

**CASE NO. 2018-00208**  
**WATER SERVICE CORPORATION OF KENTUCKY**  
**CORRECTED RESPONSES TO COMMISSION STAFF'S THIRD INFORMATION REQUEST**

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4. Refer to the responses to Staff's Second Request, Items 9.a. and 9.b.
  - a. Identify each affiliate of Water Service Kentucky's that used the services of Guastella Associates, LLC (Guastella Associates), to perform a depreciation analysis.
  - b. For those affiliates identified in Item 4.a. above, provide copies of the Depreciation Report, of the Direct Testimony filed in the proceeding, and the regulatory final decision.
  - c. In Excel spreadsheet format with formulas intact and unprotected, and all rows and columns fully accessible, provide copies of all workpapers, calculations, an assumption used by Guastella Associates in developing each depreciation analysis identified in Item 4.a. above.

Response:

- a. Guastella Associates performed depreciation studies for Utility Services of Illinois, Inc. and Utilities Inc. of Indiana.
- b. See the multiple Attachments to Response to PSC DR 3-4(b), including the testimony and regulatory decisions from two cases and five Excel files. The attachments for the depreciation study for Utility Services of Illinois, Inc. are the latest of others performed by Guastella Associates that include the multiple systems of Utility Service of Illinois, Inc. Guastella Associates had performed separate studies for a number of those same systems on the same basis as the study provided in the attachment, and they were similarly approved by the Illinois Commerce Commission.

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- Mr. Guastella was unable to locate any additional Depreciation Reports, Direct Testimony, or the regulatory decisions related to WSCK affiliates.
- c. The attachments in response to 4b, above, include the “working” exhibits. The assumptions and basis for those studies are essentially the same and consistent with the information previously provided in response to Items 24 and 25 of the Staff’s Second Request.

Witness:        John Guastella

1 UTILITIES, INC. - ILLINOIS

2 DIRECT TESTIMONY

3 OF

4 JOHN F. GUASTELLA

5

6 Q. Please state your name and business address.

7 A. John F. Guastella, Guastella Associates, LLC. 6 Beacon Street, Suite 200, Boston, MA  
8 02108.

9 Q. Please describe Guastella Associates, LLC.

10 A. Guastella Associates provides utility management, valuation and rate consulting services  
11 to both regulated and unregulated utilities.

12 Q. Have you attached a statement of your educational, professional and business  
13 background and experience?

14 A. Yes, my Qualification and Experience are attached as Appendix A.

15 Q. What is the purpose of your testimony in this case?

16 A. I was retained by Utilities, Inc. of Illinois ("Company") to perform a depreciation analysis of  
17 its water and sewer utility systems and to recommend appropriate depreciation rates.

18 Q. Before describing the depreciation analysis you performed, would you generally outline the  
19 concept of depreciation?

20 A. The goal of depreciation for rate setting purposes is to allow utilities to recover the  
21 original cost of the assets that are used and useful in providing service to their customers,

1 and at a level that spreads the recovery of the cost over the estimate life of the assets so  
2 that each generation of customers pays its fair share of the cost according to their use of  
3 the assets. The Uniform System of Accounts published by the National Association of  
4 Regulatory Utility Commissioners (“NARUC”) defines depreciation as:

5 Depreciation, as applied to depreciable utility plant, means the loss in service  
6 value not restored by current maintenance, incurred in connection with the  
7 consumption or prospective retirement of utility plant in the course of providing  
8 service from causes which are known to be in current operation and against which  
9 the utility is not protected by insurance. Among the causes to be given  
10 consideration are wear and tear, decay, action of the elements, inadequacy,  
11 obsolescence, changes in the art, changes in demand, and requirements of public  
12 authorities.

13  
14 Under this definition, depreciation studies are performed in order to estimate the average  
15 service lives of various depreciable assets, the major component with which to calculate  
16 depreciation rates. Application of depreciation rates to the original cost of assets  
17 establishes annual depreciation expense allowances in utility rates for service that will  
18 meet the goal of reasonable cost recovery and intergenerational equity.

19 Q. What are the components of the calculation of depreciation rates?

20 A. In addition to average service lives, the other component in the calculation of  
21 depreciation rates is net salvage values, or salvage value less cost of removal.

22 The relevant Uniform System of Accounts definitions are:

23 Salvage Value means the amount received for property retired, less any expenses  
24 incurred in connection with the sale or in preparing the property for sale, or, if  
25 retained, the amount at which the material recoverable is chargeable to materials  
26 and supplies, or other appropriate account.  
27

1            Cost of Removal means the cost of demolishing, dismantling, tearing down or  
2 otherwise removing utility plant, including the cost of transportation and handling  
3 incidental thereto.

4  
5            Net Salvage Value means the salvage value of property retired less the cost of  
6 removal.

7  
8            For proper rate setting, the calculation of depreciation rates and resultant depreciation  
9 expense recognizes that the allowance for depreciation should include the recovery of the  
10 original cost of the depreciable assets less any anticipated positive salvage values and/or  
11 plus any anticipated cost of removal. Under this calculation of depreciation rates,  
12 existing and future customers will pay their fair share of the cost and net salvage value of  
13 the assets that have been used to provide utility service to them.

14 Q.        How does the accounting for depreciation affect rates for service?

15 A.        Annual depreciation expense accruals are of course credits, or increases, to the  
16 accumulated depreciation. Recognition of positive net salvage decreases the accrual and  
17 negative net salvage, due to cost of removal, increases the accrual. Accordingly,  
18 accumulated depreciation is higher or lower depending on net salvage value, and the rate  
19 base on which utilities are given an opportunity to earn a return is lower or higher,  
20 respectively. Instructions in the Uniform System of Accounts describe the accounting  
21 with respect to the retirement of a retirement unit of property as follows:

22            If the retirement unit is of a depreciable class, the book cost of the unit retired and  
23 credited to utility plant shall be charged to the accumulated depreciation  
24 applicable to such property. The cost of removal and the salvage shall be charged  
25 or credited, as appropriate, to such depreciation account.  
26

1 Under the required accounting, the accumulated depreciation would decrease by the  
2 original cost of the retired property and also the cost of removal, determined at the time of  
3 retirement, which ideally would offset, on average, the annual accruals that had increased  
4 the accumulated depreciation over the years. In other words, as annual accruals that  
5 include recovery of the original cost as well as cost of removal accumulate, they increase  
6 the reserve for depreciation and, therefore, decrease the rate base. The booking of the  
7 cost of removal when assets are retired would decrease the reserve for depreciation, and  
8 increase the rate base.

9 It is also noted that for rate setting purposes the establishment of reasonable  
10 depreciation rates is primarily a matter of achieving intergenerational equity -- existing  
11 and future customers paying their fair share of the costs associated with the assets that are  
12 used to provide them with service. Further, while depreciation expense is a deduction to  
13 revenues when calculating utility operating income (return on net investment or rate  
14 base), it is a “non-cash” expense; depreciation expense is for the most part a recovery of  
15 the original cost of assets for which expenditures had previously been made. Thus,  
16 depreciation expense is a source of internally generated funds, along with retained  
17 earnings. Because dividends to stockholders are only paid out of net income, these  
18 internally generated funds provide financing of new plant, not additional return on  
19 investment. The level of these internally-generated funds, however, only provides part of  
20 the capital needed for new plant, because the original cost of the assets being recovered  
21 through depreciation allowances is typically only a small fraction of the current cost of

1 new plant and facilities -- the balance of the funding must be obtained from the attraction  
2 of outside debt and/or equity capital.

3 Accordingly, in addition to intergenerational equity, establishing reasonable  
4 depreciation rates that provide for the recovery of the original cost of assets and net  
5 salvage values, including cost of removal, should, at least theoretically, improve the  
6 utility's ability to attract capital at a lower cost -- because the portion of the new outside  
7 capital in relation to existing investment would not be higher than otherwise needed to  
8 make up for a shortfall in internally generated capital and debt coverage requirements.

9 Obviously, a lower cost of capital has a beneficial impact on rates for service. This  
10 potential benefit assumes a long-term effect of adequate depreciation practices.

11 Depreciation practices, however, are not a substitute or offset for other rate setting  
12 policies that should establish new rates for service in order to cover the cost of service for  
13 the period when those rates become effective. Accordingly, appropriate depreciation  
14 practices, coupled with other rate setting practices that provide a utility with a realistic  
15 opportunity to achieve the allowed return on investment, will in the long run improve the  
16 utility's ability to attract the lowest cost of capital.

17 Q. Please describe the analysis which you performed for the Company.

18 A. The Company's water and sewer systems are comprised of relatively small utilities that  
19 do not have sufficient retirement data that are readily available to perform either an  
20 actuarial or simulated plant balance method for determining average service lives. I have,  
21 therefore, undertaken a comparative analysis in order to establish appropriate average

1 service lives and depreciation rates, similar to the analysis previously accepted by the  
2 Illinois Commerce Commission (“ICC”) for many small utilities. I reviewed average  
3 service lives and net salvage values approved by the ICC for a number of other utilities  
4 for a full range of primary plant accounts, and found that they were applicable to the  
5 Company. Those average service lives and net salvage values are also consistent with  
6 studies of comparable property of other utilities, which I have examined. The average  
7 service lives are within the range of data compiled for various utilities and regulatory  
8 agencies around the country.

9 Q. What comparisons did you make?

10 A. I compiled average service lives, net salvage values and depreciation rates of other water  
11 utilities in various states, including Illinois, guidelines available from certain states,  
12 publications of the National Association of Regulatory Utility Commissioners, and results  
13 of actuarial and simulated plant balance studies which have been performed by Guastella  
14 Associates, and other consultants.

15 Q. Have you prepared an exhibit which shows the results of your depreciation study and a  
16 summary of your recommendations?

17 A. Yes. My recommendations with respect to the depreciation study are shown on Schedules  
18 JFG-1 and JFG-2 for water and sewer, respectively, attached to my testimony.

19 Q. Did the Company’s retirements affect your depreciation study?

20 A. No. As mentioned, the Company has not experienced sufficient retirements with which to  
21 perform either an actuarial or simulated plant balance method for determining average



1 service lives. Further review of these retirements does not warrant a revision to the  
2 recommended depreciation rates.

3 Q. Please describe Schedules JFG-1 and JFG-2

4 A. These schedules show the average service lives which I am recommending for The  
5 Company for all of its water and sewer systems. The recommended average service lives  
6 are the same as the average service lives approved by the ICC for other water and sewer  
7 systems. On the basis of my experience and my review of the depreciation determinations  
8 for water and sewer system assets, it is my judgment that the recommended average service  
9 lives and net salvage for all plant accounts shown on Schedules JFG-1 and JFG-2 are not  
10 only reasonable, in general, but are reasonable for determining depreciation rates for the  
11 Company.

12 Q. In addition to the appropriateness of the recommended depreciation rates, are there other  
13 advantages for the Company to use similar depreciation rates for all of its systems?

14 A. Yes, there is an administrative benefit associated with a consistent depreciation and  
15 accounting practice. Moreover, since there is a general consistency in the way the Company  
16 maintains its facilities, for each system, the life of each system's assets would tend to be  
17 extended for a similar period of time.

18 Q. Are your comparative depreciation data available in work paper form?

19 A. Yes.

20 Q. How do your recommended depreciation rates compare to those approved by the ICC?

1 A. With a few possible exceptions that would have an insignificant impact, I believe my  
2 recommended depreciation rates are the same as those approved by the ICC for several  
3 utilities with which I have also performed comparative studies. I have consistently found  
4 that the average service lives and net salvage values accepted by the ICC produce  
5 depreciation rates that best meet the important goal of cost recover and intergeneration  
6 equity.

7 Q. Does that conclude your testimony at this time?

8 A. Yes.

9

# **SCHEDULES**

**Water System**

**Calculation of Depreciation Rates**

Account Number (A)	Account Description (B)	Average Service Life (C)	Percent Net Salvage (D)	Depreciation Rate (E)
<u>Intangible Plant</u>				
301	Organization			
302	Franchises & Consents			
<u>Source of Supply Plant</u>				
303	Land and Land Rights			
304	Structures and Improvements	30.00	-25%	4.17%
305	Collecting & Impounding Res.	66.66	0%	1.50%
306	Lake, River and Other Intakes	75.00	-10%	1.47%
307	Wells and Springs	60.00	0%	1.67%
309	Supply Mains	90.00	-70%	1.89%
<u>Pumping Plant</u>				
303	Land and Land Rights			
304	Structures and Improvements	55.00	-25%	2.27%
310	Power Generating Equipment	30.00	0%	3.33%
311	Source of Supply & Pumping Equip.	40.00	-25%	3.13%
311.26	Source of Supply & Pumping Equip. - Hydraulic	40.00	-25%	3.13%
311.4	Transmission & Distribution Pumping Equip.	40.00	-25%	3.13%
<u>Water Treatment Plant</u>				
303	Land and Land Rights			
304	Structures and Improvements	45.00	-25%	2.78%
311	Electric Pumping Equip.	40.00	-25%	3.13%
320	Water Treatment Equipment	35.00	-25%	3.57%
339	Other Plant & Misc. Equipment	35.00	-25%	3.57%
<u>Transmission &amp; Dist. Plant</u>				
303	Land and Land Rights			
304	Structures and Improvements	30.00	-25%	4.17%
311	Electric Pumping Equip.	40.00	-25%	3.13%
330	Dist. Reservoirs & Standpipes	60.00	0%	1.67%
331	T & D Mains	90.00	-70%	1.89%
333	Services	60.00	-100%	3.33%
334	Meters	14.00	13%	6.21%
334	Meter Installations	45.00	-100%	4.44%
335	Hydrants	43.00	-70%	3.95%
336	Backflow Prevention Devices	45.00	-100%	4.44%
339	Other Plant & Misc. Equipment	30.00	-25%	4.17%
<u>General Plant</u>				
303	Land and Land Rights			
304	Structures and Improvements	25.00	0%	4.00%
340	Office Furniture	19.00	10%	4.74%
340	Personal Computers	*		
340	PC Software	*		
340	MainFrame Computers	*		
340	MainFrame Software	*		
340	Other Machinery & Equipment	20.00	0%	5.00%
342	Stores Equipment	29.00	5%	3.28%
344	Laboratory Equipment	20.00	0%	5.00%
345	Power Equipment	10.00	50%	5.00%
346	Communication Equipment	8.00	0%	12.50%
347	Miscellaneous Equipment	20.00	0%	5.00%
341	Transportation Equipment	6.50	30%	10.77%
343	Tools, Shop and Garage Equip.	13.00	5%	7.31%
348	Other Tangible Plant	20.00	0%	5.00%

\* The Company includes depreciation expense for these accounts on an allocated basis.

**Sewer System**

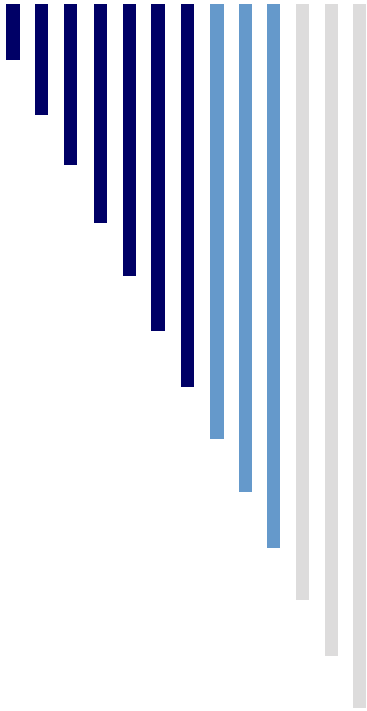
**Calculation of Depreciation Rates**

Account Number (A)	Account Description (B)	Average Service Life (C)	Percent Net Salvage (D)	Depreciation Rate (E)
<u>Intangible Plant</u>				
351	Organization			
352	Franchises & Consents			
352	Franchises-Reclaimed Water distribution			
353	Land and Land Rights - Intang. Plant			
<u>Collection Plant</u>				
353	Land and Land Rights - Collect.			
354	Structures and Improvements	35.0	-25%	3.57%
355	Power Gen. Equip-Collection	30.0	0%	3.33%
360	Collection Sewers - Force	90.0	-70%	1.89%
361	Collection Sewers - Gravity	90.0	-70%	1.89%
363	Service to Customers	45.0	-70%	3.78%
364	Flow Measuring Devices	35.0	0%	2.86%
365	Flow Measuring Installations	30.0	0%	3.33%
389	Other Plant & Misc. Equip.	30.0	0%	3.33%
<u>Pumping Plant</u>				
353	Land and Land Rights			
354	Structures and Improvements	30.0	0%	3.33%
355	Power Gen. Equip-Pumping	30.0	0%	3.33%
370	Receiving Wells	30.0	0%	3.33%
371	Pumping Equipment	40.0	-25%	3.13%
389	Other Plant & Misc. Equip.	30.0	0%	3.33%
<u>Treatment Plant</u>				
353	Land and Land Rights			
353	Land&LandRights-ReclaimWater Treatment			
353	Land&LandRights-ReclaimWater Distribution			
354	Structures and Improvements	35.0	-25%	3.57%
354	Struct&Imprvmnt-Reclaim Water Treatment	35.0	-25%	3.57%
354	Struct&Imprvmnt-Reclaim Water Distribution	35.0	-25%	3.57%
355	Power Gen. Equip-Treatment & Disposal Plant	30.0	0%	3.33%
355	PowerGen. Equip-Reclaim Water Treatment	30.0	0%	3.33%
355	PowerGen.Equip-Reclaim System Distribution	30.0	0%	3.33%
375	Transmission & Distrib System-Reuse	90.0	-70%	1.89%
380	Treatment & Disposal Equip.	35.0	-25%	3.57%
380	Treatment & Disposal Equip.-Lagoon	35.0	-25%	3.57%
380	Treatment & Disposal Equip.-Reclaim	35.0	-25%	3.57%
381	Plant Sewers Treatment & Disposal Plant	30.0	0%	3.33%
381	Plant Sewers Reclaimed Water Treatment	30.0	0%	3.33%
382	Outfall Sewer Lines	30.0	0%	3.33%
389	Coll. - Other Plant & Misc. Equip.	90.0	-70%	1.89%
389	Other Plant & Misc. Equip.	30.0	0%	3.33%
389	Other Plant & Misc. Equip. - Rclmd Water Trtmnt	30.0	0%	3.33%
389	Other Plant & Misc. Equip. - Rclmd Water Dist.	30.0	0%	3.33%
<u>General Plant</u>				
353	Land and Land Rights			
354	Structures and Improvements	25.0	0%	4.00%
394	Laboratory Equipment	20.0	0%	5.00%
390	Office Furniture	19.0	10%	4.74%
390	Personal Computers	*		
390	PC Software	*		
390	MainFrame Computers	*		
390	MainFrame Software	*		
390	Other Machinery & Equipment	20.0	0%	5.00%
392	Stores Equipment	29.0	5%	3.28%
395	Power Equipment	10.0	50%	5.00%
396	Communication Equipment	8.0	0%	12.50%
397	Miscellaneous Equipment	20.0	0%	5.00%
391	Transportation Equipment	6.5	30%	10.77%
393	Tools, Shop and Garage Equip.	13.0	5%	7.31%
398	Other Tangible Plant	20.0	0%	5.00%

\* The Company includes depreciation expense for these accounts on an allocated basis.

# APPENDIX A

**Qualifications & Experience**



**Rate Setting  
Valuation  
Management  
Consulting**

*...SERVING REGULATED AND UNREGULATED WATER AND WASTEWATER UTILITIES SINCE 1978*

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## INTRODUCTION

### GUASTELLA ASSOCIATES, LLC

Guastella Associates, LLC (“formerly John F. Guastella Associates, Inc.”) is a consulting firm that specializes in providing utility rate setting, valuation and management services for public and privately-owned water and wastewater utilities.

John F. Guastella established Guastella Associates in 1978. Previously, Mr. Guastella was Director of the Water Division of the New York Public Service Commission. The Water Division provided the New York Commission with technical assistance in regulating the rates and service provided by approximately 450 privately-owned utilities. During the period from 1987 through 1991, Mr. Guastella also managed a 5,500 customer water utility in New York State. In 1989, Guastella Associates acquired the rates and valuation section of Coffin & Richardson, Inc., a general consulting firm that also provided a full range of services to water and wastewater utilities.

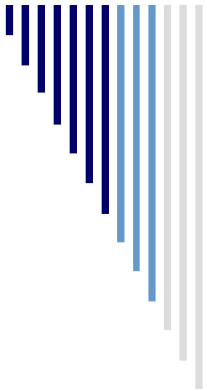
As can be seen from the following qualifications and experience, key staff members have many years of combined experience in virtually every aspect of utility rate setting and valuation. The technical expertise of key staff, combined with their former employment by real estate and utility companies, a regulatory agency, and the management of water utilities, provides a total perspective towards addressing the rates and valuation needs of today’s water and wastewater utilities.

Guastella Associates has assisted the largest privately-owned utilities with respect to the most challenging issues, performing complex studies and providing expert testimony in administrative hearings as well as court proceedings. In addition, our client base has included hundreds of small water and wastewater utilities - - obtaining rate increases that turn operating losses into profits, posturing them for financing, correcting record keeping errors and, for some, negotiating their sale at multiples of their original cost net investment rate base. Some of our most successful assignments have been to help establish new developer-related water and wastewater utilities, applying the correct principles at the outset in order to develop fully compensatory initial rates, record keeping procedures and asset management, so they are structured to become self-sustaining utilities that will achieve the highest possible profit and ultimate market value.

Our wide-range of experience and expertise has enabled us to successfully address the special needs of large investor-owned utilities in rate cases and condemnation proceedings. We bring the same high level of expertise to the small water and wastewater utilities, which is essential to their success, and at prices they can afford.

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# OUTLINE OF SERVICES

## GUATELLA ASSOCIATES, LLC

Guastella Associates, LLC (“formerly John F. Guastella Associates, Inc.”) is a consulting firm specializing in utility management, valuation, appraisals and rate determinations. Guastella Associates has been providing professional services to regulated and unregulated utilities since 1978.

Specific areas of expertise includes:

I. RATE ANALYSIS

A. Revenue Requirements

1. Examination of books and records -- revenues, expenses and capital investment.
2. Determination of the cost of providing service (revenue requirement) -- normalize historical data, establish known changes and perform projections.

B. Rate Design

1. Perform cost allocation studies to establish cost of service for residential, commercial, industrial, wholesale and fire protection customers, and for other special users.
2. Develop rate structures -- combine billing analyses and cost allocations to form usage rates, flat rates, minimum service and facilities charges, and such other special charges as connection fees, availability rates, etc.

C. Reports

1. Investor-owned utilities -- prepare complete rate filings for submission to regulatory agencies; prepare testimony, exhibits, and assist in all aspects of adjudication process.
  2. Municipal utilities -- prepare detailed rate reports in support of rate increases for use by municipal officials and presentation at municipal hearings.
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# OUTLINE OF SERVICES

## GUASTELLA ASSOCIATES, LLC

### II. VALUATIONS

#### A. Appraisals

1. Eminent domain condemnation proceedings, negotiations for sale of utilities, damage claims for insurance and ad valorem tax and management purposes.
2. Determinations of original cost, replacement cost, reproduction cost and market value, including going concern value.
3. Calculation of the present value of cash flow under the income approach to market value determinations.
4. Analyses of market data under the sales comparison approach.

#### B. Depreciation

1. Actuarial studies using retirement rate or simulated plant balances methods to determine average service lives of physical property, theoretical depreciation reserve requirements and depreciation rates.
2. Establish affordable depreciation rates on the basis of comparative analyses of similar property of other utilities and practices of regulatory agencies and association

#### C. Feasibility Studies

1. Utility acquisitions by investors and municipalities.
2. Economic studies to establish extension of service costs and policy -- inside and outside service area.
3. Main extension agreements, guaranteed revenue contracts, refund provisions.

#### D. Financial Planning

1. Establish financing requirements for capital improvements.
2. Determine revenue and rate needs for various combinations of debt and equity financing.
3. Assist certain utilities in securing financing.
4. Establish financing needs, initial rates and regulatory approval of proposed new utilities.

