as reasonable without explanation. In spite of the OUCC’s agreement, we believe two issues need to be addressed prior to approval of the SDC.

First, Ms. Stull testified that Indiana American’s SDC should not include general plant accounts, because those accounts consist of assets that do not provide capacity to the system. Petitioner’s Exhibit SSH-S1 includes \$37,598,825 in general plant, before depreciation. In

rebuttal, Mr. Hoffman made no attempt to specifically identify the general account assets or to justify their inclusion in the SDC. He stated only that Indiana American included specific general plant accounts that should normally be included in the SDC calculation. The account descriptions on pages 430-433 of MSFR #10 differentiate accounts by function, for example, supply, pumping, treatment, transmission and distribution, and general. Absent sufficient justification for the inclusion of assets in general plant accounts, and based on the account descriptions in MSFR #10, we find that the general plant accounts should be excluded from the SDC calculation.

Second, Indiana American’s SDC, as reflected in Petitioner’s Exhibit SSH-S1, Schedule 2, reflects the use of a 13-month average for plant budgeted to be completed between November 2014 and November 2015. This is inconsistent with our rate base determination in the PHC Order and Final Order in Cause No. 44450 that rate base must be based on actual utility plant in service, used and useful, before being included in Indiana American’s rates and charges. Indiana American’s SDC may not include projects that are not yet completed and in service. Therefore, Indiana American shall file in this Cause revised SDCs based on actual utility plant in service as of November 30, 2014, that is included in its December 12, 2014 certification filing. The revised SDCs shall use the same methodology Indiana American used in this case but shall exclude the general plant accounts as discussed above.

We find that Indiana American’s proposed SDCs are reasonable with the modifications above. Indiana American shall be authorized to establish and implement the SDCs upon approval of the revised SDCs by the Commission’s Water/Wastewater Staff. We also find that received SDCs are to be treated as CIAC for accounting purposes.

In addition, we accept the OUCC’s recommendation that Indiana American be required to evaluate its level of system development charges every five (5) years and report to the Commission and the OUCC the results of that evaluation.

B. Connection Fees. We find that Indiana American’s proposed connection fees are reasonable, and we approved the fees as proposed in Petitioner’s Exhibit SSH-S2, which are detailed in the following table.

<u>Meter Size</u>	<u>Connection Fee</u>
5/8	\$ 800
1	1,400
2	2,400
3	8,100
4	10,800
6	12,900
8	15,700
10	19,400
12	19,800

We also find that received connection fees are to be treated as CIAC for accounting purposes.

C. Developer Refunds. The OUCC’s recommendation that we reject Indiana American’s proposal to eliminate revenue refunds to developers for extending water main to

their developments appears to be based upon the OUCC's legal position that this Commission is without authority to grant such relief from our water main extension rules. We disagree.

Under Indiana Code § 8-1-2-69, we have general authority to regulate utility service. *Wilfong v. Indiana Gas Co.*, 399 N.E.2d 788, 791 (Ind. Ct. App. 1980) (finding that "the general language of this provision is sufficient to permit the commission to authorize the gas company not to provide gas service to new customers"). We have relied on this statutory authority in other cases where circumstances warranted an exception from the rule. In *Indianapolis Water Co.*, Cause No. 41861, the Commission was asked to approve an agreement between Indianapolis Water and one of its customers that resolved a customer complaint by allowing a deviation from the normal main extension rules. The Agreement amended a prior main extension agreement between the parties and provided, among other things, that the time period during which the customer may collect subsequent connector refunds would be extended an additional ten years. The Commission, in approving the variance, explained:

Applicants' Petition is a request for relief from the ten-year limit for collecting subsequent collectors' fees located in 170 IAC 6-1.5-35 and 170 IAC 6-1.5-36. The Agreement resulted from negotiations after Irsay filed a complaint with the Commission, and the Commission encourages parties to "fashion settlement agreements." General Administrative Order 1997-2. *Under Indiana Code § 8-1-2-69, the Commission is authorized to fashion remedies when the requirements of the statutes and administrative codes may produce results that are "unjust, unreasonable, unwholesome, unsanitary, unsafe, insufficient, preferential, unjustly discriminatory, inadequate, or otherwise in violation of this chapter, as the case may be."* Based on the evidence presented and the record as a whole, the Commission finds that it is appropriate to extend the ten-year limit on the collection of subsequent connector fee in this case.

Cause No. 41861, Order at 2 (emphasis added).

We find that the circumstances under which we may grant a variance or exception from our promulgated rules exist in this Cause. Indiana American has provided sufficient evidence of the benefits to customers as a whole from ceasing to fund developer main extensions. There is no evidence of prejudice from Indiana American's requested change to its rules and, in fact, we note that, as Indiana American stated in rebuttal testimony, the majority of water utilities in the state are not subject to the developer refund requirement in our main extension rule.

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

1. Indiana American is authorized to establish and implement system development charges and connection fees for water utility services as described in Section 6 above.
2. Indiana American's proposed changes to its rules and regulations applicable to water services, including the elimination of refunds to developers for main extensions, as set forth in Petitioner's Exhibit SSH-S5, are approved.

3. Indiana American is authorized to reflect received system development charges and connection fees on its books and records as contributions in aid of construction.

4. Prior to placing into effect the charges approved above, Indiana American shall file appendices to its schedules of rates and charges with the Water/Wastewater Division of the Commission consistent with the findings set forth above. Such charges for water service will become effective upon approval by the Water/Wastewater Division of the Commission.

5. Indiana American shall evaluate the level of its system development charge every five (5) years from the date of this Order and submit a report on such evaluation to this Commission, with a copy provided to the OUCC.

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

STEPHAN, HUSTON, MAYS-MEDLEY, WEBER, AND ZIEGNER CONCUR:

APPROVED: JAN 28 2015

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



Brenda A. Howe
Secretary to the Commission