### III. MANAGEMENT

#### A. Operations

1. Assist in day-to-day decisions as to utility accounting and related impact on rates.
2. Solve problems as to record keeping in accordance with regulatory requirements and prescribed systems of accounts.
3. Establish general policy and tariff provisions for customer service, billing, collecting, meter testing, complaint handling, and customer and regulatory relations.

#### B. Administrative

1. Coordinate activities with regulatory agencies to assure compliance with rules, regulations and orders.
2. Negotiations for purchase or sale of utility property and special contracts.

#### C. Training

1. On-the-job training for employees while working on various projects.
  2. Special educational seminars on all aspects of utility rate settings, financing, valuation and rules.
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**PROFESSIONAL QUALIFICATIONS AND EXPERIENCE**  
**of**  
**JOHN F. GUASTELLA**

B.S., Mechanical Engineering, Stevens Institute of Technology, 1962

Member:

American Water Works Association, Lifetime Member  
National Association of Water Companies  
New England Water Works Association, Lifetime Member

Committees:

AWWA, Water Rates Committee (Manual M-1, 1983 Edition)  
National Association of Regulatory Utility Commissioners (NARUC) and NAWC, Joint-Committee on Rate Design  
NAWC, Rates and Revenues Committee  
NAWC, Small Water Company Committee

Mr. Guastella is President of Guastella Associates, LLC (“formerly John F. Guastella Associates, Inc.”) which provides management, valuation and rate consulting services for municipal and investor-owned utilities, as well as regulatory agencies. His clients include utilities in the states of Alaska, Arkansas, California, Connecticut, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Maine, Maryland, Massachusetts, Missouri, Michigan, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Dakota, Ohio, Pennsylvania, South Carolina, Texas, Rhode Island and Virginia. He has provided consulting services that include all aspects of utility regulation and rate setting, encompassing revenue requirements, revenues, operation and maintenance expenses, depreciation, taxes, return on investment, cost allocation and rate design. He has performed depreciation studies for the establishment of average service lives of utility property. He has performed appraisals of utility companies for management purposes and in connection with condemnation proceedings. He has also negotiated the sale of utility companies.

Mr. Guastella served for more than four years as President of Country Knolls Water Works, Inc., a water utility that served some 5,500 customers in Saratoga County, New York. He also served as a member of the Board of Directors of the National Association of Water Companies.

Mr. Guastella has qualified and testified as an expert witness before regulatory agencies and municipal jurisdictions in the states of Alaska, California, Connecticut, Delaware, Florida, Georgia, Illinois, Indiana, Maryland, Massachusetts, Missouri, Montana, Nevada, New Hampshire, New Mexico, New Jersey, New York, North Dakota, Ohio, Pennsylvania, Rhode Island, South Carolina, Texas and Virginia.

Prior to establishing his own firm, Mr. Guastella was employed by the New York State Public Service Commission for sixteen years. For two years he was involved in the regulation of electric and gas utilities, with the remaining years devoted to the regulation of water utilities. In 1970, he was promoted to Chief of Rates and Finance in the Commission's Water Division. In 1972, he was made Assistant Director of the Water Division. In 1974, he was appointed by Alfred E. Kahn, then Chairman of the Commission, to be Director of the Water Division, a position he held until he resigned from the Commission in August 1978.

At the Commission, his duties included the performance and supervision of engineering and economic studies concerning rates and service of many public utilities. As Director of the Water Division, he was responsible for the regulation of more than 450 water companies in New York State and headed a professional staff of 32 engineers and three technicians. A primary duty was to attend Commission sessions and advise the Commission during its decision making process. In the course of that process, an average of about fifty applications per year would be reviewed and analyzed. The applications included testimony, exhibits and briefs

involving all aspects of utility valuation and rate setting. He also made legislative proposals and participated in drafting Bills that were enacted into law: one expanded the N.Y. Public Service Commission's jurisdiction over small water companies and another dealt specifically with rate regulation and financing of developer-related water systems.

In addition to his employment and client experience, Mr. Guastella served as Vice-Chairman of the Staff-Committee on Water of the National Association of Regulatory Utility Commissioners (NARUC). This activity included the preparation of the "Model Record-Keeping Manual for Small Water Companies," which was published by the NARUC. This manual provides detailed instruction on the kinds of operation and accounting records that should be kept by small water utilities, and on how to use those records.

Each year since 1974 he has prepared study material, assisted in program coordination and served as an instructor at the Eastern Annual Seminar on Water Rate Regulation sponsored over the years by the NARUC in conjunction with the University of South Florida, Florida Atlantic University, the University of Utah, Florida State University, the University of Florida and currently Michigan State University. In 1980 he was instrumental in the establishment of the Western NARUC Rate Seminar and has annually served as an instructor since that time. This course is recognized as one of the best available for teaching rate-setting principles and methodology. More than 7,000 students have attended this course, including regulatory staff, utility personnel and members of accounting, engineering, legal and consulting firms throughout the country.

Mr. Guastella served as an instructor and panelist in a seminar on water and wastewater regulation conducted by the Independent Water and Sewer Companies of Texas. In 1998, he prepared and conducted a seminar on basic rate regulation on behalf of the New England Chapter of the National Association of Water Companies. In 2000 and 2001, Mr. Guastella developed and conducted a special seminar for developer related water and wastewater utilities in conjunction with Florida State University, and again in 2003 in conjunction with the University of Florida. It provided essential training for the financial structuring of small water and wastewater utilities, rate setting, financing and the establishment of their market value in the event of a negotiated sale or condemnation. In 2004, he prepared and conducted a special workshop seminar on behalf of the Office of Regulatory Staff of South Carolina, covering rate setting, valuation and general regulation of water and wastewater utilities. In 2006, he participated in an expert workshop on full cost pricing conducted by the U. S. Environmental Protection Agency in coordination with the Institute of Public Utilities, Michigan State University. In 2006, he prepared and conducted a special seminar on rate setting and valuation on behalf of the New York Chapter of the NAWC. In 2007, he prepared and conducted a special seminar on rate setting and valuation on behalf of the New England Chapter of NAWC. In 2013, he prepared and conducted a special seminar on rate setting and valuation on behalf of the New York Chapter of NAWC

Mr. Guastella has made presentations on a wide variety of rate, valuation and regulatory issues at meetings of the National Association of Regulatory Utility Commissioners, the American Water Works Association, the New England Water Works Association, the National Association of Water Companies, the New England Conference of Public Utilities Commissioners, the Florida, New England, New Jersey and New York Chapters of NAWC, the Mid-America Regulatory Conference, the Southeastern Association of Regulatory Utility Commissioners, the Pennsylvania Environmental Conference, the Public Utility Law Section of the New Jersey Bar Association, and the NAWC Water Utility Executive Council.

**John F. Guastella**  
**List of Proceedings in which**  
**Expert Testimony**  
**was Presented**

Year	Client	State	Regulatory Docket/Case Number
1966	Sunhill Water Corporation	New York	23968
1967	Amagansett Water Company	New York	24210
1967	Worley Homes, Inc.	New York	24466
1968	Amagansett Water Company	New York	24718
1968	Amagansett Water Company	New York	24883
1968	Sunhill Water Corporation	New York	23968
1968	Worley Homes, Inc.	New York	Supreme Court
1969	Amagansett Water Supply	New York	24883
1969	Citizens Water Supply Co.	New York	25049
1969	Worley Homes, Inc.	New York	24466/24992
1970	Brooklyn Union Gas Company	New York	25448
1970	Consolidated Edison of New York	New York	25185
1971	Hudson Valley Water Companies	New York	26093
1971	Jamaica Water Supply Company	New York	26094
1971	Port Chester Water Works, Inc.	New York	25797
1971	U & I Corp. - Merrick District	New York	26143
1971	Wanakah Water Company	New York	25873
1972	Spring Valley Water Company	New York	26226
1972	U & I Corp. - Woodhaven District	New York	26232
1973	Citizens Water Supply Company	New York	26366
1978	Rhode Island DPU&C (Bristol County)	Rhode Island	1367A
1979	Candlewick Lake Utilities Co.	Illinois	76-0218
1979	Candlewick Lake Utilities Co.	Illinois	76-0347
1979	Candlewick Lake Utilities Co.	Illinois	78-0151
1979	Jacksonville Suburban Utilities	Florida	770316-WS
1979	New York Water Service Corporation	New York	27594
1979	Salem Hills Sewerage Disposal Corp. v. V. of Voorheesville	New York	Supreme Court
1979	Seabrook Water Corporation	New Jersey	7910-846
1979	Southern Utilities Corporation	Florida	770317-WS
1979	Township of South Brunswick	New Jersey	Municipal
1979	Westchester Joint Water Works	New York	Municipal
1979	Woodhaven Utilities Corporation	Illinois	77-0109
1980	Crestwood Village Sewer Company	New Jersey	BPU 802-78
1980	Crestwood Village Water Company	New Jersey	BPU 802-77
1980	Gateway Water Supply Corporation	Texas	Municipal
1980	GWW-Central Florida District	Florida	800004-WS
1980	Jamaica Water Supply Company	New York	27587
1980	Rhode Island DPU&C (Newport Water)	Rhode Island	1480
1981	Briarcliff Utilities, Inc.	Texas	3620
1981	Candlewick Lake Utilities Co.	Illinois	81-0011
1981	Caroline Water Company, Inc.	Virginia	810065
1981	GDU, Inc. - Northport	Florida	Municipal
1981	GDU, Inc. - Port Charlotte	Florida	Municipal
1981	GDU, Inc. - Port Malabar	Florida	80-2192
1981	Hobe Sound Water Company	Florida	8000776
1981	Lake Buckhorn Utilities, Inc.	Ohio	80-999
1981	Lake Kiowa Utilities, Inc.	Texas	3621
1981	Lakengren Utilities, Inc.	Ohio	80-1001
1981	Lorelei Utilities, Inc.	Ohio	80-1000
1981	New York Water Service Corporation	New York	28042
1981	Rhode Island DPU&C (Newport Water)	Rhode Island	1581
1981	Shawnee Hills Utility Company	Ohio	80-1002
1981	Smithville Water Company, Inc.	New Jersey	808-541
1981	Spring Valley Water Company, Inc.	New York	27936
1981	Spring Valley Water Company, Inc.	New York	27936
1981	Sunhill Water Corporation	New York	27903
1981	Swan Lake Water Corporation	New York	27904
1982	Chesterfield Commons Sewer Company	New Jersey	822-84
1982	Chesterfield Commons Water Company	New Jersey	822-83
1982	Crescent Waste Treatment Corp.	New York	Municipal
1982	Crestwood Village Sewer Company	New Jersey	821-33
1982	Crestwood Village Water Company	New Jersey	821-38
1982	Salem Hills Sewerage Disposal Corp.	New York	Municipal
1982	Township of South Brunswick	New Jersey	Municipal
1982	Woodhaven Utilities Corporation	Illinois	82-0167
1983	Country Knolls Water Works, Inc.	New York	28194
1983	Heritage Hills Water Works Corp.	New York	28453
1984	Crestwood Village Sewer Company	New Jersey	8310-861
1984	Crestwood Village Water Company	New Jersey	8310-860
1984	Environmental Disposal Corp.	New Jersey	816-552
1984	GDU, Inc. - Port St. Lucie	Florida	830421
1984	Heritage Village Water (water/sewer)	Connecticut	84-08-03
1984	Hurley Water Company, Inc.	New York	28820
1984	New York Water Service Corporation	New York	28901
1985	Deltona Utilities (water/sewer)	Florida	830281
1985	J. Filiberto Sanitation, Inc.	New Jersey	8411-1213
1985	Sterling Forest Pollution Control	New York	Municipal
1985	Water Works Enterprise, Grand Forks	North Dakota	Municipal
1986	GDU, Inc. - Port Charlotte	Florida	Municipal
1986	GDU, Inc. - Sebastian Highlands	Florida	Municipal
1986	Kings Grant Water/Sewer Companies (settled)	New Jersey	WR8508-868
1986	Mt. Ebo Sewage Works, Inc.	New York	Municipal
1986	Sterling Forest Pollution Control	New York	Municipal
1987	Country Knolls Water Works, Inc.	New York	29443
1987	Crestwood Village Sewer Co. (settled)	New Jersey	WR8701-38

**John F. Guastella**  
**List of Proceedings in which**  
**Expert Testimony**  
**was Presented**

Year	Client	State	Regulatory Docket/Case Number
1987	Deltona Utilities - Marco Island	Florida	850151-WS
1987	Deltona Utilities, Inc. - Citrus Springs (settled)	Florida	870092-WS
1987	First Brewster Water Corp. v. Town of Southeast (settled)	New York	Supreme Court
1987	GDU, Inc. - Silver Springs Shores	Florida	870239-WS
1987	Ocean County Landfill Corporation	New Jersey	SR-8703117
1987	Palm Coast Utility Corporation	Florida	870166-WS
1987	Sanlando Utilities Corp. (settled)	Florida	860683-WS
1987	Township of South Brunswick	New Jersey	Municipal
1987	Woodhaven Utilities Corp. (settled)	Illinois	87-0047
1988	Crescent Estates Water Co., Inc.	New York	88-W-035
1988	Elizabethtown Water Co.	New Jersey	OAL PUC3464-88
1988	Heritage Village Water Company	Connecticut	87-10-02
1988	Instant Disposal Service, Inc.	New Jersey	SR-87080864
1988	J. Filiberto Sanitation v. Morris County Transfer Station	New Jersey	01487-88
1988	Ohio Water Service Co.	Ohio	86-1887-WW-CO1
1988	St. Augustine Shores Utilities	Florida	870980-WS
1989	Elizabethtown Water Co.	New Jersey	BPU WR89020132J
1989	GDU (FPSC generic proceeding as to rate setting procedures)	Florida	880883-WS
1989	Gordon's Corner Water Co.	New Jersey	OAL PUC479-89
1989	Heritage Hills Sewage Works	Connecticut	Municipal
1989	Heritage Village Water Company	Connecticut	87-10-02
1989	Palm Coast Utility Corporation	Florida	890277-WS
1989	Southbridge Water Supply Co.	Massachusetts	DPU 89-25
1989	Sterling Forest Water Co.	New York	PSC 88-W-263
1990	American Utilities, Inc. - United States Bankruptcy Court	New Jersey	85-00316
1990	City of Carson City	Nevada	Municipal
1990	Country Knolls Water Works, Inc.	New York	90-W-0458
1990	Elizabethtown Water Company	New Jersey	WR900050497J
1990	Kent County Water Authority	Rhode Island	1952
1990	Palm Coast Utility Corporation	Florida	871395-WS
1990	Southern States Utilities, Inc.	Florida	Workshop
1990	Trenton Water Works	New Jersey	WR90020077J
1990	Waste Management of New Jersey	New Jersey	SE 87070552
1990	Waste Management of New Jersey	New Jersey	SE 87070566
1991	City of Grand Forks	North Dakota	Municipal
1991	Gordon's Corner Water Co.	New Jersey	OAL PUC8329-90
1991	Southern States Utilities, Inc.	Florida	900329-WS
1992	Elizabethtown Water Co.	New Jersey	WR 91081293J
1992	General Development Utilities, Inc. - Port Malabar Division	Florida	911030-WS
1992	General Development Utilities, Inc. - West Coast Division	Florida	911067-WS
1992	Heritage Hills Water Works, Inc.	New York	92-2-0576
1993	General Development Utilities, Inc. - Port LaBelle Division	Florida	911737-WS
1993	General Development Utilities, Inc. - Silver Springs Shores	Florida	911733-WS
1993	General Waterworks of Pennsylvania - Dauphin Cons. Water Supply	Pennsylvania	R-00932604
1993	Kent County Water Authority	Rhode Island	2098
1993	Southern States Utilities - FPSC Rulemaking	Florida	911082-WS
1993	Southern States Utilities - Marco Island	Florida	920655-WS
1994	Capital City Water Company	Missouri	WR-94-297
1994	Capital City Water Company	Missouri	WR-94-297
1994	Elizabethtown Water Company	New Jersey	WR94080346
1994	Elizabethtown Water Company	New Jersey	WR94080346
1994	Environmental Disposal Corp.	New Jersey	WR94070319
1994	General Development Utilities - Port Charlotte	Florida	940000-WS
1994	General Waterworks of Pennsylvania	Pennsylvania	R-00943152
1994	Hoosier Water Company - Mooresville Division	Indiana	39839
1994	Hoosier Water Company - Warsaw Division	Indiana	39838
1994	Hoosier Water Company - Winchester Division	Indiana	39840
1994	West Lafayette Water Company	Indiana	39841
1994	Wilmington Suburban Water Corporation	Delaware	94-149 (stld)
1995	Butte Water Company	Montana	Cause 90-C-90
1995	Heritage Hills Sewage Works Corporation	New York	Municipal
1996	Consumers Illinois Water Company	Illinois	95-0342
1996	Elizabethtown Water Company	New Jersey	WR95110557
1996	Palm Coast Utility Corporation	Florida	951056-WS
1996	PenPac, Inc.	New Jersey	OAL-00788-93N
1996	Southern States Utilities, Marco Island	Florida	950495-WS
1997	Crestwood Village Water Company	New Jersey	BPU 96100739
1997	Indiana American Water Co., Inc.	Indiana	IURC 40703
1997	Missouri-American Water Company	Missouri	WR-97-237
1997	South County Water Corp	New York	97-W-0667
1997	United Water Florida	Florida	960451-WS
1998	Consumer Illinois Water Company	Illinois	98-0632
1998	Consumers Illinois Water Company	Illinois	97-0351
1998	Heritage Hills Water Company	New York	97-W-1561
1998	Missouri-American Wastewater Company	Missouri	SR-97-238
1999	Consumers Illinois Water Company	Illinois	99-0288
1999	Environmental Disposal Corp.	New Jersey	WR99040249
1999	Indiana American Water Co., Inc.	Indiana	IURC 41320
2000	South Haven Sewer Works, Inc.	Indiana	Cause: 41410
2000	Utilities Inc. of Maryland	Maryland	CAL 97-17811
2001	Artesian Water Company	Delaware	00-649
2001	Citizens Utilities Company	Illinois	01-0001
2001	Elizabethtown Water Company	New Jersey	WR-0104205
2001	Kiawah Island Utility, Inc.	South Carolina	2001-164-W/S
2001	Placid Lakes Water Company	Florida	011621-WU

**John F. Guastella**  
**List of Proceedings in which**  
**Expert Testimony**  
**was Presented**

Year	Client	State	Regulatory Docket/Case Number
2001	South Haven Sewer Works, Inc.	Indiana	41903
2001	Southlake Utilities, Inc.	Florida	981609-WS
2002	Artesian Water Company	Delaware	02-109
2002	Consumers Illinois Water- Grant Park	Illinois	02-0480
2002	Consumers Illinois Water- Village Woods	Illinois	02-0539
2002	Valencia Water Company	California	02-05-013
2003	Consumers Illinois Water - Indianola	Illinois	03-0069
2003	Elizabethtown Water Company	New Jersey	WR-030-70510
2003	Golden Heart Utilities, Inc.	Alaska	U-02-13, 14 & 15
2003	Utilities, Inc. - Georgia	Georgia	CV02-0495-AB
2004	Aquarion Water Company	Connecticut	04-02-14
2004	Artesian Water Company	Delaware	04-42
2004	El Dorado Utilities, Inc.	New Mexico	D-101-CU-2004-
2004	Environmental Disposal Corp.	New Jersey	DPU WR 03 070509
2004	Heritage Hills Water Company	New York	03-W-1182
2004	Sun Valley Water & Washoe County Dept. of Water Revenues	Nevada	TMWA Municipal
2004	Jersey City MUA	New Jersey	Municipal
2004	Rockland Electric Company	New Jersey	EF02110852
2005	Aquarion Water Company	New Hampshire	DW 05-119
2005	Intercoastal Utilities, Inc.	Florida	04-0007-0011-0001
2005	Haig Point Utility Company, Inc.	South Carolina	2005-34-W/S
2005	South Central Connecticut Regional Water Auth.	Connecticut	Municipal
2006	Pennichuck Water Works, Inc.	New Hampshire	DW-04048
2006	Village of Williston Park	New York	Municipal
2006	Jersey City MUA	New Jersey	Municipal
2006	Groton Utilities	Connecticut	Municipal
2006	Connecticut Water Company	Connecticut	06-07-08
2006	Birmingham Utilities, Inc.	Connecticut	06-05-10
2006	Aqua Florida Utilities, Inc.	Florida	060368-WS
2007	Aquarion Water Company of CT	Connecticut	07-05-19
2007	Pennichuck Water Works, Inc.	New Hampshire	DW 04-048
2007	Aqua Indiana - Utility Center	Indiana	43331
2007	Environmental Disposal Corp.	New Jersey	WR 04 080760
2007	Aqua Florida Utilities, Inc.	Florida	07-0183
2007	Aqua Illinois, Inc. - Hawthorn Woods, Willowbrook & Vermilion	Illinois	07-0620/07-0621/08-0067
2008	Aqua Florida Utilities, Inc.	Florida	080121-WS
2008	Aquarion Water Company of MA	Massachusetts	D.P.U. 08-27
2008	Haig Point Utility Company, Inc.	South Carolina	2007-414-WS
2009	R.M.V. Land & C.M. Livestock, L.C.C.	New Jersey	EM02050313
2010	City of Griffin	Georgia	Civil Action No. 09V-2866
2010	Connecticut Water Company	Connecticut	09-12-11
2010	Montville WPCA	Connecticut	1400012464
2010	Milford Water Company	Massachusetts	DPU 10-78
2010	Arizona American Water Company	Arizona	W-01303A-10-0448
2011	Aqua Illinois	Illinois	ICC Docket (Consolidated)
2011	Artesian Water Company	Maryland	MPSC Case 9252
2011	Artesian Water Company	Delaware	PSC 11-207
2011	Kiawah Island Utility, Inc.	South Carolina	2011-317-WS
2012	Washington Gas Light	Maryland	Senate SB541
2012	Washington Gas Light	Maryland	House HB662
2012	Daufuskie Island Utility	South Carolina	2011-229-W/S
2012	Milford Water Company	Massachusetts	DPU 12-86
2013	Artesian Water Company	Pennsylvania	2:10-CV-07453-JP
2013	Aquarion Water Company	Massachusetts	CA 09-00592E
2013	Water Management Services	Florida	110200-WU
2013	City of Fernandina Beach	Florida	Civil Action No. 13CA000485AXYX
2013	City of Elizabeth	New Jersey	Docket Nos. UNN-L-0556-10 and UNN-L- 2608-11
2014	Daufuskie Island Utility Company, Inc.	South Carolina	Case No. 2013-CP-07-02255
2014	Artesian Water Company	Delaware	Docket No. PSC 14-132

# Papers and Presentations

By

**John F. Guastella**

Year	Title	Forum
1974 through 2014	1. Basics of Rate Setting 2. Cost Allocation and Rate Design 3. Revenue Requirements	Semi-annual seminars on utility rate regulation, National Association of Regulatory Utility Commissioners, sponsored by the University of South Florida, the University of Utah, Florida State University, The University of Florida and currently Michigan State University
1974	Rate Design Studies: A Regulatory Point-of-View	Annual convention of the National Association of Water Companies, New Haven, Connecticut
1976	Lifeline Rates	Annual convention of the National Association of Water Companies, Chattanooga, Tennessee
1977	Regulating Water Utilities: The Customers' Best Interest	Annual symposium of the New England Conference of Public Utilities Commissioners, Mystic Seaport, Connecticut
1978	Rate Design: Preaching v. Practice	Annual convention of the National Association of Water Companies, Baton Rouge, Louisiana
1979	Small Water Companies	Annual symposium of the New England Conference of Public Utilities Commissioners, Newport, Rhode Island
1979	Rate Making Problems Peculiar to Private Water and Sewer Companies	Special educational program sponsored by Independent Water and Sewer Companies of Texas, Austin, Texas
1980	Water Utility Regulation	Annual meeting of the National Association of Regulatory Utility Commissioners, Houston, Texas
1981	The Impact of Water Rates on Water Usage	Annual Pennsylvania Environmental Conference, Harrisburg, Pennsylvania
1981	A Realistic Approach to Regulating Water Utilities	Mid-America Regulatory Conference, Clarksville, Indiana
1982	Issues in Water Utility Regulation	Annual symposium of the New England Conference of Public Utilities Commissioners, Rockport, Maine
1982	New Approaches to the Regulation of Water Utilities	Southeastern Association of Regulatory Utility Commissioners, Asheville, North Carolina
1983	Allocating Costs and Revenues Fairly and Effectively	Maryland Water and Sewer Finance Conference, Westminster, Maryland
1983	Lifeline and Social Policy Pricing	Annual conference of the American Water Works Association, Las Vegas, Nevada (published)
1984	The Real Cost of Service: Some Special Considerations	Annual New Jersey Section AWWA Spring Meeting, Atlantic City, New Jersey
1987	Margin Reserve: It's Not the Issue	Florida Waterworks Association Newsletter, April/May/June 1987 issue
1987	A "Current" Issue: CIAC	NAWC - New England Chapter November 6, 1987 meeting
1988	Small Water Company Rate Setting: Take It or Leave It	NAWC - New York Chapter June 14, 1988 meeting
1989	The Solution to all the Problems of Good Small Water Companies	NAWC Quarterly magazine, Winter issue
1989	Current Issues Workshop - Panel	New England Conference of Public Utilities Commissioners, Kennebunkport, Maine
1991	Alternative Rate Structures	New Jersey Section 1991 Annual Conference, AWWA, Atlantic City, New Jersey
1994	Conservation Impact on Water Rates	New England NAWC and New England AWWA, Sturbridge, Massachusetts



# Papers and Presentations

By

**John F. Guastella**

Year	Title	Forum
1996	Utility Regulation - 21st Century	NAWC Annual Meeting, Orlando, Florida
1997	Current Status Drinking Water State Revolving Fund	NAWC Annual Meeting, San Diego, California
1998	Small Water Companies - Problems and Solutions	NAWC Annual Meeting, Indianapolis, Indiana
1998	Basic Rate Regulation Seminar	New England Chapter - NAWC, Rockport, Maine
2000	Developer Related Water and Sewer Utilities Seminar	Florida State University, Orlando, Florida
2001	Developer Related Water and Sewer Utilities Seminar	Florida State University, Orlando, Florida
2002	Regulatory Cooperation - Small Company Education	New England Chapter - NAWC, Annual Meeting
2003	Developer Related Water and Sewer Utilities Seminar	University of Florida, Orlando, Florida
2004	Basic Regulation & Rate Setting Training Seminar	Office of Regulatory Staff, Columbia, South Carolina
2005	Municipal Water Rates	Nassua-Suffolk Water Commissioners Association, Franklin Square, New York
2005	Innovations in Rate Setting and Procedures	NAWC New York Chapter, West Point, New York
2006	Basics of Rate Setting	The Connecticut Water Company, Clinton, Connecticut
2006	Innovations in Rate Setting and Procedures	NAWC New York Chapter, Catskill, New York
2006	Best Practices as Regulatory Policy	NAWC New England Chapter, Ogunquit, Maine
2006	Rate and Valuation Seminar	NAWC New York Chapter
2006	Full Cost Pricing	U.S. Environmental Protection Agency Expert Workshop, Lansing, Michigan
2006	Innovations in Rate Setting	NAWC New England Chapter, Portsmouth, New Hampshire
2007	Weather Sensitive Customer Demands	NAWC Water Utility Executive Council, Half Moon Bay, California
2007	Basics of Rate Setting and Valuation Seminar	NAWC New England Chapter, Ogunquit, Maine
2007	Small Company Characteristics	National Drinking Water Symposium, La Jolla, California
2013	Rate and Valuation Seminar	NAWC New York Chapter

**STATE OF ILLINOIS**

**ILLINOIS COMMERCE COMMISSION**

<b>Utility Services of Illinois, Inc.</b>	:	
	:	
<b>Proposed Rate Increases for Water and Sewer Service. (tariffs filed November 10, 2014)</b>	:	<b>14-0741</b>
	:	

**ORDER**

**September 22, 2015**



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**STATE OF ILLINOIS**

**ILLINOIS COMMERCE COMMISSION**

**Utility Services of Illinois, Inc.** :  
: **14-0741**  
**Proposed Rate Increases for Water** :  
**and Sewer Service. (tariffs filed** :  
**November 10, 2014)** :

**ORDER**

By the Commission:

**I. INTRODUCTION**

**A. Procedural History**

On November 10, 2014, Utility Services of Illinois, Inc. (“USI” or the “Company”) filed tariff sheets with the Illinois Commerce Commission (“Commission”), pursuant to Section 9-201 of the Public Utilities Act (“Act”). In these tariff sheets – ILL.C.C. No. 3 First Revised Title Sheet, First Revised Sheet Nos. 1 through 4 and ILL.C.C. No. 4 First Revised Title Sheet, First Revised Sheet Nos. 1 and 2 – USI proposed a general increase in rates for water and sewer service as well as other proposed changes.

Notice of the proposed changes reflected in the tariff sheets was sent to customers, posted in USI’s business offices, and published in a newspaper of general circulation in its service areas, in accordance with the requirements of Section 9-201(a) of the Act and the provisions of 83 Ill. Adm. Code Part 255. The Commission issued an Order on December 17, 2014 suspending the tariffs up to and including April 10, 2015 and initiating this proceeding. Subsequently, the Commission re-suspended the tariffs on March 25, 2015 up to and including October 10, 2015.

On December 19, 2014, the Attorney General of the State of Illinois (the “AG”) filed an appearance. On January 16, 2015, the Company filed a Motion for Entry of a Protective Order in this proceeding, which was granted on February 18, 2015. On January 6, 2015, the Galena Territory Association (“GTA”) filed a verified petition to intervene. On April 23, 2015, Westlake Village Master Homeowners Association, Inc. (“WVMHA”) filed a verified petition to intervene. On April 30, 2015, Westlake Village Limited Partnership (“WVLP”) filed a verified petition to intervene. On July 6, 2015, Lake Holiday Property Owners Association, Inc. (“LHPOA”) filed a verified petition to intervene. All of the petitions were granted.

Pursuant to notice as required by the law and rules and regulations of the Commission, an evidentiary hearing was held before a duly authorized Administrative Law Judge (“ALJ”) of the Commission at its offices in Chicago, Illinois on May 20, 2015. At the evidentiary hearing, the Company, the AG, Staff of the Commission (“Staff”), GTA, WVMHA, and WVLP (collectively, GTA, WVMHA, and WVLP are the “Intervenors”), appeared and presented testimony.

The Company presented the following witnesses: Steven Lubertozzi, President of USI; Dimitry I. Neyzelman, a Financial Planning and Analysis Manager at Utilities, Inc. (“UI”); Justin Kersey, the Financial Planning and Analysis Manager of USI; Bruce T. Haas, Vice President of Operations for the Midwest Region of UI; John F. Guastella, President of Guastella Associates, LLC; and Dylan W. D’Ascendis, a Managing Consultant at Sussex Economic Advisors, LLC.

The following witnesses testified on behalf of Staff: Richard W. Bridal II, Mary H. Everson, and Theresa Ebrey, Accountants in the Accounting Department of the Financial Analysis Division; Christopher Boggs, a Rate Analyst in the Rates Department of the Financial Analysis Division; Janis Freetly, a Senior Financial Analyst in the Finance Department of the Financial Analysis Division, Jonathan M. Sperry, a Water Engineer in the Water Engineering Program of the Safety and Reliability Division; and Michael McNally, a Senior Financial Analyst in the Finance Department of the Financial Analysis Division.

The Intervenor presented the following witnesses: Joe Mattingley, the Chief Executive Officer of GTA on behalf of GTA; Steven Korn, a member of the board of directors of WVMHA on behalf of WVMHA; and Timothy H. Jagielski, the Assistant Counsel at Williams Charles, Ltd. on behalf of WVLP. The AG presented the testimony of Frank W. Radigan, a Consultant at Hudson River Energy Group.

Initial Briefs and Reply Briefs were filed by all of the parties, except LHPOA, on June 16, 2015 and July 7, 2015, respectively. On July 17, 2015, Staff filed a Motion to Deny Requests for Public Forum, which was granted on August 3, 2015. The record was subsequently marked “Heard and Taken.”

The ALJ’s Proposed Order was served on August 7, 2015. On August 21, 2015, the AG and the Intervenor along with LHPOA filed Briefs on Exceptions. On September 4, 2015, the Company and Staff filed Reply Briefs on Exceptions. This Order considers all of the positions and arguments set forth in the Briefs on Exceptions and Reply Briefs on Exceptions.

## **B. Nature of Operations**

USI is a wholly owned subsidiary of UI. UI owns approximately 63 water and sewer utilities operating in 15 states, including USI. Water Service Corporation (“WSC”) manages the operation for all of UI’s water and wastewater systems, including USI. WSC provides management, administration, engineering, accounting, billing, data processing, and regulatory services for the utility systems. WSC’s expenses are assigned directly to a utility or distributed to the various companies pursuant to a formula that has been approved by the Commission.

USI was incorporated in 2013 solely for implementation of the merger into a single entity of the 23 separate wholly owned subsidiaries of UI that provided water and sewer services in Illinois (the “Illinois Utilities”). The merger was approved by the Commission on October 7, 2014 in Docket No.13-0618. Under the approved merger, the existing rates of each of the Illinois Utilities remained in effect for the customers located in divisions of USI corresponding to the service areas that were served by the former UI operating subsidiaries. More than half of those utilities had not filed for a

general rate increase since 2010, and the rates for six of those companies were established during the period from 1987 through 2004. For most of the predecessors that filed for rate increases after 2010, the current rates were designed to recover expense levels based on test years that included costs incurred in 2010.

USI provides water service to approximately 12,000 customers and almost 3,000 availability customers via almost 50 wells and more than 1.39 million (“mm”) linear feet of water distribution mains. USI also provides wastewater service to approximately 4,000 customers via more than .240 mm linear feet of wastewater collection mains and seven wastewater treatment facilities. USI serves customers in twelve different counties throughout Illinois, including Jo Daviess, Kane, Lake, LaSalle, Marshall, McHenry, Peoria, Stephenson, Vermilion, Will, and Winnebago.

### **C. Test Year**

USI’s filing is based on a future test year ending December 31, 2015, with pro forma adjustments for known and measurable changes. No party challenged the reasonableness of using the year 2015 as a future test year.

The Commission concludes that the test year ending December 31, 2015, with adjustments for known and measurable changes, is appropriate for the purposes of this proceeding.

### **D. Requested Increase**

USI originally proposed to increase annual revenues by \$2,326,239 for water service and \$576,917 for sewer service. In surrebuttal testimony, USI proposed a \$2,061,306 revenue increase for water and \$533,552 increase for sewer which reflects that USI agreed with or accepted, in whole or in part, numerous Staff and AG proposed adjustments and updated certain items.

## **II. RATE BASE**

### **A. Uncontested Issues**

#### **1. Working Capital**

Staff witness Ebrey proposed an adjustment to the Company’s proposed calculation of cash working capital to remove the impact of real estate taxes where payment is deferred for more than one year because the deferral results in an extended payment lag from which the Company has the use of the funds. Staff Ex. 1.0 at 7-8. The Company accepted Staff’s adjustment. USI Ex. 7.0 at 1-2.

The Commission finds that this adjustment is appropriate.

#### **2. Plant Disallowances from Prior Proceedings (Including Derivative Impacts)**

Staff proposed an adjustment to remove certain plant that had previously been disallowed in prior rate cases of Del-Mar Water Company and the derivative adjustments for that plant. Staff Ex 3.0 at 2. The Company accepted Staff’s adjustment. USI Ex. 7.0 at 2 and Scheds. 7.02 W and 7.04 W.

The Commission finds that adjustment to be appropriate.



### **3. Capitalized Time in Plant Accounts with No Assets**

Staff witness Ebrey proposed an adjustment to remove capitalized labor associated with plant accounts 307 and 335 because there were no assets in those accounts. Staff Ex. 3.0 at 3-4. The Company accepted Staff's adjustment. USI Ex. 7.0 at 2 and Schedules 7.02 W and 7.04 W.

The Commission finds that Ms. Ebrey has correctly analyzed this issue and her position is adopted.

### **4. Derivative Impact of Illinois State Income Tax Rate Change**

Staff proposed an adjustment to reflect the impact on accumulated deferred income taxes ("ADIT") for the decrease in the Illinois state income tax ("SIT") rate from 9.5% to 7.75% effective January 1, 2015, in accordance with Public Act 98-496. Staff Ex. 1.0 at 9-10. The Company accepted Staff's adjustment. USI Ex. 7.0 at 8. No other party addressed this issue in testimony.

The Commission finds that adjustment to be appropriate.

### **5. Derivative Impact of 2014 Bonus Depreciation**

Staff proposed an adjustment to reflect the impact on ADIT of the 50% bonus depreciation that the Company elected in 2014. Staff Ex. 1.0 at 12-13. The Company agreed with Staff's adjustment and updated the adjustment to include the impact of changes in 2014 utility plant in service (as set forth in USI Exhibit 7.0, Schedule 7.11 W) and to use the correct SIT rate of 7.75% as opposed to the 9.5% that was used in the calculation of Staff's adjustment. USI Ex. 7.0 at 3; USI Ex. 8.0 at 1-2. Staff concurs with the updated adjustment proposed by USI. Staff Ex. 7.0 at 6. No other party addressed this issue in testimony.

The Commission finds that adjustment to be appropriate.

### **6. Oakwood Main Project**

USI proposed adjustments in its rebuttal testimony to include a major water main project for the Oakwood service area. USI Ex. 7.0 at 2; USI Ex. 9.0 at 1-3. USI first discussed this plant addition in its December 22, 2014 supplemental direct testimony, USI Exhibit 5.01, wherein USI stated that the project was expected to be completed by the end of 2014 and was unintentionally left out of USI's direct testimony exhibits. USI Ex. 5.01 at 1-3. Staff reviewed supporting documentation for the main project and did not object to the inclusion of the project in rate base. Staff Ex. 7.0 at 7. No other party addressed this issue in testimony.

The Commission finds that adjustment to be appropriate.

### **7. Capitalization of Costs Associated with 83 Ill. Adm. Code 280**

In its original response to a Staff data request, Staff DR RWB 3.02, the Company indicated that it intended to include costs associated with the implementation of 83 Ill. Adm. Code 280, Procedures for Gas, Electric, Water and Sanitary Sewer Utilities Governing Eligibility for Service, Deposits, Billing, Payments, Refunds and Disconnection of Service, in its test year forecast. In the Company's supplemental

response to Staff DR RWB 3.02, the Company stated that in order to ensure compliance with the rule changes to 83 Ill. Adm. Code 280 it will spend \$643,140 which will be capitalized to computers and depreciation over eight years, resulting in an increase to the Company's depreciation expense of \$80,393. Staff Ex. 1.0 at 21-22. Staff's direct testimony required that if USI intended to request recovery of these costs, the Company should in its rebuttal testimony clearly set forth the necessary changes to its proposed revenue requirement and provide a detailed explanation of these additional costs. USI provided the required explanation in its rebuttal testimony and referenced its responses to Staff DRs RWB 7.01-7.03 which were outstanding at the time Staff's direct testimony was prepared. USI Ex. 7.0 at 2-3; USI Ex. 6.0 at 5-6. Staff has no objection to including the proposed costs required to implement and comply with changes to 83 Ill. Adm. Code 280. Staff Ex. 7.0 at 8. No other party addressed this issue in testimony.

The Commission finds these adjustments to be appropriate.

## **8. Original Cost Determination**

Based on the adjustments to plant in service recommended by Staff and as calculated on Schedule 1.15, Staff recommended that the Commission Order include the following language:

IT IS FURTHER ORDERED that the \$37,241,560 original cost of water plant in service for Utility Services of Illinois, Inc. at December 31, 2013, as reflected on Staff Schedule 1.15, is unconditionally approved as the water original costs of plant.

IT IS FURTHER ORDERED that the \$11,760,334 original cost of sewer plant in service for Utility Services of Illinois, Inc. at December 31, 2013, as reflected on Staff Schedule 1.15, is unconditionally approved as the sewer original costs of plant.

Staff used December 31, 2013 for the original cost determination because the twelve months ending December 31, 2013 represents the most recent calendar year for which final historical data is available. Because USI maintains its books on a calendar year basis, using the most recent calendar year for which final historical data is available would set a more reasonable starting point for updating the original cost determination in future rate cases. Due to its acquisition during 2014, the Galena Territories–Oakwood service area was not included in Staff's original cost recommendation. Staff Ex. 1.0 at 21-22. The Company agreed with Staff's recommendation. USI Ex. 7.0 at 3. No other party addressed this issue in testimony.

The Commission finds Staff's recommended language is appropriate and should be included in the Ordering paragraphs.

## **B. Contested Issues**

### **1. Deferred Charges**

The impact on rate base of the contested operating expense issue concerning deferred maintenance expense is discussed in Section III.B.1 of this Order.

### **C. Commission Analysis and Conclusion**

The development of the approved water rate base adopted for USI for purposes of this proceeding is shown in Appendix A to this Order, while the approved sewer rate base adopted for the Company is shown in Appendix B to this Order.

The Commission finds that the adjustments to the rate base reflected in the appendices are supported by the evidence, are reasonable, and should be adopted.

## **III. OPERATING EXPENSES**

### **A. Uncontested Issues**

#### **1. Add-On Taxes / Public Utility Tax**

Staff proposed an adjustment to remove add-on taxes from operating revenues and expenses. Additional amounts of add-on tax included in the Company's proposed increases were removed through the gross revenue conversion factor on column (f) of Schedules 1.01 W and 1.01 S. The taxes are an add-on charge to customers' bills and are not an actual operating expense of the utility. Staff Ex. 1.0 at 8. The Company agreed with Staff's adjustment. USI Ex. 7.0 at 1-2. No other party addressed this issue in testimony.

The Commission finds Staff's adjustment to be reasonable.

#### **2. Illinois State Income Tax Rate Change**

Staff proposed an adjustment to reflect the impact on the test year expenses at present rates for the decrease in the Illinois SIT rate from 9.5% to 7.75% effective January 1, 2015, in accordance with Public Act 98-496, Income Tax Rate – Section 201. Staff Ex. 1.0 at 9. USI agreed with Staff's adjustment. USI Ex. 7.0 at 8. No other party addressed this issue in testimony.

The Commission finds this adjustment is proper.

#### **3. Lake Marian Loss of Prudent Abandonment Amortization**

Staff proposed an adjustment to extend the length of the amortization period for the Lake Marian Water Production Plant Loss of Prudent Abandonment. Staff's adjustment results in a reduction to the annual amortization expense. Staff Ex. 1.0 at 10-11. The Company does not agree with Staff's adjustment; however, for purposes of reducing the number of issues in this proceeding the Company accepted Staff's adjustment. USI Ex. 7.0 at 9. No other party addressed this issue in testimony.

The Commission finds Staff's adjustment to be reasonable.

#### **4. 2014 Bonus Depreciation**

Staff proposed an adjustment to include the impact of the calendar year 2014 50% bonus depreciation in the revenue requirement. Staff Ex. 7.0 at 12-13. The Company agreed with Staff's adjustment and updated the adjustment to include the impact of changes in 2014 utility plant in service (as set forth in USI Exhibit 7.0, Schedule 7.11 W) and to use the correct SIT rate of 7.75% as opposed to the 9.5% that was used in the calculation of Staff's adjustment. USI Ex. 7.0 at 3; USI Ex. 8.0 at 1-2.

Staff concurs with the updated adjustment proposed by USI. Staff Ex. 7.0 at 6. No other party addressed this issue in testimony.

The Commission finds Staff's proposed adjustment, as updated by the Company, to be reasonable.

#### **5. Holiday Parties, Events & Picnics Expense**

Staff proposed in direct testimony the removal of USI's holiday parties, events, and picnics expense because these costs are not necessary for the provision of utility service and should not be recovered from ratepayers. Staff Ex. 2.0 at 10. USI did not oppose this adjustment in its rebuttal testimony. USI Ex. 7.0 at 8.

The Commission finds Staff's adjustment to be reasonable.

#### **6. Customer Service Expense**

Staff proposed a reduction to USI's forecasted billing and customer services expense to a more reasonable level as determined by the Company in its response to Staff DR MHE 7.05. Staff Ex. 2.0 at 11-12. USI agreed with the adjustment in its rebuttal testimony. USI Ex. 7.0 at 8.

The Commission finds Staff's adjustment to be reasonable.

#### **7. Unaccounted-For Water Expenses**

Staff witness Sperry testified that the amount by which the unaccounted-for water exceeds the maximum as defined by the Company's tariffs is 4.2%. Staff Ex. 11.0 at 3, Sched. 11.03. Given Mr. Sperry's testimony that the Company's unaccounted-for water was in excess of that permitted by the Company's tariff, Staff witness Everson calculated an adjustment to operating expenses of negative \$25,893 to account for excess purchased power and fuel, excess chemicals, and excess purchased water. Staff Ex. 8.0, Sched. 8.03. USI did not oppose Mr. Sperry's testimony nor Ms. Everson's proposed adjustment. USI Ex. 13.0 at 5.

The Commission finds Staff's adjustment to be reasonable.

#### **8. Rent Expense**

Staff proposed an adjustment to reduce the level of the rent expense based on a more reasonable rate per square foot for the proposed new lease than the rate per square foot proposed by the Company. Staff Ex. 2.0 at 8-10. The AG's proposed adjustment eliminated the increased rent expense that its witness determined to be unsupported. AG Ex. 1.0 at 6. At the evidentiary hearing, USI accepted the AG's adjustment, eliminating the increase to rent expense in its entirety, thus making Staff's proposed adjustment moot.

The Commission finds the AG's adjustment to be appropriate.

#### **9. Rate Case Expense**

##### **a. Legal Fees**

Pursuant to Section 9-229 of the Act, the Commission is to "specifically assess the justness and reasonableness of any amount expended by a public utility to compensate attorneys or technical experts to prepare and litigate a general rate case

filing. This issue shall be expressly addressed in the Commission's final order." 220 ILCS 5/9-229. No party, including Staff, proposed an adjustment for legal fees in their testimony or Initial Briefs. The Company proposed legal fees of \$200,000, to which Staff agreed. USI Ex. 7.2; USI Ex. 13.2; and Staff Ex. 2.0, Sched. 8.02 at 3. In the present case, the Company has chosen outside counsel to represent them in litigation. In response to a data request, the Company provided copies not only of the amount budgeted for outside counsel and his hourly rate, but also detailed hourly billing records and invoices for outside counsel outlining the services performed along with the date and time in which he performed them. The responses were admitted into the record as USI Exhibit 13.2. These expenses appear commensurate with the expected cost of a case of this type.

The Commission finds that the expenses incurred for outside counsel to litigate this proceeding are just and reasonable under Section 9-229 of the Act.

**b. Depreciation Study Witness**

Staff witness Sperry testified that USI incurred \$15,724 in charges for work related to a depreciation study as of the filing of Staff's rebuttal testimony. Staff Ex. 11.0 at 2. USI estimated a total cost of \$32,000 for the depreciation study, but that estimate assumed approximately \$16,000 in costs related to post filing work (e.g., preparation of rebuttal testimony, testimony at hearings and post hearing briefing). USI Ex. 7.2, Part 1. Given that the depreciation rates are uncontested, there should be no further costs incurred related to the issue. Therefore, Mr. Sperry recommended that a negative adjustment of \$16,276 be made to rate case expense to reflect actual charges incurred related to the depreciation study. Staff Ex. 11.0 at 2-3, 6. USI agreed with Staff's recommendation. USI Ex. 13.0 at 3.

The Commission finds this adjustment to be reasonable.

**c. Rate of Return Witness**

Staff proposed an adjustment to rate case expense for USI's rate of return witness's expenses. Staff witness McNally testified that the \$23,956 actually billed for work related to rebuttal testimony was not just and reasonable. Staff Ex. 12.0 at 2. Staff and the Company reached an agreement on the appropriate level of costs for the Company's expert testimony. They agreed that \$20,000 would be a reasonable amount to recover through rates. *Id.* The adjustment is reflected in Staff witness Everson's rebuttal schedules. Staff Ex. 8.0 at 4. The Company confirmed that agreement in the surrebuttal testimony. USI Ex.13.0 at 3.

The Commission finds that the expenses incurred for the costs of the rate of return witness, as modified by the agreement of Staff and the Company are just and reasonable under Section 9-229 of the Act.

**d. Mailing, Travel, and Other Costs**

Staff proposed an adjustment to USI's forecasted travel to public forums since the Commission did not hold any public forums and none had been planned. Staff Ex. 2.0 at 91-101. The Company incorporated Staff's adjustment into its surrebuttal testimony schedules; therefore it is no longer contesting this issue. USI Ex. 13.0 at 3.

The Commission finds this adjustment to be reasonable.

## **10. Fuel Expense**

Staff proposed a two-fold adjustment to USI's fuel expense to reflect the decline in fuel prices that occurred after USI prepared its fuel forecast and to remove the inclusion of the 2% escalation factor USI added to its forecast. Staff calculated its adjustment using the U.S. Energy Information Administration Short Term Energy Outlook, dated February 2015. Staff Ex. 2.0 at 2. Staff proposed a fuel expense forecast of \$2.66 per gallon for the 2015 test year based on its calculation. In its surrebuttal testimony, USI accepted Staff's proposal to use \$2.66 per gallon for the projection of the 2015 fuel expense. USI Ex. 12.0 at 2. In its Reply Brief, the AG changed its recommendation stating that it agreed that Staff's recommendation should be adopted because its analysis shows that the 18-month average of gasoline price forecast is \$2.69 per gallon which is comparable to Staff's recommendation. The Intervenor do not oppose Staff's approach.

The Commission finds Staff's adjustment to be reasonable.

## **B. Contested Issues**

### **1. Deferred Maintenance Expense**

#### **a. Company's Position**

USI witness Haas provided descriptions of, the need for, and cost information regarding major deferred maintenance projects that were included in the Company's revenue request. Among other things, these projects included hydro tank inspections, inspection and cleaning of sewer systems, inflow and infiltration research and repair, and hydro tank painting. USI Ex. 5.2.

The Company notes that it accepted Staff's proposed adjustments to deferred maintenance expense. The resulting annual expense supported by Staff and the Company is \$294,440.

The Company complains that AG witness Radigan focused on the overall level of spending rather than specific projects and proposed a blanket adjustment to reduce total deferred maintenance expense to \$300,000. The Company states that it specifically identified the projects that would be performed and the costs (USI Exhibits 5.2 and 5.3), contrary to the AG's incorrect assertion that USI "did not show any reason for such a dramatic increase" in the level of deferred maintenance expense.

The Company further complains that Mr. Radigan did not identify any specific maintenance project that should be postponed or canceled in order to maintain the annual expense level he thought should be constant over time. According to the Company, the AG failed to provide any factual basis for its assumption that all maintenance can be staggered so the future expense should be based on the same number of projects at the same cost as in past years. USI Exhibit 5.2 identifies the Company's Policy and Maintenance Guidelines associated with its Asset Management Program underlying the timing of the deferred maintenance projects. The Company argues maintenance schedules are affected by a diverse set of factors, including among other things, the nature of the maintenance, age and type of facility or equipment being

maintained, climate, extent of deterioration from varying demands placed on the assets, improved asset management techniques and budgeting constraints. The Company contends that the AG's recommendation did not examine or assess any aspect of the Asset Management Program. Accordingly, the Company urges the Commission to reject the AG's recommendation.

#### **b. AG's Position**

The AG argues that given the large number of water and sewer facilities owned by the Company, it should be doing several deferred maintenance projects like painting, testing, and inspecting each year, and its annual expense should be constant over time. AG Ex. 1.0 at 12. However, the AG contends that the Company's projected deferred maintenance expense is almost double that of 2014 and approximately four times greater than what was incurred in 2009, 2010, and 2011. *Id.* at 13. According to the AG, the Company did not show any reason for such a dramatic increase. Thus, AG witness Radigan recommended that the Company should only be allowed recovery of \$300,000 for deferred maintenance, which is over 20% higher than the 2014 actual expense amount of \$245,000. *Id.* at 13.

The AG states that while Staff witness Bridal's recommendation to reduce deferred maintenance expense by almost \$200,000 is very close to the amount of Mr. Radigan's proposed adjustment, Mr. Bridal's proposal is based on a different theory. The reduction recommended by Mr. Bridal is based primarily on an adjustment that extends the amortization period on certain tank painting projects from five years to ten years. Staff Ex. 1.0 at 17; Staff Sched. 1.14 W at 1; Tr. at 72. The AG asserts that Mr. Bridal admitted during cross-examination that his proposal to lengthen the amortization period on tank painting will not preclude USI from recovering those costs; it merely stretches out the period for recovering the costs. Tr. at 75. The AG adds that Mr. Bridal took no consideration of the number of proposed tank painting projects in the 2015 test year against the historic average of such projects. Tr. at 76. The AG concludes that it does not object to the Commission adopting Mr. Bridal's extended amortization period. However, because Mr. Bridal's adjustment makes no attempt to consider the justness and reasonableness of the amount of the Company's proposed cost recovery for deferred maintenance, the AG argues that the Commission should adopt Mr. Radigan's proposed adjustment in addition to Staff's recommended adjustments.

With respect to USI's position, the AG notes that the Company argues that Mr. Radigan's proposed adjustment should be rejected because he failed to identify any unnecessary projects and he did not conduct any inspections of the facilities in question. The AG contends that USI's argument flips the burden of proof on its head because the Company bears the burden of establishing the just and reasonableness of its proposed rates pursuant to Section 9-201(c) of the Act and USI failed to meet its burden.

#### **c. Intervenors' Position**

The Intervenors note that although the AG and Staff recommended different approaches to reduce deferred maintenance expense, the final numbers reached by both parties were within a few thousand dollars. Thus, the Intervenors state that they do not oppose the Company's revised expense level of \$294,440, which reflects its

acceptance of Staff's adjustments, since it is nearly identical to the AG's proposed reduction. USI Ex. 12.0 at 9.

#### **d. Staff's Position**

Staff proposed three adjustments to deferred maintenance expense and deferred charges. Staff proposed an adjustment to remove deferred volatile organic compound testing costs that were incurred prior to the test year and for which the Commission did not authorize the deferral as required by 83 Ill. Adm. Code 605, the Uniform System of Accounts in Illinois, Instructions to Account 186, Miscellaneous Deferred Debits. Staff also proposed an adjustment to remove the cost of painting the Company logo on tanks. Staff explains that this adjustment was made because: (1) painting the Company logo on tanks is not necessary for the provision of utility services; (2) the costs to paint the Company logo on tanks are incurred for promotional, institutional, or goodwill advertising which is not permitted under the Act; and (3) recovery of the costs incurred to paint the Company logo on tanks is contrary to Commission guidance in its Final Order in the Company's most recent rate case. Finally, Staff changed the amortization period for tank painting from the Company-proposed period of five years to ten years, thereby reducing the amount of deferred maintenance expense included in the revenue requirement. Staff argues that ten years is a more reasonable length of time between tank paintings because it is consistent with the amortization period that has been requested by the Company in prior rate cases and consistent with the amortization period approved by the Commission in prior rate cases. Staff Ex. 1.0 at 13-17.

Staff agrees with AG witness Radigan in that the Company's forecasted level of deferred maintenance expense for the test year was beyond what should be expected. Staff observes that its analysis and resulting adjustments removed specific, non-recoverable costs in addition to extending the amortization period for various tank painting projects from five years to ten years, consistent with prior Commission practice. *Id.* These adjustments reduced water deferred maintenance expense for the test year by \$199,896. Staff Ex. 1.0, Sched. 1.14 W. Staff explains that while its adjustment to extend the amortization period for tank painting projects reduced test year tank painting amortization expense, these adjustments also increased deferred charges in rate base by \$459,640. *Id.* The net effect of Staff's adjustments to deferred maintenance and deferred charges was to reduce the revenue requirement requested by the Company for its water service areas by \$154,583. Staff Ex. 1.0, Sched. 1.05 W.

Staff takes issue with the AG's assertion that Staff makes no attempt to consider the justness and reasonableness of the amount of the Company's proposed cost recovery for deferred maintenance, but instead only proposes to stretch out the recovery of the same costs over a longer period. Staff argues that this statement mischaracterized Staff's position and it is incorrect, as Staff witness Bridal proposed adjustments which disallowed several deferred maintenance costs because the deferrals had not been authorized by the Commission, were not necessary for the provision of utility services, or were not permitted under the Act. Staff Ex. 1.0 at 13-16. Thus, Staff asserts that it did consider the justness and reasonableness of the amount requested by the Company for deferred maintenance.



Staff states that the AG is correct that one component of Mr. Bridal's adjustment to extend the amortization period for tank painting from five years to ten years does extend the recovery of the same costs over a longer period. However, Staff notes that the ten year amortization period is consistent with both the Company's and the Commission's prior practice. Staff Ex. 1.0 at 16-17. Staff further notes that the AG does not object to Mr. Bridal's reasoning regarding the extended amortization period.

Staff maintains that for the reasons set forth above, the Commission should adopt its adjustments to deferred maintenance expense and deferred charges.

#### **e. Commission Analysis and Conclusion**

As noted by the Intervenor, Staff and the AG are in agreement that the Company's forecasted level of deferred maintenance expense for the test year was beyond what should be expected. Although Staff and the AG recommended different approaches to reduce this expense, they both reached similar results. The Commission agrees with these parties that the deferred maintenance expense should be adjusted downward. Based on a review of the record, the Commission finds that Staff's proposed adjustments are supported by the evidence, reasonable, and should be adopted. Contrary to the AG's assertions, Staff's analysis shows that it considered whether the amount requested by the Company was just and reasonable. Staff identified specific costs that should be disallowed because the deferrals had not been authorized by the Commission, were not necessary for the provision of utility service, and were not permitted under the Act. Moreover, its adjustment, which the AG does not object to the Commission adopting, to extend the amortization period for tank painting projects is consistent with both the Company's and the Commission's prior practice. For these reasons, the Commission adopts Staff's adjustments, which were accepted by the Company, and declines to approve any further reductions proposed by the AG.

### **2. Rate Case Expense – WSC Personnel**

#### **a. Company's Position**

USI asserts that its revenue request includes the costs of WSC employees who performed the work necessary to file and obtain Commission approval of new rates. These costs were supported by time records maintained by WSC employees, which were admitted into the evidentiary record. USI Ex. 7.2 (Part 1); USI Ex. 13.2 (Part 1). Those records identify the employees who performed the work, provide a description of the work performed, and show the amount of time spent. USI contends that the same type of information was provided to the Commission in Docket Nos. 12-0603/12-0604 (Consol.). Both Staff and the Commission found that the utilities in those cases had provided sufficient information to support the recovery of WSC employee costs as part of rate case expense. USI Ex. 12.0 at 10. Consequently, USI asserts, the AG's argument that the Company has not provided sufficient support for the recovery of costs of internal personnel who worked on this rate case is unfounded.

USI avers that the AG's argument with respect to the accounting for rate case expense attributable to WSC employees is the same argument that was previously reviewed and rejected by Staff in Docket Nos. 11-0059/11-0141/11-0142 (Consol.) and Docket Nos. 11-0561 through 11-0566 (Consol.). In the latter proceeding, Staff

reviewed the Company's method of accounting for internal employee costs related to rate cases and verified it ensured no double counting of internal labor in rate case expense and test year labor charges.

According to the Company, the test year operating expenses allocated to USI for WSC wages and salaries do not include any amounts for employees working on rate cases because those employees charge that time directly ("cap time") to the particular company, as they are required to do by the Affiliated Interest Agreement ("AIA") approved by the Commission. Those direct charges are subtracted from the amount of operating expenses that are allocated to operating companies such as USI. In other words, the residual amounts allocated to USI and other UI affiliates include no directly assigned expense for work performed by employees on rate cases. USI points out that its exhibits show the amount of cap time reductions. The Company reduced its expenses by \$112,028 for rate case cap time. USI Ex. 3.2 at 1. Thus, the Company contends the reductions are not mere "bald assertions" as claimed by the AG. They are backed up by the books and records of the Company, which reflect the time reported by employees as cap time.

#### **b. AG's Position**

The AG argues that USI did not establish that certain WSC employees' salaries are not included in both rate case expense and wages and salaries expense. AG witness Radigan observed that without a showing that there is no double counting of internal staff time allocated to both wages and salaries expense and rate case expense, all rate case expense costs should be excluded from the test year revenue requirement. AG Ex. 2.0 at 18. The AG asserts that because USI failed to show that there is no double counting, the AG recommended that the Commission adopt Mr. Radigan's recommendation that the internal staff component of rate case expense be removed from the test year revenue requirement – a downward adjustment of one-fifth of \$195,470, or \$39,094. AG Ex. 1.0 at 10.

The AG contends that USI's assertion that the Commission rejected the AG's argument concerning double counting before in Docket Nos. 11-0561 through 11-0566 (Consol.) is erroneous. The AG submits that the Commission did not address this argument because the companies did not provide enough evidence to establish that their proposed rate case expense was just and reasonable. *Charmar Water Company, et. al.*, Docket Nos. 11-0561 through 11-0566 (Consol.), Final Order at 20 (May 22, 2012). The AG notes that the Commission stated that it was mindful of the double counting concern raised by the AG, but it did not address that issue, because "[t]he Commission cannot make an informed judgment regarding that initial "single"-counting of these labor expenses, as that information is not in the record." *Id.*

#### **c. Staff's Position**

In direct testimony, Staff proposed an adjustment to reduce rate case expense from WSC. Staff explains that this adjustment was recommended because the Company's supporting documentation was only minimally descriptive of the duties performed and of the number of hours spent for each duty. Staff Ex. 2.0 at 6. Staff points out that USI's rebuttal testimony included an update to its actual and estimated

rate case expense, which included more detailed descriptions of time spent by WSC employees. USI Ex. 7.0 at 5.

Staff accepted the detailed listing of time spent by WSC employees provided by USI in its rebuttal testimony and withdrew its adjustment in rebuttal testimony. Staff Ex. 8.0 at 4.

#### **d. Commission Analysis and Conclusion**

The Commission does not believe that the AG's proposed adjustment to disallow rate case expense attributable to WSC personnel is warranted. The record shows that the Company has provided detailed information regarding what actual expenses were incurred, by whom, for what purpose, and why such expenses were necessary to either prepare the case, respond to discovery, prepare testimony, or complete other activities pertinent to the case. The Company also included a reasonable estimate of the costs to bring the case to conclusion. The information provided by the Company is consistent with past Commission practice, notably Docket Nos. 12-0603/12-0604 (Consol.).

The Commission agrees with the Company that there is no evidence of double counting. As the Company stated, the exhibits provided by USI show the amount of cap time reductions. Specifically, they show that the Company reduced its expenses by \$112,028 for rate case cap time. It is also noteworthy that the AG itself admitted in direct testimony that USI included a 50% reduction to salaries related to rate case activities in 2015.

Moreover, the Commission has considered the costs expended by the Company, as discussed in this Section and Section III.A.9, to compensate attorneys and technical experts to prepare and litigate this rate case proceeding and assesses that such costs in the total amount of \$738,522, which is \$147,704 amortized over five years, are just and reasonable pursuant to Section 9-229 of the Act. 220 ILCS 5/9-229.

### **3. Insurance Expense**

#### **a. Company's Position**

The Company states that its proposed revenue request for insurance expense included a share of the common insurance expense forecasted to be incurred by WSC. The total costs of the entire UI organization across all states were forecasted to decline by 2.2% between 2014 and 2015. USI explains that the costs were allocated to all UI operating companies on the basis of the number of equivalent residential connections ("ERCs") each utility has. This allocation is required by the AIA approved by the Commission. Thus, the Company states that while the total insurance expense was forecasted to decrease, USI's share of those costs would increase because the UI's system-wide decrease was offset by the larger share of the costs that were required by the AIA to be allocated to USI. USI Ex. 14.0 at 7.

USI explains that it provided a table in its surrebuttal testimony to better explain the increase to insurance expense that shows: a WSC overall insurance expense decline of 2.2%, consistent with its explanation in USI Exhibit 3.1; an increase in USI's ERC base of 2.5%; and the resulting 0.3% increase in USI's allocation of WSC insurance expense between 2014 and 2015. USI Ex. 14.0 at 2-3.

USI takes issue with the AG's proposed adjustment and urges the Commission to reject the adjustment. According to USI, the AG opposes the amount of insurance expense included in the Company's revenue request because the AG failed to verify how the amount was calculated. USI contends that the AG's adjustment fails to incorporate WSC's current insurance policies and using a historical average of insurance costs, as the AG's adjustment proposes, is not reflective of USI's current operating conditions. USI Ex. 14.0 at 8.

#### **b. AG's Position**

The AG claims that the Company's forecast should be rejected because the numbers do not add up. AG witness Radigan testified that USI's insurance expense increased from \$187,804 in 2014 to a projected \$196,978 in the 2015 future test year, a 4.88% increase. AG Ex. 1.0 at 10-11. The AG highlights that according to USI, its share of WSC's insurance costs for all of the UI subsidiaries increased from 6.90% to 7.07%, a 2.46% increase. USI Ex. 14.0 at 2. However, the AG asserts that USI provided no explanation as to how a 2.46% increase in its share of overall WSC insurance costs coupled with a 2.2% decrease in WSC overall insurance costs yields an almost 5% increase in insurance expense for the Company.

The AG also claims that USI's evidentiary presentation concerning insurance costs was part of a pattern the Company followed in this case on several issues. According to the AG, USI presented minimal information supporting certain increased expenses in its direct case. When Staff and/or the AG challenged some of those expenses in their respective direct cases, USI provided additional information regarding the challenged items. When Staff and/or the AG argued that the additional information was not sufficient, USI provided even more detail in its surrebuttal case. The AG argues that is precisely what USI did with insurance expense. The AG asserts that the Commission should not reward such "hide-the-ball" tactics. Utilities should be required to submit all supporting information in their direct cases. Moreover, the AG contends that Staff and the Intervenors should not have to expend scarce resources extracting additional information from utilities for explanations that purportedly support their requested rate increases.

The AG states that while the information submitted in USI's surrebuttal testimony satisfied Staff's concerns about this issue, the additional information did not satisfy the AG's concerns. The AG maintains that the Company did not meet its burden of proof on this issue. It recommends that the Commission reject USI's proposed test year expense level and adopt the proposal made by Mr. Radigan, which uses the \$174,525 two-year average as the test year insurance expense in the Company's revenue requirement.

#### **c. Staff's Position**

Staff states that in rebuttal testimony it supported the AG's proposed adjustment to decrease the Company's forecasted insurance expense for the 2015 test year, but changed its position later upon review of the Company's surrebuttal testimony. Staff explains that in rebuttal testimony it agreed with the AG's theoretical basis in its direct testimony for an adjustment to insurance expense, but did not agree with using the average of 2013 and 2014 insurance expense to determine the adjustment. Staff

instead proposed reducing USI's insurance expense by 2.2% to match the forecast basis USI provided in USI Exhibit 3.1 (Guidelines for 2014-2015 Forecast) that showed WSC would experience a 2.2% decrease in cost between 2014 and 2015. Staff notes that USI challenged these adjustments and stated in its rebuttal testimony that: "Total allocated costs to USI do not decrease between FY 2014 and FY 2015 because of incremental allocations related to the acquisition of USI's Oakwood system." USI Ex. 8.0 at 6-7.

Staff asserts that it subsequently withdrew its adjustment based on the detailed table USI presented in its surrebuttal testimony to better explain the increase to insurance expense.

#### **d. Commission Analysis and Conclusion**

The Commission finds that the Company has provided adequate support for its increase in insurance expense for the 2015 test year. The Company explains, that pursuant to the cost allocation formula in the AIA approved by the Commission, common expenses such as insurance, are required to be allocated to affiliated operating utilities based upon the number of ERCs. Thus, the total allocated costs to USI do not decrease between 2014 and 2015 because of its incremental allocations related to the acquisition of USI's Oakwood system. As illustrated in the table presented by the Company in surrebuttal testimony, USI's customer base in 2015 is a larger percentage of UI's customer base than in 2014, thus the Company will not experience the 2.2% decrease forecasted for WSC but rather it will experience a slight increase in insurance expense due to the increase in its share of the total UI customer base. Like Staff, the Commission is satisfied with this explanation of the Company's increase in insurance expense.

Additionally, the Commission agrees with the Company that adjusting this expense by using USI's 2013 to 2014 average insurance expense, as proposed by the AG, is not reasonable. 2013 to 2014 allocated costs do not reflect UI's or USI's current customer base, and it is therefore a poor predictor of USI's anticipated costs for the test year. Moreover, 2013 to 2014 costs do not reflect the anticipated level of insurance expense to be incurred by WSC. Therefore, the Commission declines to adopt the AG's recommendation to use the two-year average as the test year insurance expense instead of the Company's forecast which is based on current and projected insurance policies.

### **4. Wages & Salaries Expense – WSC Personnel**

#### **a. Company's Position**

The Company explains that it calculated its wages and salaries expense forecast based on current and anticipated levels of staffing for 2014 and 2015. USI challenges the AG's proposal to use the most recent 18-month period available, January 2013 through June 2014, as a basis for setting the net salaries and wages expense level for the test year revenue requirement.

According to USI, the AG's recommendation is flawed because it fails to identify any position that should be eliminated or any misallocation of the costs that it believes exists in the Company's accounting records. AG witness Radigan relied on historical

levels without considering additional staffing related to the recent acquisition of the sewer and water systems that serve the Village of Oakwood as well as the incremental allocations that would result from the increase in ERCs that drive the allocation of common costs in accordance with the AIA. USI Ex. 8.0 at 7. USI argues that the AG's recommendation is also problematic because it would ignore the 3% annual base pay increases that have and are anticipated to occur. In addition, Mr. Radigan's analysis also fails to incorporate the filling of vacant positions. *Id.* The Company maintains that the use of historical expense levels as Mr. Radigan recommended would defeat the purpose of a future test year and destine the Company to repeat the financial results that the Company's accounting records show fail to produce an adequate return on investment.

#### **b. AG's Position**

The AG alleges that the Company's proposed wages and salaries expense is overstated. AG witness Radigan explained that wages and salaries expense is comprised of two components: (1) salaries and wages and (2) maintenance expense charged to plant. AG Ex. 1.0 at 14. He explained that salaries and wages are the payroll costs for a company and maintenance expense charged to plant is employee time spent on a project that is capitalized and as wages and salaries expense become part of the project over time. *Id.* at 14. Mr. Radigan further explained that net wages and salaries expense is calculated by subtracting the maintenance expense charged to plant from salaries and wages.

The AG points out that for its 2015 test year, the Company is forecasting a net wages and salaries level of \$1,133,588, a 45% increase over the annualized value from the most recent 18-month period available. *Id.* at 15-16. As to the wages and salaries component, the AG notes that the Company projects a forecasted increase from \$1.226 million to \$1.684 million – a 37% increase, far in excess of a 3% annual labor cost increase. AG Ex. 1.0 at 16.

The AG contends that USI's explanations for its proposed increase in wages and salaries expense are meritless. The AG asserts that the Company did not prove that the Oakwood acquisition increased its headcount. AG Ex. 2.0 at 17. Mr. Radigan also found, that salary expense has been flat over the past five years, despite salary increases during that time. *Id.* at 17. Further, the AG states that for ten particular employees, the Company is requesting a portion of their time to be recovered under salaries and wages and the same portion to be recovered under rate case expense. *Id.* at 16-17.

Additionally, the AG states that USI has not met its burden of proof. The Company's entire argument in the AG's view is a critique of Mr. Radigan's alleged failures to conduct additional discovery or to review information provided which does not satisfy the Company's obligation to prove its case.

For these reasons, the AG recommends that the Commission adopt Mr. Radigan's proposal to use the most recent 18-month period available, January 2013 through June 2014, as a basis for setting a net wages and salaries expense level for the test year. This results in an expense level of \$781,934 for the test year revenue requirement. AG Ex. 1.0 at 17.

### **c. Commission Analysis and Conclusion**

The Commission finds that the Company has provided sufficient information to justify its anticipated future test year wages and salary expense. The Commission agrees with the Company that the AG's reliance on historical averages fails to consider the additional staffing related to the acquisition of USI's Oakwood system, the incremental allocations from the increased percentage of USI's ERC's, an anticipated 3% annual base pay increase, and the filling of vacant positions. The record shows that the Company provided detailed explanations for the increase in salary and wages expense and detailed projections of salary expense for each employee in its forecast. Additionally, as stated in Section III.B.2(d) concerning rate case expense attributable to WSC personnel, there is no evidence of double counting. Thus, the Commission declines to adopt the AG's proposed adjustment.

### **5. Uncollectibles Expense**

#### **a. Company's Position**

The Company states that its uncollectible expense was determined based on its records of the following accounts: (1) agency expense, (2) uncollectible accounts expense and (3) uncollectible accounts accrual expense. The Company explains that all three accounts must be included in the calculation of uncollectible expense. The Company further explains that agency expense is the cost of engaging collection agencies to attempt collection of bad debts. Uncollectible account expense consists of the net of accounts written off and payments on previously written off balances. Uncollectible accounts accrual expense represents costs that are accruals for anticipated account balance write-offs. USI Ex. 8.0 at 4-5.

The Company states that the AG's argument that uncollectible accounts accrual expense should not be included in the calculation of uncollectible expense is incorrect. The Company asserts that to accurately assess the amount of uncollectible expense experienced by the Company, uncollectible accounts accrual expense must be included because the Company's accounting system automated processes only captures account balance write-offs when the service disconnection event is entered into the system. The Company explains that availability customers do not receive service. Because availability customers cannot be disconnected, uncollectible accounts expense only reflects the automatic write-offs triggered by disconnection and fails to account for the significant uncollectible account expense associated with customers who fail to pay availability charges.

USI further states that when all necessary components are utilized, uncollectible percentages forecasted for the test year are consistent with USI's actual experience in past years. USI Ex. 8.0 at 4-5. The Company points to its surrebuttal testimony which it maintains illustrated the significant growth in aged accounts receivable attributable to availability customers. According to the Company, its analysis determined that 95% of these balances over 181 days delinquent are unlikely to be paid and therefore should be written off. USI Ex. 14.0 at 4-6. The Company states that it will fail to achieve the target revenues necessary to cover the costs of providing service unless these write-offs are reflected in the uncollectible expenses the Company is allowed to recover in its rates. Accordingly, the Company asserts that the AG's adjustment should be rejected

because it fails to address uncollectible expense associated with delinquent availability customers or agency expense.

**b. AG's Position**

AG witness Radigan proposed to reduce the USI total water and sewer uncollectible expense by \$79,149 to \$30,000, roughly equal to recent averages. AG Ex. 1.0 at 7. In support of his adjustment, Mr. Radigan testified that he found that the Company's absolute bad debt expense (also known as "net write offs") varies widely from year to year and the Company's forecast grossly overstated uncollectible expense on a percentage basis. AG Ex. 1.0 at 6-7. The AG notes that Mr. Radigan later updated his adjustment to \$31,400 in his rebuttal testimony to include agency expense. AG Ex. 2.0 at 8.

The AG disputes the Company's assertion that Mr. Radigan's proposed adjustment should be rejected because he refused to consider uncollectible accounts accrual expense. The AG argues, citing Mr. Radigan's testimony, that the decision whether to increase uncollectible accounts accrual expense is discretionary and if that account is rising while accounts receivable is steady, the company is putting too much in reserve, which is precisely what USI is doing. *Id.* at 9-10. According to the AG, the Company's level of accounts receivable has been relatively steady from 2009 to 2014, while the Accumulated Provision for Uncollectable Accounts has almost tripled between 2008 and 2014.

Mr. Radigan testified that the Company has sufficient money in the Accumulated Provision for Uncollectible Accounts to stop setting aside any money in the uncollectible accounts accrual and to bring the Accumulated Provision for Uncollectible Accounts back down to the 2008 level (from almost \$300,000 in 2014 to \$100,000 in 2008). The AG asserts that because bad debt expense has averaged approximately \$30,000 per year, this draw down could occur for as long as five years with no more uncollectible accounts accrual. Accordingly, the AG submits that contrary to the Company's assertions, uncollectibles accounts accrual should not be included in this case because it will result in a windfall to the Company. *Id.* at 10.

**c. Staff's Position**

Staff states that it agrees with AG witness Radigan that the USI absolute bad debt expense varies widely from year to year and the percentage of absolute bad debt in comparison to revenues is lower than the uncollectible percentage proposed by the Company in this proceeding. However, Staff asserts that it does not agree with the AG's adjustment.

Staff notes that in determining its proposed uncollectible percentage in this proceeding, USI divided its forecasted Account 670 Bad Debt Expense amount by its forecasted test year operating revenues. Staff argues this approach is consistent with the approach approved by the Commission in the Company's prior rate case filings. Staff Ex. 7.0 at 9-10. In addition, as noted in the rebuttal testimony of USI witness Kersey, when calculated using consistent methodologies, the uncollectible percentages proposed by the Company in this proceeding are consistent with the Company's recent historical experience. USI Ex. 8.0 at 5. Staff further argues that Mr. Radigan's



adjustment does not appear to account for the presence of significant uncollectible amounts associated with unpaid availability charges. USI Ex. 14.0 at 4-5.

Staff recommends that the Commission approve total water and sewer test year uncollectible expense as 1.08% of approved operating revenue, as proposed by the Company. As explained above, 1.08% is consistent with the Company's recent experience, is calculated consistently with the methodology approved by the Commission in the Company's prior rate case filings, and reflects uncollectible amounts associated with unpaid availability charges. Staff asserts that should the Commission disagree with Staff and the Company and adopt Mr. Radigan's proposal, then the Commission should ensure that the AG adjustment is apportioned between water and sewer service using ERC counts set forth within Staff Cross Exhibit 1.

#### **d. Commission Analysis and Conclusion**

The Commission agrees with Staff and the Company that the AG's proposed adjustment to exclude uncollectible accounts accrual expense should be rejected. The Company's forecasted uncollectible expense of 1.08% is reasonable and supported by the record evidence.

As Staff explained, the Company calculates its uncollectible expense by determining an uncollectible percentage and multiplying that uncollectible percentage by its proposed revenues. In determining its proposed uncollectible percentage in this case, the Company divided its forecasted Account Bad Debt Expense amount by its forecasted test year operating revenues. This calculation is consistent with the methodology approved by the Commission in the Company's prior rate case filings. Moreover, the Company's forecast of 1.08% is consistent with the Company's recent historical experience and reflects the significant uncollectible amounts associated with delinquent availability customers. Accordingly, the Commission concludes that all three accounts noted by the Company must be included when determining the Company's uncollectible expense.

### **6. Sales Adjustment**

#### **a. Company's Position**

The Company asserts that the Commission should adopt its forecasted test year sales level, which reflects a 2.65% decline in customer usage. The Company explains that from August 2008 to July 2014, USI saw an average annual decline in consumption of 2.65%. According to the Company, the data buttresses the conclusion that the trend will continue and the test year consumption should be reduced by 2.65%. The Company contends that the failure to account for declining use would impede its ability to earn its authorized return and necessitate more frequent requests for rate relief, which would add additional rate case expense to be recovered from customers. USI Ex. 1.0 at 12. The Company's witnesses cited examples of industry studies, reports, executive orders, and other government policies that indicate a pervasive trend toward lower water usage per household. USI Ex. 6.0 at 11-14.

USI takes issue with AG witness Radigan's recommendation that the Commission should reject the six years of data showing annual consumption declines. Mr. Radigan suggested the decline might be attributable to increasingly wetter weather.

The Company argues that the AG's position is without merit. The Company asserts that the only weather information the AG provided was rainfall isolated to a part of the Company's service area in the far northwestern corner of the state. This information is unpersuasive since the Company also has service areas located in northeastern and central Illinois. The Company further asserts that its usage data spans across six years and so any variations in weather are likely to offset each other. Moreover, the Company maintains that the AG presented no evidence that the weather patterns over those six years were unusual, abnormal or unlikely to repeat over the next five years that the new rates will be in effect. In addition, the consumption decline also occurred in the non-summer periods when rainfall and temperature would be expected to have little impact on water use. Tr. at 51. The Company contends that the steady decline in the non-summer months over the six year period strongly supports the prospect of the continued drop in test year consumption due to factors such as improved efficiency measures, conservation consciousness, and demand response to higher costs.

The Company also argues that the AG's reference to the bivariate correlation of 0.25 cited in USI Exhibit 8.0, Schedule 8.3 cannot be used to support the AG's proposition that consumption and rainfall have a negative correlation. The Company asserts that the 0.25 correlation is a positive correlation meaning it implies higher rainfall would coincide with higher consumption. Therefore, USI Exhibit 8.0, Schedule 8.3 actually supports the Company's testimony that the AG's witness has "made inaccurate and misleading statements regarding the correlation and causation between rainfall and consumption." USI Ex. 8.0.

For these reasons, USI urges the Commission to reject the AG's recommendation to exclude the expected decline in consumption in the calculation of rates.

#### **b. AG's Position**

The AG states that the Commission should reject the Company's adjustment to reflect a 2.65% decrease in customer usage. The AG argues that USI has not proved that such a decrease is warranted because the Company has not normalized its recent sales data against rainfall over the same time period. The AG asserts that consumption and rainfall have a negative correlation; USI witness Kersey's own analysis found a bivariate correlation of 0.25 between these two variables. USI Ex. 8.0, Sched. 8.3. Moreover, as AG witness Radigan showed, Galena, Illinois, for example, has seen generally higher rainfall than normal during the past five years. AG Ex. 1.0 at 7-10. The AG argues that such a finding is consistent with high rains driving lower usage. A six-year sample of sales is predictive of future sales only if the rainfall and temperature during the six-year sample were consistent with average rainfall and temperature over a longer time period. AG Ex. 2.0 at 4-5. The AG contends that the Company did not prove that in its presentation.

The AG adds that Mr. Kersey admitted in cross-examination that the Company did not prepare any multivariate regression analysis attempting to include both temperature and rainfall as explanatory variables driving consumption. Tr. at 42. In re-direct examination, Mr. Kersey stated that the Company "look[ed] at the six-year weather" over the same time period and "compared those to "10, 20, and 100-year

averages for both rainfall and temperature, and did not see any abnormalities or a reason to adjust the consumption for weather.” However, the AG highlights that upon cross-examination, Mr. Kersey admitted that “abnormality” in his telling meant a deviation greater than five percentage points from long-term historic averages and that it is likely that he would have ignored any deviation from normal of less than five percentage points when examining rainfall over the past six years. *Id.* at 48, 50. The AG argues that a deviation of 4.9%, then, would have escaped Mr. Kersey’s attention – but such a deviation would swamp the alleged 2.65% decline in usage, meaning that his examination of the representativeness of recent rainfall trends had little value.

The AG concludes that USI failed to meet its burden of proving that its projected sales decrease is just and reasonable. Accordingly, the AG recommends that the Commission use the actual 2014 sales level, without any reduction, as the test year billing determinants in setting new rates to achieve the approved revenue requirement.

### **c. Intervenor’s Position**

The Intervenors concur with the AG that the Commission should reject the Company’s adjustment to reflect a 2.65% decrease in customer usage. The Intervenors assert that USI’s argument concerning this issue is unconvincing. They contend that the Company engaged in a debate with AG witness Radigan about whether the sales adjustment should be a rate design or revenue requirement issue instead of providing a factual basis for the adjustment. Further, the Intervenors maintain that if the Company’s adjustment is adopted it will result in a higher charge per unit rate, thereby allowing USI to reap the benefits of overstating the amount sales might decrease. In addition, the Intervenors assert that the Company’s adjustment should also be rejected because it provided no analysis or study supporting its hypothesis that a 2.65% water usage/sales decrease would continue in the future.

### **d. Staff’s Position**

Staff asserts that the Commission should reject the sales adjustment proposed by AG witness Radigan. Staff explains that it appears Mr. Radigan proposed an adjustment to increase current revenues by \$130,000, which he maintains will then reduce the total revenue requirement by \$130,000. AG Ex. 1.0 at 10. However, Staff claims that Mr. Radigan’s proposed adjustment, in the form he has proposed it, would not reduce the final total revenue requirement in the way that Mr. Radigan intends.

Staff witness Bridal explained how the total revenue requirement is calculated on his Schedule 1.01 W. Staff Ex. 1.0 at 4. Because of the way the total revenue requirement is calculated in column (i) of this schedule, Mr. Radigan’s adjustment would not change the final total revenue requirement because the final revenue requirement is calculated using the approved rate base, return on rate base, and operating expenses. Mr. Radigan’s adjustment would merely increase the current revenues shown in column (d) by \$130,000 and decrease the adjustment to the proposed amount in column (h) by an offsetting \$130,000. Staff argues this would leave the total revenue requirement in column (i) unchanged and fail to accomplish what Mr. Radigan intends.

Staff states that it does not object to the Company’s adjustment to reflect a 2.65% decrease in customer usage. However, if the Commission agrees with Mr.

Radigan that it is unreasonable to anticipate any decline in usage, then Staff recommends that the Commission increase the usage billing units by 2.65% in the calculation of rates rather than adjusting the revenues in the manner Mr. Radigan proposes. Staff notes that the AG acknowledged in its Initial Brief that if an adjustment is made, then it should be made to the usage billing units used to calculate the final rates to recover the approved revenue requirement.

**e. Commission Analysis and Conclusion**

The Commission finds that the AG's position that USI's consumption levels should not be adjusted to reflect the Company's projected decrease in customer usage of 2.65% is unpersuasive. USI has provided ample support for its projected decrease in water consumption for the 2015 test year, including six years of historical data from 2008 to 2014 showing annual consumption declines. The Company also provided industry studies, reports, executive orders, and other governmental policies indicating a trend throughout the industry toward lower water usage. Additionally, the Company presented a demonstration that shows weather normalization is unnecessary in this situation where the Company's analysis includes several years of data since any variations in the weather during this time period are likely to offset each other. Finally, the AG asserts that one of the main drivers of water use is rainfall, however, the AG failed to provide convincing evidence to support this position. The AG also failed to refute the historical data provided by the Company or to show that it is unreasonable to expect that the decline in water consumption will continue in the future. For these reasons, the Commission declines to adopt the AG's proposal and the Company's forecasted test year sales level, which reflects a 2.65% decline in customer usage, is approved.

**C. Commission Conclusions on Operating Revenues and Expense Statement**

The development of the approved water operating expense statement for USI in this proceeding is shown in Appendix A to this Order, while the approved sewer operating expense statement is shown in Appendix B to this Order. The Commission finds that the adjustments to the operating expense statements reflected in the appendices are supported by the evidence, are reasonable, and should be adopted.

**IV. RATE OF RETURN**

**A. Capital Structure**

Staff and the Company agree that USI's capital structure for the year ended December 31, 2015 is comprised of 1.74% short-term debt, 47.96% long-term debt, and 50.30% common equity. USI Ex. 11.0, Sched. 11.1.

**B. Cost of Debt**

Staff estimated that the Company's cost of short-term debt is 1.69%, based on the current interest rate on USI's short-term revolving bank facility. Staff Ex. 5.0 at 8. The Company's embedded cost of long-term debt for 2015 is 6.66%. Staff Ex. 5.0, Sched. 5.3. Staff included the annual amortization of debt expense, which reflects

straight-line amortization of the unamortized balance over the remaining life of the outstanding issue of long-term debt. Staff Ex. 5.0 at 8.

USI accepted Staff's costs of short-term and long-term debt. USI Ex. 11.0, Sched. 11.1.

### **C. Return on Equity**

For the purpose of resolving the issue, the parties have agreed to a 9.25% return on equity ("ROE") for USI for the purpose of setting rates. Staff Ex. 10.0 at 1; USI Ex. 11.0 at 2. Staff's Initial Brief noted that the decision to agree with a 9.25% ROE should not be construed to mean that Staff witness Freetly concluded that any adjustment proposed by Company witness D'Ascendis to Ms. Freetly's cost of common equity analysis had merit. Staff Ex. 10.0 at 1. A 9.25% ROE was recommended by the AG and is within the range of results produced by various methodologies used by Staff and the Company. USI Ex. 11.0 at 2.

Given the above, the Commission approves an ROE of 9.25% for USI.

### **D. Commission Analysis and Conclusion**

Having reviewed the record, the Commission finds that the Company should be authorized to earn a rate of return of 7.88%. The rate of return incorporates a return on common equity of 9.25%. The Company's rate of return was derived as follow:

<u>Source of capital</u>	<u>Amount</u>	<u>Percentage</u>	<u>Cost</u>	<u>Weighted Cost</u>
Short-term debt	\$6,496,098	1.74%	1.69%	0.04%
Long-term debt	\$178,726,842	47.96%	6.66%	3.19%
Common Equity	<u>\$187,444,000</u>	<u>50.30%</u>	<u>9.25%</u>	<u>4.65%</u>
Total	\$372,666,940	100.00%		7.88%

## **V. RATE DESIGN**

### **A. Uncontested Issues**

#### **1. Availability Charges**

The Company proposed an availability charge of \$1.68, in its initial filing, which indicates that the Company proposes to bill availability customers only the actual \$1.68 cost that it takes to send them a monthly bill. Staff Ex. 4.0 at 15.

Staff opined that charging availability customers a monthly amount that is equal to the cost of sending them a monthly bill was not appropriate. Although availability customers are not currently using water, they have the ability to avail of such service, just as full water customers do, and they should be required to pay a fee for that service privilege. According to its filing, the Company allocates approximately 11.4% of its operation and maintenance costs to availability customers. Furthermore, these customers currently pay an amount for availability service that is more than the cost of sending them a monthly bill. *Id.* at 15-16.

According to the Staff witness, the average monthly availability charge currently is approximately \$8.50 for all divisions with availability customers. Charging this rate would generate approximately 6% of the overall yearly revenue for the Company and would represent a fair portion of the contribution to revenues based on the availability of service and the approximately 11.4% of operations and maintenance costs allocated to serve these customers. Full water customers have to pay a monthly base facilities charge for the privilege to have water service available to them. Availability customers should similarly share in some of the monthly costs that the Company incurs to provide water service to all customers. *Id.* at 16. The Company indicated that it would accept the \$8.50 consolidated availability charge, which is reflected in its rebuttal schedules. USI Ex. 6.0 at 6.

Intervenors who are located in service areas not presently subject to availability charges submitted testimony in opposition to application of the availability charge on a statewide basis. The Company responded by providing testimony to clarify that its intent was to continue the availability charge only in the services areas where the charges are currently in effect, and the tariffs will be modified accordingly.

The Commission finds that Staff's proposed availability charge, which shall apply only in those service areas currently paying availability charges, is reasonable and should be adopted.

## **2. Provision of an Updated Cost of Service Study in the Company's Next Rate Case**

For its cost of service study ("COSS"), the Company used the simplified cost of service study model that Staff provided previously, which is designed for small water companies. For purposes of this case, the Company's COSS appropriately assigns costs to the various functions and rate classes. Thus, it is an acceptable guidance tool for determining rates in this case. Staff Ex. 4.0 at 25.

However, Staff witness Boggs testified that a more comprehensive COSS would likely provide a better snapshot of how the cost to serve all customers should be allocated to the different customer classes across the current water divisions and sewer divisions. Mr. Boggs recommended that the Commission order the Company to provide in its next rate case a full, in-depth COSS along the lines of those presented in the American Water Works Association's Water Rates Manual M1, Sixth Edition. This would assist in determining the most equitable way to allocate costs and expenses among the various customer classes in the consolidated group. *Id.* at 26.

The Company indicated that it will provide a COSS consistent with the American Water Work's Association's Water Rates Manual M1, Sixth Edition. The Company further explained that it would need to engage an expert to perform the study and would expect the cost of doing so to be subject to recovery as rate case expense. USI Ex. 6.0 at 7.

The Commission agrees with Mr. Boggs' recommendation.

### **B. Contested Issues**

#### **1. Consolidated Rate Structure**

**a. Consolidation of All Service Areas**  
**(i) Company's Position**

The Company proposes to combine: (1) its water divisions into one consolidated water division that has a single rate structure and (2) each of its sewer divisions into one consolidated sewer division that has a single rate structure.

Company witness Lubertozzi indicated that consolidated rates are commonplace in other regulated utilities like gas and electric. He testified that consolidated rates would allow USI to spread capital costs over a larger base of customers, thus mitigating rate shock to a smaller stand-alone division's customer base when infrastructure improvements become necessary in a particular rate area. He also indicated that, in the long-term, consolidated rates will strengthen USI and allow the customers to enjoy lower rates via fewer rate cases and lower rate case expense. USI Ex. 1.0 at 13.

The Company disagrees with the Intervenor's position that the Commission should reject the Company's proposals or in the alternative phase the rates in over several rate cases. The Company argues that the Intervenor failed to provide any specific alternative rates that should be adopted for each stand-alone service area in lieu of the uniform rates supported by the Company and Staff. More importantly, the preservation of differing rates for the separate service areas would defeat the primary purposes of the consolidation, which were to create a broader customer base over which to distribute recovery of costs and to alleviate the rate impacts associated with multiple rate proceedings that would otherwise be needed for smaller, stand-alone companies.

Additionally, the Company avers that the Intervenor oppose the consolidation proposals primarily because they have become accustomed to stand-alone rates that are below the Company-wide cost of service. The Company points out that it is true that the Intervenor will experience an increase in their rates if the proposed consolidated rate structure is approved but it is also true that customers in service areas where stand-alone rates are higher than the Company-wide cost of service will experience a decrease in their rates. Thus, the consolidation proposals will ensure that all customers make an equal contribution to the recovery of the system-wide cost of service.

Moreover, USI claims that the Intervenor exaggerate the impact of rate consolidation by focusing exclusively on the percentage of the increase for customers in the Galena Territory and Westlake Utilities service areas, and completely avoid mentioning the actual dollar amount of the monthly bills under the consolidated rates. The dollar impact is considerably more moderate than the percentage increase would suggest. Under the revenue requirement recommended by Staff, a 5/8" customer using 3,000 gallons of water per month would have a monthly water bill of \$41.86, and a monthly sewer bill of \$47.35. Further, the Intervenor cite public comments that express concerns about the perceived negative impact of the percentage increase on low and fixed income customers in these service areas. However, a lower percentage increase for the Intervenor would require a compensating increase that would impact low and fixed income customers in service areas that are currently paying much more than the consolidated rates. The Company states that the consolidated rate structure assures the affordability of the rates is the same for all USI customers.

Finally, the Company submits that the Commission should decline to adopt the Intervenor's alternative recommendation to phase-in the consolidation of rates over several rate cases. USI asserts that this proposal would take 15 years based on the time between rate cases upon which the amortization of rate case has been based in this case. Additionally, the Intervenor ignores the administrative costs associated with maintaining 23 different sets of rates and applying the changes in multiple steps over years.

Accordingly, the Company asserts that the Commission should reject the Intervenor's arguments and approve the Company's proposed consolidated rate structure.

### **(ii) Intervenor's Position**

The Intervenor objects to the Company's consolidation proposals. They claim that Staff provided testimony that the consolidated rate structure will result in a rate increase that exceeds the costs to serve the average water customers of the Galena Territory, Westlake Utilities, and Lake Holiday divisions. According to the Intervenor, if water rates were based on the costs to serve these customers, the rate increases to average users served by the Galena Territory division would be 23.3%, not the 45% increase proposed. For the Westlake Utilities division, if rates were based on the cost to serve, the increase would be 78%, not the 159% increase proposed. For the Lake Holiday division, if rates were based on costs, the increase would be 40%, not the 110% proposed.

The Intervenor asserts that these draconian increases, are contrasted with the dramatic decreases in water rates that other divisions would see as a result of the proposed rate consolidation. For example, customers served by the Charmar Water division would see a nearly 65% decrease, the Del-Mar Water division would see a 55% decrease, and the Camelot Utilities division would see a decrease of 30%. The Intervenor states that USI and Staff attempt to justify this disparity by alleging that, the Company's proposals would benefit customers because in the future if a small division would need to add facilities, the increase to all customers would be less than what would be imposed on the division causing the costs to be incurred. The Intervenor argues that this is not a valid reason to adopt rates that are not reasonable, cost-based, or fair to customers. The public comments filed in this docket by ratepayers themselves, which the ALJ must review, show that ratepayers do not understand or accept that their water rates will increase by 50% to 160% under the Company's consolidated rate structure when the cost to serve those customers justifies a rate increase of only half that amount.

If the Commission permits water rates that are not cost-based, then the Intervenor suggests that system-wide water rates be set at a level where no USI ratepayer receives an average bill increase in excess of the system-wide rate increase for water service. In the alternative, if the purpose is to eventually move all of the divisions to one state-wide rate, then the Intervenor maintains that the movement should be done incrementally to avoid the rate shock caused by increasing some water rates by 160% while giving other customers decreases of over 60%. The Intervenor also recommends that if the Commission approves an incremental movement to state-



wide rates, any increase to an individual division's rates should not exceed the cost of service as listed in Staff witness Boggs' testimony. Staff Ex. 4.0 at 7.

The Intervenors also object to consolidating the wastewater rates. They argue that these proposed rates are not supported by any evidence since, as Staff noted, USI did not conduct a COSS to calculate the uniform wastewater rate. In addition, the proposed consolidation would result in the average bill for the Galena Territory division to increase by 145% and for Westlake Utilities division to increase by 52%. And as with water rates, the consolidated wastewater rate would conversely result in significant decreases for other divisions, for example, a 45% decrease for the Northern Hills Water and Sewer division and 27% decrease for the Camelot Utilities division. For these reasons, the Intervenors assert that if the Commission adopts wastewater rates that are not cost-based, then the Intervenors propose that any increase to specific wastewater divisions be limited to an increase of no more than the system-wide rate increase for wastewater service.

### (iii) Staff's Position

Staff recommends that the Commission approve the Company's consolidation proposals. Staff witness Boggs reviewed information that the Company included in its initial filing and considered bill impacts for average use customers. Staff explains that Mr. Boggs did this to determine what the rate impacts of a consolidated rate structure would be on each individual water division. Mr. Boggs' initial review indicated that, only seven divisions (Clarendon Water, Ferson Creek Utilities, Galena Territory, Killarney Water, Lake Holiday, Whispering Hills, and Westlake Utilities) would receive a higher increase under the Company's proposed consolidated rate structure than they would receive on a stand-alone basis. He testified that customers of all seven of the above mentioned water divisions would see a significant increase whether they remain a stand-alone division or whether they are consolidated with other divisions in any combination. Staff Ex. 4.0 at 5-7.

Mr. Boggs also explored several different rate structure combinations based on the bill impact scenarios and determined that some should be further analyzed. Based on his analysis, he concluded that pulling any division out of the fully consolidated group as a stand-alone group might mitigate the rate impacts to the stand-alone group, but the remainder of the consolidated group would have more significant rate impacts. However, Mr. Boggs testified that this must be weighed against the fact that, for all the water divisions, large capital improvements could be spread among a larger base of customers when it becomes necessary to update infrastructure to provide safe and reliable water service. According to Mr. Boggs, consolidation would also mitigate the impact of rate case expenses if the Company has to file for only a single division rather than more numerous stand-alone water divisions. When rate case expenses and infrastructure improvements are necessary, significant rate increases to fund these improvements could prove quite burdensome for the small number of customers in individual, smaller water divisions. Thus, Mr. Boggs further testified that the long-term benefits of consolidation outweigh its costs. *Id.* at 12-13.

Staff challenges the Intervenor's assertion that by establishing statewide rates that exceed the stand-alone cost to serve customers, USI's rates to customers served by the Galena Territory and Westlake Utilities divisions are neither just nor reasonable. Staff argues that contrary to the Intervenor's assertion, the determination of whether a rate is just and reasonable under the Act does not solely depend upon a cost analysis as the Intervenor argues. The Intervenor fails to recognize that the Act allows the Commission to consider factors other than costs when designing rates. Under the Act, one of the goals and objectives of regulation is to consider equity. 220 ILCS 5/1-102(d). Equity is the fair treatment of consumers and investors. *Id.* Staff explains that equity involves not just considering the cost of supplying service so that it is allocated to those who cause the costs, 220 ILCS 5/1-102(d)(iii), but it can include factors other than cost of service. 220 ILCS 5/1-102(d)(iv) (stating "if factors other than cost of service are considered in regulatory decisions, the rationale for these actions is set forth").

Staff highlights that Company witness Lubertozi and Staff witness Boggs provided equitable justification for the Commission to approve a single consolidated rate rather than stand-alone rates. Staff notes that Mr. Lubertozi testified that consolidated rates are common place for other regulated entities like gas and electric. USI Ex. 1.0 at

13. He explained the benefits of costs being spread over a larger base; how the consolidated rate will strengthen USI; and how the consolidated rate will allow customers to benefit from fewer rate cases and lower rate case expense. *Id.* at 282-288. Mr. Boggs agreed in general with Mr. Lubertozi's testimony on this issue and his justification for the consolidated rate structure is noted above. Staff Ex. 4.0 at 5.

Staff mentions that the Intervenor's quote many comments made by customers of the Galena Territory and Westlake Utilities divisions that are posted on the Commission's website in the public comments section for this docket. The Intervenor's argue that the comments show that customers do not understand the proposed increases and that the rates are unreasonable, and to help those customers better understand the increases and utility charges, they should be phased-in over several rate cases, eventually culminating in a single consolidated rate. Staff asserts that putting aside whether the fact that customers do not understand a rate or believe a rate is unreasonable is a sufficient basis to justify a phase-in given the equity goal and objective in Section 5/1-102(d)(ii) of the Act, the Commission is free to reject a phase-in. It clearly is within the Commission's discretion to approve a single consolidated rate in this case, as the Company proposes and Staff supports. Staff further asserts that the courts give great deference to the Commission in setting rates and the courts have held that "because of its complexity and need to apply informed judgment, rate design is uniquely a matter for the Commission's discretion." See *Iowa-Illinois Gas & Electric Co. v. Illinois Commerce Comm'n*, 19 Ill. 2d 436, 442, 167 N.E.2d 414 (1960); *Central Illinois Public Service Co. v. Illinois Commerce Comm'n*, 243 Ill. App. 3d 421, 445, 610 N.E.2d 1356, 183 Ill. Dec. 112 (1993).

Based upon the above, Staff contends that the Commission should reject the Intervenor's arguments for a phase-in and approve the Company's proposed consolidated rate structure.

#### **(iv) Commission Analysis and Conclusion**

The Commission finds that the Company's consolidated rate structure is reasonable, supported by the evidence, and should be adopted. The Commission declines to adopt the phase-in recommended by the Intervenor's.

As of the date of this Order, 599 public comments were posted on the Commission's e-Docket system regarding the consolidated rates proposed by USI. The Commission appreciates these comments as well as the time and effort expended by those who prepared and provided them. These comments have not been taken lightly and they have been carefully considered by the Commission to the extent permitted by law. The Commission is very much aware that the comments express strong opposition to the proposed rate increases, however, they do not overcome the evidence supporting the proposed consolidated rates. Moreover, the Commission is of the opinion that the benefits of the rate consolidation outweigh the disadvantages.

As Staff stated, cost of service is not the only consideration that may be used to determine whether rates are just and reasonable. Contrary to the Intervenor's arguments, the Commission is permitted under the Act to consider many factors other than costs when designing rates. Under the Act, one of the goals and objectives of regulation is to consider equity, which is the fair treatment of customers and investors.

220 ILC 5/102(d). The Commission believes the consolidation proposals advance this objective. The record shows that only seven of the twenty-two water divisions reviewed by Staff will experience a higher increase under the Company's proposed consolidated rate structure than they would receive on a stand-alone basis. All of these divisions will experience a significant increase in rates whether they are a stand-alone division or consolidated with other divisions in any combination. Staff Ex. 4.0 at 5-7. Further, many of the customers in these divisions, including Galena Territory, Lake Holiday, and Westlake Utilities, have been charged stand-alone rates that are below the Company-wide cost of service and the customers in the divisions identified by the Intervenors that will experience a decrease in rates have been charged rates that exceed the Company-wide cost of service. Thus, a consolidated rate structure will address this disparity and ensure that all customers make an equal and appropriate contribution to the recovery of the system-wide cost of service.

The Commission also notes that Staff's analysis of several different rate structure combinations based on bill impact scenarios shows that removing any division from the consolidated group as a stand-alone group might mitigate the rate impacts to the stand-alone group, but the remainder of the consolidated group would have significant rate impacts. Additionally, the consolidated rate structure moves USI closer to the rate structure most common for other regulated utilities. It will allow the Company to spread capital costs over a larger base of customers, thus mitigating rate shock to a smaller stand-alone division's customer base when infrastructure improvements are necessary. It would also alleviate the rate impacts associated with multiple rate proceedings that would otherwise be needed for smaller, stand-alone divisions.

Finally, the Commission believes the Intervenors have not provided sufficient support to show that their recommendation that the consolidated rates should be phased-in over several rate cases is a better approach. The phase-in would delay the Company's recovery of its costs of service for an unreasonable amount of time since it could take up to 15 years to phase-in the consolidated rates. There was no evidence provided concerning the impact of the administrative costs related to maintaining different sets of rates and applying the changes in multiple steps over the years. Moreover, the Intervenors did not include specific alternative rates for each stand-alone service area in its recommendation to use instead of the uniform rates supported by the Company and Staff.

**b. Inclusion of Oakwood in Rate Design**

**(i) Company's Position**

The Company explains that it purchased the Oakwood division's water and wastewater operations through an Asset Purchase Agreement ("APA") dated September 9, 2013 from the Village of Oakwood. The transaction was approved by the Commission through a Certificate of Public Convenience and Necessity in Docket No. 13-0564 on March 19, 2014. Under the APA, the Company agreed to continue to charge the current rates for a period of two years. Thereafter, rates were to be charged consistent with the Company's consolidated rate schedule as approved by the Commission.

The Company asserts that it included Oakwood in the consolidated group's revenue requirement in the Company's direct testimony even though Oakwood's rates remain unchanged because of the rate freeze in the APA. The Company states that Oakwood would in effect be subsidized by the consolidated group because Oakwood is included in the total revenue requirement, but its rates are not revised to reflect that revenue requirement.

USI points to the two alternatives offered by Staff witness Boggs to address Oakwood's subsidization by the consolidated group. The first suggestion was that Oakwood could be removed from the consolidated group's revenue requirement and rates entirely. This would ensure that the consolidated group's rates reflected only the consolidated group's revenue requirement. A second alternative was suggested by the Company in its responses to a Staff data request. Under this alternative, the Company would seek to unify the Oakwood service area rates and revenue requirement with the rest of the consolidated group when the restriction on rates charged to customers in the Oakwood service area expires. This would be accomplished by leaving Oakwood in the consolidated group's revenue requirement, calculating consolidated rates for all USI customers including Oakwood, but not applying the consolidated group's rates to Oakwood customers until March 10, 2016 when the rate freeze expires. The Company explains that Oakwood customers would continue to pay the current Oakwood rates until March 10, 2016. This would create a revenue requirement shortfall with respect to the Oakwood rates until March 10, 2016. The Company indicates that this shortfall would be a shareholder expense and would not be passed on to customers.

### **(ii) GTA's Position**

GTA witness Mattingley expressed concern about the effect USI's acquisition of the Oakwood division might have on the water and wastewater rates for the Galena Territory division. He specifically requested information concerning what costs attributable to Oakwood are included in Galena Territory's rates to GTA and its members, and what benefits, if any, Galena Territory achieved for Galena by acquiring a system over 200 miles from the city. GTA Ex. 1 at 3-4. In rebuttal testimony, Mr. Mattingley continued to express concern about including Oakwood as part of Galena Territory. GTA Ex. 2 at 3. He stated that he was not completely satisfied with USI's response that there are costs included from all 23 operating areas in all customer's rates.

### **(iii) Staff's Position**

Like the Company, Staff included Oakwood in the consolidated group's revenue requirement in its direct testimony and determined that Oakwood would in effect be subsidized by the consolidated group, including the Galena Territory division. As previously noted, Staff witness Boggs offered two alternatives to address this issue. He stated that both alternatives would adequately address the subsidization issue, but the alternative suggested by the Company, which would add the Oakwood service territory to the rest of the consolidated group would provide certain advantages. USI Ex. 13.0 at 5-7.

Mr. Boggs testified that the primary advantage that the Oakwood service area water customers would realize from being included in the consolidated group is having a

larger customer base to spread capital improvement costs over when large infrastructure investments and repairs are needed. In addition, Oakwood's usage charge would decrease by \$0.01 per 1,000 gallons. Moreover, the Company would avoid another rate case in a year to determine the rates that would be needed to recover the new revenue requirement for the Oakwood service area. Mr. Boggs explained that with only 737 water customers, rate case expense for those customers would further increase the rates that would be needed to recover the revenue requirement that will eventually be determined. Staff Ex. 9.0 at 7.

Mr. Boggs stated that the chief advantage to all Oakwood sewer customers from consolidation is the ability to spread future capital expenses and rate case expenses over a larger group of customers, thereby mitigating future bill impacts. In addition, the sewer rates would also decrease by \$2.45 per month on a flat-rate basis. *Id.* at 8.

Accordingly, Staff recommends that the Commission approve this approach because of the advantages identified by Mr. Boggs.

#### **(iv) Commission Analysis and Conclusion**

The Commission concurs with Staff and the Company that the best way to address the potential for Oakwood to be subsidized by the consolidated group is the alternative suggested by the Company. This option would entail adding the Oakwood service territory to the rest of the consolidated group but not applying the consolidated rates to Oakwood customers until March 10, 2016 when the rate freeze expires. This approach would not unfairly impact other customers since the shortfall would be borne by shareholders and it would not be passed on to customers. Additionally, it would be beneficial to Oakwood customers because future capital improvement costs and rate case expenses could be spread over a larger group of customers, thereby mitigating future bill impacts. Further, if this alternative is adopted, the Company would not have to file another rate case in a year to determine the rates that would be needed to recover the new revenue requirement for the Oakwood service area.

## **VI. OTHER**

### **A. Elimination of Purchased Water and Purchased Sewer Surcharges**

The Company proposed to eliminate all of its purchased water surcharges and purchased sewer surcharges and to include the costs of all purchased water and purchased sewer services within base rates. Inclusion of the costs of all purchased water and sewer services within base rates is consistent with the Company's proposal to establish a consolidated rate structure for its customers, and eliminates the need for annual purchased water and purchased sewer reconciliation proceedings. USI Ex. 1.0 at 12-13; USI Ex. 2.0 at 7-8.

Staff recommends that the Commission approve the Company's proposal to eliminate its purchased water and purchased sewer surcharges, subject to Staff's proposed language and Commission approval of a new transition/clean up tariff which provides for the final reconciliations of purchased water and purchased sewer surcharges, as discussed in Section VI.B. below. Staff Ex. 1.0 at 17-19; Staff Ex. 7.0 at 11-14. The Company agrees with Staff's conditions. USI Ex. 7.0 at 10-11.

The Commission finds the Company's proposal, as modified by Staff's conditions, to be reasonable.

**B. Final Reconciliations of Purchased Water and Purchased Sewer Surcharges**

As discussed in Section VI.A. above, the Company agrees with Staff's recommendations and conditions concerning the Company's proposal to eliminate all of its purchased water surcharges and purchased sewer surcharges. USI Ex. 7.0 at 10-11.

In the event that the Commission approves the Company's proposal to eliminate all of its purchased water surcharges and purchased sewer surcharges and to include the costs of all purchased water and sewer services within base rates, the Commission should adopt Staff's recommendations as follows:

- The final order in this proceeding should authorize and require USI to include with its compliance filing in this proceeding, tariff sheets consistent with the proposed language on page 12 of Staff Exhibit 7 that:
  - provide a mechanism for the reconciliation of purchased water and sewer costs and revenues for any reconciliation periods that have not yet been considered by an order of the Commission;
  - provide a mechanism for the refund or recovery of any cumulative (over)/under recovery determined from those reconciliations; and
  - provide for the disposition of any Factor Os ordered by the Commission that result from the proceedings to reconcile the revenues and expenses of each surcharge that have not yet been considered by the Commission at the time an order is entered in this proceeding;
- The final order in this proceeding should require the Company to file, within 90 days of the final order in this proceeding, a petition for a final reconciliation of the USI purchased water and purchased sewer surcharges for the year 2015 up to the effective date of new tariffs filed in compliance with the final order in this proceeding; and
- The final order in this proceeding should include the following language in the Ordering paragraphs:

IT IS FURTHER ORDERED that within 90 days of the date of this Order, Utility Services of Illinois, Inc. shall for the period from January 1, 2015, through the effective date of new tariffs filed in accordance with this Order, file a final reconciliation of its purchased water and purchased sewer surcharges, along with a petition requesting approval of said reconciliation which includes testimony and schedules that support the accuracy of the costs and charges for the period being reconciled.

The Commission finds Staff's recommendations are reasonable and Staff's recommended language should be included in the Findings and Ordering paragraphs.



### **C. Proposed Depreciation Rates**

USI witness Guastella provided a depreciation study utilizing comparable data for average service lives, net salvage values, depreciation rates of other water and sewer utilities, as well as state and industry guidelines. USI Ex. 4.0 at 6. Mr. Guastella proposed separate water and sewer depreciation rates for each primary account. USI Ex. 4.0, Scheds. JFG-1 and JFG-2.

Staff witness Sperry did not object to the Company's depreciation study or the proposed depreciation rates. Staff Ex. 6.0 at 5.

The Commission approves the sewer and water depreciation rates proposed by the Company.

### **D. Maximum Allowable Unaccounted-for Water Percentage**

USI proposed to combine all of the Company's existing percentages of maximum unaccounted-for water, without changes, into a single tariff sheet for all of its service areas. USI Ex. 2.0 at 11.

Staff witness Sperry recommended that the maximum level of unaccounted-for water for the four service areas (Clarendon Water, Great Northern, Walk-Up Woods, and Westlake Utilities) be reduced to 15% in USI's revised Schedule of Rates and Charges tariffs for water service. Staff Ex. 6.0 at 9. The Company accepted Staff's recommendations.

The Commission adopts Staff's recommended maximum levels of unaccounted for water.

### **E. Other Tariff Change Proposals**

In anticipation of the Commission's approval of the Company's consolidation proposals, the Company proposed several changes to its tariffs. In its Unaccounted for Water tariff, the Company condensed the existing percentages applicable to the various service divisions into a single sheet (ICC No. 3, Original Sheet No. 4.). In its Schedule of Rates tariff, the Company has created uniform miscellaneous charges that it derived from its current tariffs in each service territory. The Company also proposed to change all service divisions to a monthly billing cycle. This will make all the service divisions' billing cycles consistent with each other and with the billing cycles that the Commission has been approving in recent individual rate cases for the utility company's predecessor. Staff Ex. 4.0 at 34.

Staff recommends that the Commission approve the Company's tariff change proposals. Doing so will make the tariffs uniform if the Commission approves the consolidated rate structure.

Approving the proposed tariff changes would add consistency and uniformity to each service division's individual tariff. Therefore, the Company's proposed changes are reasonable and the Commission approves these proposals.

## VII. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having given due consideration to the entire record herein and being fully advised in the premises, is of the opinion and finds that:

- (1) USI provides water and sewer service to the public within the State of Illinois, and, as such, is a public utility within the meaning of the Act;
- (2) the Commission has jurisdiction over USI and of the subject-matter herein;
- (3) the recital of facts and conclusions reached in the prefatory portion of this Order are supported by the evidence, and are hereby adopted as findings of fact;
- (4) a test year ending December 31, 2015, should be adopted for the purpose of this rate proceeding;
- (5) the \$37,241,560 original cost of water plant in service for USI at December 31, 2013, as reflected on Staff's Schedule 1.15 W, is unconditionally approved as the original costs of plant;
- (6) the \$11,760,334 original cost of sewer plant in service for USI at December 31, 2013, as reflected on Staff's Schedule 1.15 S, is unconditionally approved as the original costs of plant;
- (7) a fair and reasonable rate of return on the rate base for USI is 7.88%; rates should be set to allow the Company an opportunity to earn that rate of return on its rate base, as is determined herein;
- (8) the rates which are presently in effect for USI are insufficient to generate the operating income necessary to permit the Company to earn a fair and reasonable rate of return; those rates should be permanently canceled and annulled as of the effective date of the new tariffs allowed by this Order;
- (9) the rates proposed by USI would produce a rate of return in excess of a return that is fair and reasonable; the Proposed Tariffs of Utility Services of Illinois, Inc. should be permanently canceled and annulled;
- (10) pursuant to Section 9-229 of the Act, the Commission has specifically assessed the amounts expended by the Company to compensate attorneys and experts to prepare and litigate this general rate case filing and finds those amounts, as adjusted, to be just and reasonable, with the Commission's more detailed supporting findings on this subject as set forth in this Order;
- (11) USI should be permitted to file new tariff sheets setting forth the rates designed to produce operating revenues as shown in Appendix A and B as such revenues are necessary to provide the Company a rate of return of 7.88% on their rate base, consistent with the findings herein; these tariff sheets shall be applicable to service furnished on or after their effective date;

- (12) USI shall also file new tariff sheets consistent with the proposed language set forth on page 12 of Staff Exhibit 7 as discussed in Section VI.B. of this Order concerning final reconciliations of purchased water and purchased sewer surcharges;
- (13) the new tariff sheets authorized to be filed by this Order shall reflect an effective date not less than five working days after the date of filing, with the tariff sheets to be corrected within that time period if necessary, except as is otherwise required by Section 9-201(b) of the Act as amended;
- (14) USI shall file, within 90 days of the date of this Order, a petition for a final reconciliation of the USI purchased water and purchased sewer surcharges for the year 2015 up to the effective date of new tariffs filed in compliance with the Order in this proceeding;
- (15) all remaining motions, petitions, objections, or other matters in this proceeding should be disposed of in a manner consistent with the conclusions reached herein; and
- (16) USI shall otherwise perform all actions that this Order requires of it.

IT IS THEREFORE ORDERED by the Commission that the tariff sheets proposing a general increase in water rates filed by Utility Services of Illinois, Inc. on November 10, 2014 are hereby permanently canceled and annulled.

IT IS FURTHER ORDERED that Utility Services of Illinois, Inc. is authorized to place into effect tariff sheets which will produce the annual operating revenues and operating incomes set forth in the Findings above, and are consistent with Appendices A and B to this Order, to be effective on the date of filing for water and sewer service furnished on and after such effective date.

IT IS FURTHER ORDERED that Utility Services of Illinois, Inc. shall also place into effect tariff sheets consistent with the proposed language set forth on page 12 of Staff Exhibit 7 as discussed in Section VI.B. of this Order concerning final reconciliations of purchased water and purchased sewer surcharges;

IT IS FURTHER ORDERED that Utility Services of Illinois, Inc. must file its Rate tariffs consistent with the requirements of the Findings above.

IT IS FURTHER ORDERED that upon the effective date of the tariff sheets filed pursuant to this Order, the presently effective tariff sheets of Utility Services of Illinois, Inc., which are replaced thereby are permanently canceled and annulled.

IT IS FURTHER ORDERED that within 90 days of the date of this Order, Utility Services of Illinois, Inc. shall for the period from January 1, 2015, through the effective date of new tariffs filed in accordance with this Order, file a final reconciliation of its purchased water and purchased sewer surcharges, along with a petition requesting approval of said reconciliation which includes testimony and schedules that support the accuracy of the costs and charges for the period being reconciled.

IT IS FURTHER ORDERED that any petitions, objections or motions made in this proceeding and not otherwise specifically disposed of herein are hereby disposed of in a manner consistent with the conclusions contained herein.

IT IS FURTHER ORDERED that the \$37,241,560 original cost of water plant in service for Utility Services of Illinois, Inc. at December 31, 2013, as reflected on Staff's Schedule 1.15 W, is unconditionally approved as the original costs of plant.

IT IS FURTHER ORDERED that the \$11,760,334 original cost of sewer plant in service for Utility Services of Illinois, Inc. at December 31, 2013, as reflected on Staff's Schedule 1.15 S is unconditionally approved as the original costs of plant.

IT IS FURTHER ORDERED that, subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By Order of the Commission this 22<sup>nd</sup> day of September, 2015.

(SIGNED) BRIEN SHEAHAN

Chairman

**PETITIONER'S EXHIBIT 5**

**COMMUNITY UTILITIES OF INDIANA, INC.**

**INDIANA UTILITY REGULATORY COMMISSION**

**CAUSE NO. 44724**

**DIRECT TESTIMONY**

**OF**

**JOHN F. GUASTELLA**

**SPONSORING PETITIONER'S ATTACHMENTS JFG-1 THROUGH JFG-4**

**COMMUNITY UTILITIES OF INDIANA, INC.**

**CAUSE NO. 44724**

**Direct Testimony of John F. Guastella**

1

**INTRODUCTION AND QUALIFICATIONS**

2 **Q1. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A1. My name is John F. Guastella, and my business address is Guastella Associates, LLC.  
4 725 N. Highway A1A, Suite B103, Jupiter, Florida 33477.

5 **Q2. PLEASE DESCRIBE GUASTELLA ASSOCIATES, LLC.**

6 A2. Guastella Associates provides utility management, valuation and rate consulting services  
7 to both regulated and unregulated utilities.

8 **Q3. HAVE YOU ATTACHED A STATEMENT OF YOUR EDUCATIONAL,  
9 PROFESSIONAL AND BUSINESS BACKGROUND AND EXPERIENCE?**

10 A3. Yes, a statement of Qualification and Experience is attached as Appendix A.

11 **Q4. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?**

12 A4. I was retained by Community Utilities of Indiana, Inc. (“Company” or “CUII”) to perform  
13 a depreciation analysis of its water and sewer utility systems and to recommend  
14 appropriate depreciation rates.

15 **Q5. BEFORE DESCRIBING THE DEPRECIATION ANALYSIS YOU  
16 PERFORMED, WOULD YOU GENERALLY OUTLINE THE CONCEPT OF  
17 DEPRECIATION?**

1 A5. The goal of depreciation for rate setting purposes is to allow utilities to recover the  
2 original cost of the assets that are used and useful in providing service to their customers,  
3 and at a level that spreads the recovery of the cost over the estimate life of the assets so  
4 that each generation of customers pays its fair share of the cost according to their use of  
5 the assets. The Uniform System of Accounts published by the National Association of  
6 Regulatory Utility Commissioners (“NARUC”) defines depreciation as:

7 Depreciation, as applied to depreciable utility plant, means the loss in  
8 service value not restored by current maintenance, incurred in connection  
9 with the consumption or prospective retirement of utility plant in the  
10 course of providing service from causes which are known to be in current  
11 operation and against which the utility is not protected by insurance.  
12 Among the causes to be given consideration are wear and tear, decay,  
13 action of the elements, inadequacy, obsolescence, changes in the art,  
14 changes in demand, and requirements of public authorities.

15 Under this definition, depreciation studies are performed in order to estimate the average  
16 service lives of various depreciable assets, the major component with which to calculate  
17 depreciation rates. Application of depreciation rates to the original cost of assets  
18 establishes annual depreciation expense allowances in utility rates for service that will  
19 meet the goal of reasonable cost recovery and intergenerational equity.

20 **Q6. WHAT ARE THE COMPONENTS OF THE CALCULATION OF**  
21 **DEPRECIATION RATES?**

22 A6. In addition to average service lives, the other component in the calculation of  
23 depreciation rates is net salvage values, or salvage value less cost of removal.

24 The relevant Uniform System of Accounts definitions are:

25 Salvage Value means the amount received for property retired, less any  
26 expenses incurred in connection with the sale or in preparing the property  
27 for sale, or, if retained, the amount at which the material recoverable is  
28 chargeable to materials and supplies, or other appropriate account.

1            Cost of Removal means the cost of demolishing, dismantling, tearing  
2 down or otherwise removing utility plant, including the cost of  
3 transportation and handling incidental thereto.

4            Net Salvage Value means the salvage value of property retired less the cost  
5 of removal.

6            For proper rate setting, the calculation of depreciation rates and resultant depreciation  
7 expense recognizes that the allowance for depreciation should include the recovery of the  
8 original cost of the depreciable assets less any anticipated positive salvage values and/or  
9 plus any anticipated cost of removal. Under this calculation of depreciation rates,  
10 existing and future customers will pay their fair share of the cost and net salvage value of  
11 the assets that have been used to provide utility service to them.

12 **Q7. HOW DOES THE ACCOUNTING FOR DEPRECIATION AFFECT RATES FOR**  
13 **SERVICE?**

14 A7. Annual depreciation expense accruals are of course credits, or increases, to the  
15 accumulated depreciation. Recognition of positive net salvage decreases the accrual and  
16 negative net salvage, due to cost of removal, increases the accrual. Accordingly,  
17 accumulated depreciation is higher or lower depending on net salvage value, and the rate  
18 base on which utilities are given an opportunity to earn a return is lower or higher,  
19 respectively. Instructions in the Uniform System of Accounts describe the accounting  
20 with respect to the retirement of a retirement unit of property as follows:

21            If the retirement unit is of a depreciable class, the book cost of the unit  
22 retired and credited to utility plant shall be charged to the accumulated  
23 depreciation applicable to such property. The cost of removal and the  
24 salvage shall be charged or credited, as appropriate, to such depreciation  
25 account.



1 Under the required accounting, the accumulated depreciation would decrease by the  
2 original cost of the retired property and also the cost of removal, determined at the time of  
3 retirement, which ideally would offset, on average, the annual accruals that had increased  
4 the accumulated depreciation over the years. In other words, as annual accruals that  
5 include recovery of the original cost as well as cost of removal accumulate, they increase  
6 the reserve for depreciation and, therefore, decrease the rate base. The booking of the  
7 cost of removal when assets are retired would decrease the reserve for depreciation, and  
8 increase the rate base.

9 It is also noted that for rate setting purposes the establishment of reasonable depreciation  
10 rates is primarily a matter of achieving intergenerational equity -- existing and future  
11 customers paying their fair share of the costs associated with the assets that are used to  
12 provide them with service. Further, while depreciation expense is a deduction to  
13 revenues when calculating utility operating income (return on net investment or rate  
14 base), it is a "non-cash" expense; depreciation expense is for the most part a recovery of  
15 the original cost of assets for which expenditures had previously been made. Thus,  
16 depreciation expense is a source of internally generated funds, along with retained  
17 earnings. Because dividends to stockholders are only paid out of net income, these  
18 internally generated funds provide financing of new plant, not additional return on  
19 investment. The level of these internally-generated funds, however, only provides part of  
20 the capital needed for new plant, because the original cost of the assets being recovered  
21 through depreciation allowances is typically only a small fraction of the current cost of  
22 adding or replacing plant and facilities -- the balance of the funding must be obtained  
23 from the attraction of outside debt and/or equity capital.

1 Accordingly, in addition to intergenerational equity, establishing reasonable depreciation  
2 rates that provide for the recovery of the original cost of assets and net salvage values,  
3 including cost of removal, should, at least theoretically, improve the utility's ability to  
4 attract capital at a lower cost -- because the portion of the new outside capital in relation  
5 to existing investment would not be higher than otherwise needed to make up for a  
6 shortfall in internally generated capital and debt coverage requirements. Obviously, a  
7 lower cost of capital has a beneficial impact on rates for service. This potential benefit  
8 assumes a long-term effect of adequate depreciation practices. Depreciation practices,  
9 however, are not a substitute or offset for other rate setting policies that should establish  
10 new rates for service in order to cover the cost of service for the period when those rates  
11 become effective. Appropriate depreciation practices, coupled with other rate setting  
12 practices that provide a utility with a realistic opportunity to achieve the allowed return on  
13 investment, will in the long run improve the utility's ability to attract the lowest cost of  
14 capital.

15 **Q8. PLEASE DESCRIBE THE ANALYSIS WHICH YOU PERFORMED FOR THE**  
16 **COMPANY.**

17 A8. The Company's water and sewer systems are comprised of relatively small utilities that  
18 do not have sufficient retirement data that are readily available to perform either an  
19 actuarial or simulated plant balance method for determining average service lives. I have,  
20 therefore, undertaken a comparative analysis in order to establish appropriate average  
21 service lives and depreciation rates. I have prepared similar comparative analyses that  
22 have been accepted in other jurisdictions in recent years. It is also my experience that

1 depreciation rates for small water and sewer utilities are commonly based on the use of  
2 comparisons. The most recent comparative depreciation study that I performed was on  
3 behalf of Utility Services of Illinois, Inc. (a sister utility of CUII) in connection with a rate  
4 application to the Illinois Commerce Commission (“ICC”) in Docket No. 14-0741. The  
5 ICC accepted the study in its entirety, including the recommended average service lives,  
6 net salvage values and resultant depreciation rates. Those average service lives and net  
7 salvage values are also consistent with studies of comparable property of other utilities,  
8 which I have examined. The average service lives are within the range of data compiled  
9 for various utilities and regulatory agencies around the country.

10 **Q9. WHAT COMPARISONS DID YOU MAKE?**

11 A9. I compiled average service lives, net salvage values and depreciation rates of other water  
12 utilities in various states, including Utilities & Industries Corp., Long Island Water  
13 Corporation, Elizabethtown Water Company, Citizens Water Company, Artesian Water  
14 Company, Illinois American Water Company, Middlesex Water Company, Citizens  
15 Water Company, the New Jersey American utilities, Pennichuck Water Company, Aqua  
16 Illinois, Inc. divisions known as Candlewick, Fairhaven Estates, Hawthorn Woods,  
17 Ivanhoe, Oak Run, Ravenna, University Park, Vermilion, Willowbrook, Elwood Green,  
18 Kankakee and Corporate, and NARUC guideline depreciation rates, California Public  
19 Utilities Commission Standard Practice depreciation rates, and Florida Public Service  
20 Commission rules and regulations on depreciation rates.

1 **Q10. HAVE YOU PREPARED AN EXHIBIT WHICH SHOWS THE RESULTS OF**  
2 **YOUR DEPRECIATION STUDY AND A SUMMARY OF YOUR**  
3 **RECOMMENDATIONS?**

4 A10. Yes. My recommendations with respect to the depreciation study are shown on  
5 Attachments JFG-1 and JFG-2 for water and sewer, respectively, attached to my  
6 testimony.

7 **Q11. WHAT IS THE BASIS FOR THE NEGATIVE NET SALVAGE VALUES?**

8 A11. I used net salvage values that were established some years ago by the ICC, a regulatory  
9 agency that has made significant progress with respect to recognizing the current cost of  
10 removal in relation to the original cost of depreciable assets. An analysis of the dramatic  
11 increases in construction costs with respect to utility assets supports the ICC's initiative.  
12 It is obvious that the current cost of dismantling and removing such assets as structures,  
13 storage facilities, pumps, etc. is significant in terms of the absolute costs, particularly in  
14 relation to their original costs. With respect to such assets as mains and service laterals,  
15 the cost of removal is also significant, even if only a small portion of the costs associated  
16 with trenching for the replacement and installation of a new section of a main or  
17 replacement of a service lateral is allocated to the cost of removal.

18 **Q12. HAVE YOU PREPARED A SCHEDULE DEMONSTRATING THE**  
19 **RELATIONSHIP OF ORIGINAL AND CURRENT CONSTRUCTION COSTS?**

20 A12. Yes, Attachments JFG-3 and JFG-4 for water and sewer, respectively, contain  
21 calculations of the multiples of current constructions costs over original costs. The  
22 calculation determines, for each respective account, the ratio of the current year Handy-

1 Whitman Construction cost Index to the vintage year index, with the vintage years  
2 determined by the number of years of the respective average service life. For example,  
3 for water Account 304.1 Structures & Improvements has an average service life of 40  
4 years, which is equivalent to the vintage years 1975, or 40 years back from 2015, and the  
5 2015 index of 129 is divided by the 1975 index of 129 producing a ratio or multiple of  
6 3.58 -- meaning that the current cost or construction is nearly 3.6 times greater than the  
7 original cost. Clearly, the current cost to remove or replace structures would be a  
8 significant percentage of the original cost. With respect to mains for which current costs  
9 are about 26 times the original cost 70 years ago, if only 5% of the cost of installing the  
10 new mains is the cost to replace the old mains, the relationship of the cost of removal to  
11 the original costs would be 100%. This analysis confirms the reasonableness of net  
12 salvage percentages used by the ICC, and which I use in this study.

13 **Q13. IS THE USE OF HANDY-WHITMAN INDICES COMMON IN PREPARING**  
14 **CURRENT COSTS IN COMPARISON TO HISTORICAL COSTS?**

15 A13. Yes. The Handy-Whitman Construction cost Index is commonly used in construction  
16 cost comparisons like the one I prepared in this case.

17 **Q14. DID THE COMPANY'S RETIREMENTS AFFECT YOUR DEPRECIATION**  
18 **STUDY?**

19 A14. No. As mentioned, the Company has not experienced sufficient retirements with which  
20 to perform either an actuarial or simulated plant balance method for determining average  
21 service lives.

22 **Q15. PLEASE DESCRIBE ATTACHMENTS JFG-1 AND JFG-2.**

1 A15. These schedules show the average service lives which I am recommending for the  
2 Company for its water and sewer systems. The recommended average service lives are  
3 the same as the average service lives approved by the ICC for other water and sewer  
4 systems. On the basis of my experience and my review of the depreciation  
5 determinations for water and sewer system assets, it is my judgment that the  
6 recommended average service lives and net salvage for all plant accounts shown on  
7 Attachments JFG-1 and JFG-2 are not only reasonable, in general, but are reasonable for  
8 determining depreciation rates for the Company.

9 **Q16. IN ADDITION TO THE APPROPRIATENESS OF THE RECOMMENDED**  
10 **DEPRECIATION RATES, ARE THERE OTHER ADVANTAGES FOR THE**  
11 **COMPANY TO USE SIMILAR DEPRECIATION RATES FOR ALL OF ITS**  
12 **SYSTEMS?**

13 A16. Yes, there is an administrative benefit associated with a consistent depreciation and  
14 accounting practice. Moreover, since there is a general consistency in the way the  
15 Company maintains its facilities, for each system, the life of each system's assets would  
16 tend to be extended for a similar period of time.

17 **Q17. ARE YOUR COMPARATIVE DEPRECIATION DATA AVAILABLE IN WORK**  
18 **PAPER FORM?**

19 A17. Yes.

20 **Q18. DOES THAT CONCLUDE YOUR PREFILED DIRECT TESTIMONY AT THIS**  
21 **TIME?**

22 A18. Yes.

23

## VERIFICATION

I, John F. Guastella, President of Guastella Associates, LLC, affirm under penalties of perjury that the foregoing representations are true and correct to the best of my knowledge, information, and belief.

A handwritten signature in black ink, appearing to read "John F. Guastella". The signature is written in a cursive style with a large initial "J" and "G".

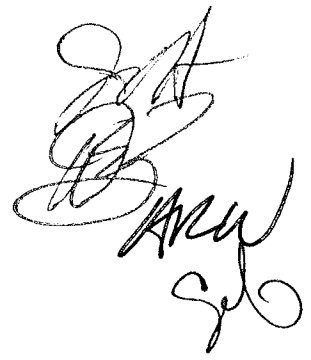
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John F. Guastella

Date: December 15, 2015

ORIGINAL

STATE OF INDIANA



INDIANA UTILITY REGULATORY COMMISSION

PETITION OF COMMUNITY UTILITIES OF INDIANA, )  
INC. FOR (1) AUTHORITY TO INCREASE ITS RATES )  
AND CHARGES FOR WATER AND WASTEWATER )  
UTILITY SERVICE; (2) APPROVAL OF NEW )  
SCHEDULES OF RATES AND CHARGES APPLICABLE )  
THERE TO; AND (3) APPROVAL OF NEW )  
DEPRECIATION RATES )

CAUSE NO. 44724

APPROVED: JAN 24 2018

ORDER OF THE COMMISSION

Presiding Officers:

Angela Rapp Weber, Commissioner

Lora L. Manion, Administrative Law Judge



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On December 15, 2015, Community Utilities of Indiana, Inc. (“Petitioner” or “Company”) filed its Petition and Submission of Case-in-Chief under Ind. Code § 8-1-2-42.7 and Notice of Intent to File Information Required Under Minimum Standard Filing Requirements. Petitioner requested approval of new uniform schedules of rates and charges applicable to its water and wastewater utility services in two phases. On December 15, 2015, Petitioner filed its case-in-chief, work papers, and information required by the Minimum Standard Filing Requirements at 170 IAC 1-5. Petitioner also filed a Motion for Protective Order regarding work papers with confidential information, and the Motion was granted on January 29, 2016, by the Presiding Officers.

On December 22, 2015, a Petition to Intervene was filed by Lakes of the Four Seasons Property Owners’ Association (“LOFS”). LOFS is a property owners’ association that represents the residents within Lakes of the Four Seasons Subdivision, and the residents and the association are water and wastewater customers of Petitioner. The Presiding Officers subsequently granted the Petition on January 27, 2016.

On January 6, 2016, the Presiding Officers filed a docket entry directing Petitioner to address five deficiencies in its materials submitted pursuant to the Minimum Standard Filing Requirements. On January 12, 2016, Petitioner filed its response.

On February 15, 2016, the Presiding Officers established a procedural schedule for the Cause. On April 22, 2016, the Indiana Office of Utility Consumer Counselor (“OUCC”) and LOFS filed their respective cases-in-chief.

On April 20, 2016, the Presiding Officers filed a docket entry directing Petitioner to provide detailed rate schedules for each of the two proposed phased-rate increases. Petitioner filed its response on April 29, 2016.

On May 13, 2016, Petitioner filed an Unopposed Motion to Vacate Hearing Date and for Modification of Procedural Schedule. On May 31, 2016, Petitioner filed an Unopposed Motion to Suspend Procedural Schedule to permit Petitioner to investigate a potential issue related to its rate base. Both Motions were granted without objection.

On May 24, 2016, the Presiding Officers filed a docket entry requesting clarifications from Petitioner, OUCC, and LOFS regarding their cases-in-chief. Petitioner and OUCC filed their respective responses on June 17, 2016.

On June 27, 2016, Petitioner filed the supplemental direct testimony of witnesses Steven M. Lubertozzi, President of Petitioner, and Justin P. Kersey, Vice President of Operations of Utilities, Inc. and its subsidiaries. The OUCC and LOFS filed their respective supplemental testimony on October 24, 2016. Petitioner filed its rebuttal testimony on December 30, 2016.

On July 27, 2016, the Presiding Officers filed a docket entry rescheduling the hearing from August 2, 2016, to October 4, 2016, and requested a procedural schedule going forward in this Cause from the parties.

On August 5, 2016, Petitioner filed its Response to the Commission Docket Entry Dated July 27, 2016, Regarding Procedural Schedule and proposed procedural dates, as agreed to by the

parties. On September 27, 2016, the Presiding Officers granted modifications to the filing and hearing schedules and continued the hearing to January 10, 2017.

On October 3, 2016, the OUCC filed its Motion to Modify Procedural Schedule, and the Motion was granted by the Presiding Officers on October 19, 2016.

On November 21, 2016, Petitioner filed its Unopposed Motion for Extension of Time to extend the due date for its pre-filing of rebuttal testimony to December 7, 2016, and the Presiding Officers granted the Motion on November 23, 2016.

On December 5, 2016, the Presiding Officers granted a request from the parties to extend the rebuttal pre-filing date for Petitioner and to continue the hearing date to February 7, 2017.

On February 2, 2017, the Presiding Officers filed a docket entry requesting written responses from Petitioner to 44 questions at or prior to the February 7, 2017 hearing. On February 3, 2017, the Presiding Officers filed a docket entry requesting written responses from the OUCC to 14 questions at or prior to the February 7, 2017 hearing. Petitioner and OUCC subsequently filed their respective responses.

The Commission conducted a public evidentiary hearing beginning at 9:30 a.m. on February 7, 2017, in Room 222 of the PNC Center, Indianapolis, Indiana. At the hearing, the parties presented their respective evidence and offered witnesses for cross-examination. On April 12, 2017, the Commission conducted a public hearing to ensure that notice was properly published in all counties in which Petitioner serves, at which time the record of the prior hearing was incorporated by reference.

The Commission, based upon the applicable law and the evidence presented, finds as follows:

1. **Notice and Jurisdiction.** Notice of the filing of the Petition was given and published by Petitioner as required by law. Notice was given by Petitioner to its customers summarizing the nature and extent of the proposed changes in its rates and charges for water and wastewater services. Notice of the hearings in this Cause was given and published as required by law. Petitioner is a public utility as defined in Ind. Code § 8-1-2-1(a). Pursuant to Ind. Code §§ 8-1-2-42 and 42.7, the Commission has jurisdiction over Petitioner's rates and charges for utility service.

2. **Petitioner's Organization and Business.** Petitioner is a public utility incorporated under the laws of Indiana with its principal office address located at 2335 Sanders Road, Northbrook, IL 60062.

Petitioner was incorporated in 2015 for implementation of the merger into a single entity of the three wholly-owned subsidiaries of Utilities, Inc. that provide water and wastewater services in Indiana. Those subsidiaries are Twin Lakes Utilities, Inc. ("Twin Lakes"), Water Service Company of Indiana, Inc. ("WSCIP"), and Indiana Water Service, Inc. ("IWSIP"). The merger was approved by the Commission's July 8, 2015 Order in Cause No. 44587.

Petitioner provides water service to approximately 5,000 customers and wastewater service to approximately 3,300 customers. Petitioner renders water and wastewater service by means of utility plant, property, equipment, and related facilities owned, operated, managed, and controlled by it that are used and useful for the convenience of the public in the provision of water and wastewater service. Petitioner's service area includes portions of Jasper, Lake, Newton, and Porter counties.

3. **Existing Rates.** The basic rates and charges for Petitioner's operating divisions were previously approved in separate rate proceedings for each division. Twin Lakes' basic rates and charges were most recently approved in the Commission's April 23, 2014 Order in Cause No. 44388. WSCI's basic rates and charges were last approved in the Commission's March 27, 2013 Order in Cause No. 44104. IWSI's basic rates and charges were last modified by the Commission's November 7, 2012 Order in Cause No. 44097.

4. **Relief Requested.** Petitioner requested authority to increase its rates and charges for water and wastewater utility service and approval of: (1) new schedules of rates and charges that would provide for uniform water and wastewater rates across all three operating divisions, (2) revised depreciation rates, and (3) any other such relief as may be appropriate and proper. Petitioner requested a 50.09% increase in water rates and charges to produce additional revenues of \$928,932 per year and a 30.71% increase in wastewater rates and charges to produce additional revenues of \$666,033 per year.<sup>1</sup>

5. **Test Year and Rate Base Cut-Off.** Petitioner proposed a forward-looking test period using projected data as authorized by Ind. Code § 8-1-2-42.7(d). Petitioner initially proposed Phase I rates based on rate base as of September 30, 2016, and Phase II rates based on rate base as of September 30, 2017. Subsequent to Petitioner's case-in-chief filing, the parties agreed that Phase I rates will be based on actual rate base, as adjusted, at February 29, 2016. Petitioner initially proposed Phase I to be effective on or about October 9, 2016, and Phase II to be made effective on or about October 9, 2017.

However, given the significant delays to the procedural schedule, we find it no longer necessary to process Petitioner's case in two phases. Petitioner's rate base cut-off shall be for utility plant-in-service ("UPIS") as of September 30, 2017. We further find the test year to be used for determining Petitioner's projected operating revenues, expenses, and operating income shall be the 12-month period ending September 30, 2017, subject to the rate base certification process discussed in the section titled Rate Base Update Mechanism.

6. **Rate Design.** Since the Commission's approval of the merger that resulted in the formation of Petitioner in the Commission's July 8, 2015 Order in Cause No. 44587, Petitioner has maintained separate tariffs for each of its water and wastewater operating divisions. In this proceeding, Petitioner proposed to adopt single-tariff pricing for all of its water and wastewater operations. In support of its proposal, Petitioner presented the testimony of Mr. Scott A. Miller, partner in the firm of H.J. Umbaugh & Associates, LLP. Mr. Miller presented a cost-of-service study for each of Petitioner's individual water and wastewater service territories within Indiana as

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<sup>1</sup> Petitioner did not provide percentage amounts. The Commission calculated percentages based on the amounts proposed by Petitioner.

well as state-wide consolidated water and wastewater cost-of-service studies. He said these analyses were then used as a basis to make recommendations regarding changes in Petitioner's present schedules of rates and charges for water and wastewater service.

Based on his cost-of-service study, Mr. Miller concluded that consolidated rates appear reasonable for the individual service territories. He said on their own, each service territory is relatively small and lacks the economies of scale that could ultimately result in savings to the customers. He said consolidating the rates mirrors the overall ownership and operation of the different units and more closely matches the allocation of costs to the service areas. He concluded that the consolidated water and wastewater rates proposed in his accounting report are fair, just, non-discriminatory, and reasonable and necessary to meet the projected revenue requirements of Petitioner.

Ms. Margaret Stull, Senior Utility Analyst, on behalf of the OUCC, testified that single-tariff pricing in this case appears reasonable. She described the review and evaluation she performed to reach this conclusion. She stated that in its next base rate case, Petitioner should provide all work papers and schedules both on a combined basis and an individual-company basis. She said this will allow any party to that case to review and determine whether single-tariff pricing continues to be reasonable. Mr. Jerome D. Mierzwa, Principal and Vice President of Exeter Associates, Inc., also testified on behalf of the OUCC and concluded that Petitioner's proposed consolidated rate designs for water and wastewater are reasonable. He suggested that the rates should be proportionately scaled-back if the revenue increase authorized by the Commission is less than Petitioner's proposal.

Based on the evidence presented, the Commission finds Petitioner's proposed move to single-tariff pricing is reasonable and in the public interest. Accordingly, we approve the rate design shown in Petitioner's Exhibit 4, Attachment SAM-1. We further find that if Petitioner proposes a change in its rate design in a future proceeding, it should provide all work papers and schedules both on a combined basis and an individual-company basis to demonstrate whether single-tariff pricing continues to be reasonable.

7. **Rate Base.**

A. **Customer Deposits, Plant Acquisition Adjustment, and RedZone Robotics Invoices.**

While the parties presented different amounts for customer deposits in their respective rate base calculations, no testimony was provided to explain the difference. Based on Petitioner's general ledger trial balance as of February 29, 2016, we find customer deposits for the consolidated water operations to be \$37,650 and for the consolidated wastewater operations to be \$23,759. The parties agreed to a plant acquisition adjustment for the consolidated water operations of \$332,047 and to remove RedZone Robotics invoices totaling \$26,555. The remaining rate base issues are discussed below.



## B. Ground-Storage Tanks.

1. Petitioner's Evidence. Mr. Steven M. Lubertozi testified regarding the Twin Lakes water system, which includes one 200,000-gallon elevated-storage tank and two 500,000-gallon ground-storage tanks ("North GST" and "South GST").<sup>2</sup> He testified that Petitioner disassembled the Peabody 500,000-gallon ground-storage tank ("Peabody GST"), and replaced it with the new North GST in 2014-2015.<sup>3</sup> He explained that Peabody GST had numerous leaks around the bottom ring of the tank and had needed to be replaced. Mr. Lubertozi testified that North GST provides the necessary storage to meet the needs of the community and it provides redundancy. He testified in his case-in-chief that North GST was constructed at a cost of \$507,443 and placed in service in the fourth quarter of 2015.

Regarding Commission approval and Petitioner's construction of South GST, in the Commission's April 23, 2014 Order in Cause No. 44388, Petitioner was allowed to add to rate base \$650,000, which was Petitioner's proposed cost to construct South GST. That Order also approved a Stipulation and Settlement Agreement between Petitioner, OUCC, and LOFS. Petitioner built South GST during 2013-2014. Accordingly, Petitioner included the actual cost to build South GST in its rate base in this Cause. Petitioner's actual cost exceeded its previously proposed cost, but Petitioner did not offer pre-filed testimony to explain the exceedance. However, as discussed below, the OUCC analyzed the cost to construct South GST and presented evidence regarding the cost.

2. OUCC's Evidence. Mr. James T. Parks, OUCC Utility Analyst II, testified that ratepayers should not be expected to pay for new tanks that are poorly planned, unnecessary, or include inflated costs of construction. Additionally, Mr. Parks said that Petitioner could have discussed with the OUCC why it needed the new North GST.

Mr. Parks testified regarding the representations he believed Petitioner made regarding the scope that was included in the \$650,000 tank project in Cause No. 44388. Mr. Parks testified that the OUCC accepted Petitioner's proposal in Cause No. 44388 to build South GST *and to rehabilitate Peabody GST* for a total of \$650,000. However, Mr. Parks testified that other than listing the project's \$650,000 cost in Cause No. 44388, Petitioner provided no details regarding the costs. Finally, Mr. Parks testified that the plan the OUCC agreed to in Cause No. 44388 was *not* a plan for Petitioner to build South GST and to replace Peabody GST with the new North GST.

Mr. Parks testified regarding the types of planning studies Mr. Parks believed Petitioner should have performed prior to constructing North GST. He testified that Petitioner did not provide studies concerning water consumption, well production, water treatment plant production, high-service pumping, storage amounts, or life-cycle analysis to the OUCC to demonstrate that constructing North GST was prudent. He stated if Petitioner's studies showed additional water storage was in fact needed, alternatives could have included a new tank of a different capacity, type, or location. Mr. Parks testified that even though life-cycle analysis is a long-established engineering practice used by well-managed utilities and it is beneficial for planning major capital

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<sup>2</sup> Mr. Lubertozi adopted the pre-filed testimony originally provided by Mr. Bruce Haas, Pet. Ex. 3 at 10.

<sup>3</sup> During cross-examination by the OUCC, Mr. Lubertozi mistakenly identified the new tank in Petitioner's pre-filed testimony in this Cause as South GST.

improvement projects such as water tanks, Petitioner did not provide these types of studies for its capital projects.

Additionally, Mr. Parks stated in his supplemental testimony that Petitioner's justification for replacing Peabody GST with North GST appeared to be limited to a two-hour desktop review that was summarized in a one-page letter dated March 3, 2015, from RHMG Engineers, Inc. ("RHMG"). He said RHMG's letter was submitted only after the OUCC filed its direct testimony recommending the Commission to disallow the construction costs for North GST. The initial February 26, 2015 email from Petitioner to RHMG requested an opinion on the feasibility of replacement and a project quote, which the OUCC presumed to be a project quote for the design of North GST. Mr. Parks testified that it appeared to him that Petitioner only requested RHMG's opinion to support the decision Petitioner already made.

Mr. Parks presented data regarding Petitioner's production quantities and demand, and he concluded that the data did not support Petitioner needing to build North GST. Mr. Parks said Petitioner's actual water production dropped to an average of 591,000 gallons per day ("gpd") and a peak-day demand of 1,116,703 gpd. He testified that Petitioner has met peak demand historically even during droughts by using its storage tanks and other water system components including wells, two treatment plants, and high-service pumps with a combined 1,685,000 gpd capacity. Mr. Parks testified that it is good practice to have the water-storage volume recommended by the Ten States Standards, but many utilities do not meet the minimum, including Indianapolis, Shelbyville, and Petitioner's own WSCI division.<sup>4</sup>

Mr. Parks testified that Petitioner hired contractor Central Sewer & Water ("CS&W") to perform construction work on the new North GST and some of the work reportedly performed was never performed and some of the invoice amounts were inflated. He testified that work invoiced by CS&W, which Petitioner alleged was done as directed by Mr. Bob Bakalar, Lake County Building Inspector, was neither required by the Inspector nor actually done. The work Mr. Parks believes was not done totaled \$80,200 and included \$8,500 that CS&W billed on Invoice No. 4093 and 80% of the \$89,500 CS&W billed on Invoice No. 4102. Mr. Parks testified that he spoke directly to Mr. Bakalar who confirmed he made only one inspection of North GST. Mr. Bakalar told Mr. Parks he never ordered additional excavations and ordering more stone did not happen. Mr. Parks also testified that CS&W Invoice Nos. 4084 and 4105 appeared to have inflated costs based on his cost estimations. Mr. Parks eventually proposed that the Commission disallow all costs to construct the new North GST.

Mr. Parks testified that Petitioner hired CS&W to perform construction work on South GST and he believed some of those costs were inflated also. He testified Petitioner paid CS&W nearly \$110,000 on South GST for site restoration, a water line, and a storm sewer, which were built but not on the design drawings. Mr. Parks also alleged that CS&W charged more for some work than typical. Additionally, he stated that Petitioner capitalized 756 hours of employee time equaling \$35,763 to the South GST project. However, since Petitioner did not describe the work performed or why the capitalized time was necessary, it was not possible to verify that the capitalized charges were prudent or should be recoverable.

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<sup>4</sup> *Recommended Standards for Water Works* (commonly known as the Ten States Standards), Great Lakes - Upper Mississippi River Board of State and Provincial Public Health and Environmental Managers, 2012 Edition.

Regarding the cost to construct South GST, Mr. Parks testified that Petitioner should have selected a different contractor, Cady Aquastore, to construct South GST. He said that if Petitioner would have selected Cady Aquastore, Petitioner would have left nearly \$300,000 available for rehabilitating Peabody GST and avoided constructing North GST.

Finally, Mr. Parks recommended that the entire cost of \$543,997 to construct North GST be disallowed for the reasons discussed above, but the \$18,800 cost to dismantle Peabody GST should be allowed. Petitioner's revised North GST cost of \$562,797 less \$18,800 cost to dismantle Peabody GST is \$543,997. Mr. Parks also recommended that the cost for South GST be capped at \$650,000, the same amount that was proposed and approved in Cause No. 44388.

3. Petitioner's Rebuttal. Mr. Kersey responded to the OUCC's position that Petitioner did not follow its plan presented in Cause No. 44388 to construct South GST *and rehabilitate Peabody GST* for \$650,000. Mr. Kersey disputed Mr. Parks's statement that the cost of rehabbing Peabody GST was supposed to be included in the \$650,000 cost. Mr. Kersey stated that the OUCC failed to produce a single document in discovery to support its position that rehabbing Peabody GST was included within Petitioner's \$650,000 plan. Mr. Kersey concluded that Mr. Parks did not correctly interpret Petitioner's position in Cause No. 44388.

Additionally, Petitioner's engineering consultants ultimately recommended replacement, not rehabilitation of Peabody GST. Ms. Marcia McCutchan, P.E., Executive Vice President of RHMG, stated that based on her personal observations of the condition and continuing corrosion of Peabody GST and discussions regarding the cost of various tank rehabilitation options, RHMG recommended replacement of Peabody GST.

Regarding the various studies performed during the planning process, Ms. McCutchan stated that RHMG's involvement with Petitioner's tanks dates back to 1990 and RHMG has extensive knowledge and experience with Peabody GST and the decision to replace it. Ms. McCutchan said that she was on site in 1992 and assisted with the startup of Peabody GST. Ms. McCutchan testified that she visited the site several times over the past 25 years including numerous times in 2013 and 2014 when she observed the condition and continuing corrosion of Peabody GST.

Ms. McCutchan testified that the decision to replace Peabody GST with the North GST was based on a review of records and information regarding the tank, as well as an evaluation of viable alternatives. The decision was not based on a two-hour desktop review as Mr. Parks suggested. Ms. McCutchan explained during cross-examination that she did not keep records of all of her recommendations to Petitioner and she kept a lot of knowledge in her head. Tr. at C-61, 62. She also said there were additional documents regarding the tanks in her files, not all of which she had provided to Petitioner. *Id.* at C-59.

Ms. McCutchan testified that she conducted an informal engineering analysis of Petitioner's water storage requirements under the Ten States Standards, but she did not create a written copy. *Id.* at C-81, 82. Ms. McCutchan testified that she was not surprised that Petitioner did not perform a life-cycle cost analysis because, based on Petitioner's and RHMG's experience with alternative water-storage structures for tanks in this volume range, performing a life-cycle

cost analysis was not necessary to determine that a ground-storage tank of steel construction is the recommended alternative.

Mr. Lubertozzi responded to Mr. Parks's contention that Petitioner did not conduct proper studies prior to its decision to replace Peabody GST. Mr. Lubertozzi stated that Petitioner relied upon the independent assessment of RHMG, and he provided an e-mail from Petitioner's former Area Manager to Ms. McCutchan seeking RHMG's opinion regarding the feasibility of replacement versus rehabilitation of Peabody GST. He said this e-mail showed that there was no doubt that on February 26, 2015, Petitioner's local management was contemplating rehabilitating Peabody GST. Mr. Lubertozzi testified that, in his opinion, replacement of Peabody GST was reasonable and prudent.

Mr. Lubertozzi replied to the OUCC's contention that North GST was not needed to meet finished-water storage requirements. He testified that after construction of both North GST and South GST, the Twin Lakes service territory still only has 1,200,000 gallons of finished-water storage capacity. He testified that the OUCC supported this level of water capacity in Cause No. 44388. He stated that it is unreasonable for the OUCC to accept a given capacity level in one case, only to reject that capacity level in the next case.

Regarding finished-water storage requirements, Dr. John Norton, PhD, P.E., a project manager for Utilities, Inc., also discussed his concerns regarding the OUCC's calculation of minimum-recommended storage volume using the average-daily demand calculated from a multi-year period. He testified that *average-daily demand* calculated from a multi-year period does not account for seasonal variations, regional weather occurrences, operational upsets, power outages, firefighting demand, or other real factors which affect and impact water plant operations. Instead, Dr. Norton testified that minimum-recommended storage volume should have been calculated based on the *peak-daily flow* determined from daily-flow values measured over a representative period of time, preferably over a multi-year period.

Ms. McCutchan also testified regarding Petitioner's finished-water storage requirements. She testified that for communities similar to the Lakes of the Four Seasons with golf and lake amenities, summer demand levels are typically consistently higher than annual average-day demand and should be the design basis for system storage. She also pointed out that the Lakes of the Four Seasons Fire Department relies on Petitioner as a key source of water for its firefighting needs. Thus, to meet these demands and maintain reliable operations, she testified that RHMG continues to recommend finished-water storage volume *in excess of* 1.0 million gallons.

Responding to Mr. Parks's testimony that Petitioner should have selected Cady Aquastore to construct South GST and used the savings to rehabilitate Peabody GST, Dr. Norton disagreed. He said that Cady Aquastore's quote did not include the entire scope of work to construct South GST. Additionally, he testified that the issues with Peabody GST indicated that replacement was needed, not rehabilitation. Dr. Norton testified that Petitioner consulted with RHMG and an independent tank consulting firm, Tank Industry Consultants, about how to proceed with Peabody GST. Dr. Norton testified that those firms advised that the costs to rehabilitate Peabody GST would have exceeded the cost of replacement. Dr. Norton said that Petitioner reviewed the ongoing issues with Peabody GST and failure of the bottom ring and floor of the tank, and based on the condition

and number of leaks that had occurred, Petitioner agreed that a complete replacement of Peabody GST was appropriate.

Concerning CS&W's invoices, Mr. Lubertozi discussed Invoice No. 4102 for work on North GST, previously addressed by Mr. Parks, and stated that because of the nature of the excavation work contained in that invoice, Petitioner could not physically confirm the work was performed. To minimize controversy, Mr. Lubertozi said that Petitioner would accept Mr. Parks's recommended disallowance of \$71,700 related to the unconfirmed work on North GST.

Regarding CS&W's invoices and the OUCC's proposal to cap construction costs on South GST to \$650,000, Mr. Lubertozi testified that Petitioner does not accept the OUCC's adjustments on the CS&W costs for South GST construction because Petitioner compared CS&W's construction costs on South GST to North GST, and the costs were similar. He stated that based on the similarity of these projects and the nature of the work performed, Petitioner does not believe that a cost cap of \$650,000 is warranted for South GST.

Mr. Lubertozi responded to Mr. Parks's ultimate recommendation that North GST be totally disallowed from rate base. Mr. Lubertozi stated that the capital markets would have a negative reaction to the Commission disallowing the total cost of North GST. Mr. Lubertozi said that if the Commission were to disallow North GST from rate base, Petitioner would be forced to record a net loss of \$562,797 in the year the Commission's Order is finalized. Mr. Lubertozi testified that \$562,797 reflects the net effect of several accounting journal entries, including entries to UPIS and accumulated depreciation. Pet. Ex. R1 at 19. He said this loss would require Petitioner to sell or transfer North GST and then it would not be available to be used by Petitioner's customers. Mr. Lubertozi agreed to only exclude \$71,700 of cost on North GST, which represented unconfirmed CS&W work.

Mr. Kersey responded to the OUCC's ultimate recommendation to limit South GST costs. Mr. Kersey testified that the OUCC proposed a limit of \$650,000 on costs associated with South GST. He testified that Petitioner does not agree with this proposed reduction because, while Petitioner's forecast in Cause No. 44388 consisted of \$650,000 in capital costs, that forecast did not include an estimate for capitalized time and an allowance for funds used during construction ("AFUDC"). He further testified that total costs booked for South GST were \$715,318. He stated that Petitioner agreed to remove AFUDC from South GST project. Finally, Mr. Kersey testified that if the Commission were to limit Petitioner's recovery of South GST project, Petitioner suggested "isolating AFUDC and capitalized time" because these components were not included in the Company's Cause No. 44388 forecast of \$650,000. Pet. Ex. R2 at 42.

4. Commission Discussion and Findings. The OUCC indicated that Petitioner in Cause No. 44388 represented that Petitioner would construct South GST and rehabilitate Peabody GST for \$650,000. However, Petitioner disagreed, saying that it agreed only to construct South GST for \$650,000, not construct South GST *and rehabilitate Peabody GST* for \$650,000. Regarding Petitioner's evidence filed in its case-in-chief under Cause No. 44388, Petitioner listed *Install Additional 500K Gallon Water Storage Tank at WTP1* for \$650,000 in its Summary of Capital Projects, Table 1. Pet. Ex. BTH at 8. WTP1 means Water Treatment Plant One. In that table, there is no reference to Peabody GST. Additionally, Petitioner, in its case-in-chief under Cause No. 44388, explained the tank project in relevant part as follows below:

The addition of a second ground storage tank [South GST] will enable [Petitioner] to continue serving the community potable water without concerns of interruption during these high demand periods. This addition will enable [Petitioner] to service the existing ground storage tank [Peabody GST], while still having the ability of 500K gallons of storage during this process. Pet. Ex. BTH at 9.

We believe that Petitioner was explaining above that adding South GST would *enable* Petitioner to service Peabody GST. We believe that Petitioner was not proposing to construct South GST and also rehabilitate Peabody GST for \$650,000. This position is supported by the fact that there was no mention of Peabody GST in Petitioner's Table 1, Summary of Capital Projects. When Petitioner submitted its case-in-chief in 2013 on Cause No. 44388, it is clear that \$650,000 was for building South GST and rehabilitating Peabody GST was a consideration. However, Petitioner ultimately decided, based on engineering advice from RHMGM, to replace Peabody GST. The evidence simply does not support the OUCC's conjecture that \$650,000 included the cost to build South GST and rehabilitate Peabody GST.

Regarding the extent of Petitioner's various studies before constructing North GST, the OUCC testified that Petitioner did not provide evidence of adequate studies being performed, including a life-cycle analysis. Ms. McCutchan provided rebuttal testimony that RHMGM had extensive knowledge and experience with the water system going back to 1990. She testified that her recommendation to replace rather than rehabilitate Peabody GST was based on her extensive review of historical records, her personal observations of Peabody GST, and relative cost comparisons. Ms. McCutchan further testified that her personal experience included visiting the site numerous times in 2013 and 2014 and observing the continuing corrosion of Peabody GST. Ms. McCutchan stated there were additional documents regarding the tanks in her files that were not submitted, and she said that she prepared an informal engineering analysis under the Ten States Standard. Ms. McCutchan also explained that based on Petitioner's and RHMGM's experience with alternative water storage structures for tanks in this volume range, a life-cycle analysis was not necessary to determine that a steel ground-storage tank was the recommended alternative.

Although Petitioner relied upon the extensive knowledge and experience of RHMGM, it is concerning to us that Petitioner did not submit all documents prepared by RHMGM and a summary of Ms. McCutchan's review of historical records, personal observations of Peabody GST, and relative cost comparisons. In the future, we expect Petitioner to retain better documentation to more thoroughly demonstrate that capital projects are reasonable and prudent.

Concerning Petitioner's finished-water storage-capacity needs, the OUCC argued that Petitioner should not have replaced the old Peabody GST with the new North GST because this resulted in Petitioner having excess finished-water storage capacity. Petitioner explained that the total finished-water storage capacity after completion of both tanks and removal of Peabody GST is the same total capacity amount that resulted from the construction of South GST in Cause No. 44388. No convincing evidence was presented by the OUCC that there was a change of circumstances to warrant a need for a decrease in the required capacity as compared to the capacity that resulted from the Stipulation and Settlement Agreement under previous Cause No. 44388. Petitioner's evidence regarding peak-daily flow and finished-water storage requirements for areas

with increased summer demand-support the total storage capacity of 1.2 million gallons. The Commission finds there is insufficient evidence to support the OUCC's contention that construction of North GST should not have occurred because it created excess storage capacity.

Regarding Mr. Parks's position that Petitioner should have selected Cady Aquastore's proposal to construct South GST and use the savings to rehabilitate Peabody GST, we do not agree. Because Cady Aquastore's quote was incomplete, it is unclear if there would have been any savings realized by selecting Cady Aquastore. Additionally, Mr. Parks's position is based on the assumption that rehabilitation of Peabody GST would have been prudent. However, Dr. Norton testified that Petitioner consulted with RHMG and Tank Industry Consultants about whether to repair or replace Peabody GST. Dr. Norton testified that those firms advised that the costs to rehabilitate Peabody GST would have exceeded the cost of replacement. Dr. Norton testified that both of those firms and Petitioner's own review of the ongoing problems with the tank, including its condition and leaks, indicated that replacement of Peabody GST was appropriate. Based upon our review of the evidence, we find that the replacement of Peabody GST was reasonable and prudent.

Mr. Parks alleged that Petitioner's contractor CS&W on North GST did not actually perform some work and CS&W's invoices were inflated. Mr. Parks ultimately recommended disallowing all costs to construct North GST. Mr. Lubertozzi said that Petitioner would accept a disallowance of \$71,700 on North GST related to excavation work that Petitioner could not physically confirm was performed. The Commission agrees with Petitioner and finds that \$71,700 of costs for unconfirmed work are excluded from revised construction costs for North GST of \$543,997. We discuss the total costs allowed for rate base for North GST in more detail later in this section. Additionally, we identify improvements Petitioner should make regarding its oversight of contractors' invoices, including oversight of CS&W's invoices, in this Order in the section titled Use of Three-Way-Match Process.

Additionally, Mr. Parks testified that Petitioner should have communicated with the OUCC and explained why it needed North GST. Petitioner did not dispute that more communication would have been helpful. In the future, the Commission urges Petitioner to improve its communication with the OUCC regarding significant capital-improvement projects. The OUCC can provide helpful advice to Petitioner about the types of engineering studies that are typically provided by other utilities to support capital projects, and increased communication could ultimately result in increased support for Petitioner's proposed projects.

Regarding total costs for North GST, Mr. Parks recommended that the construction costs on North GST be totally disallowed in rate base. Mr. Lubertozzi agreed to eliminate \$71,700 of costs related to a CS&W invoice on North GST discussed above. The Commission is not persuaded by the OUCC's arguments that all North GST costs should be disallowed. We agree that Petitioner should have documented its pre-construction engineering analyses more thoroughly. The current finished-water storage capacity is the same amount considered in the previous Cause No. 44388. No convincing evidence was presented to support the contention that the previously approved capacity is now excess capacity. Petitioner found a need for a capacity of 1.2 million gallons, and it could not prudently rehabilitate Peabody GST. Accordingly, Petitioner built the new North GST with the same storage capacity as the tank it replaced, Peabody GST. We do not believe that there

is a rational basis to disallow the total cost of North GST. The Commission finds that North GST, which is now in service, is used and useful in Petitioner's water system and supports the needs of the community for finished-water storage. The Commission approves the net addition of \$491,097 to rate base for the demolition of Peabody GST and the construction of North GST. For North GST, the calculation of the total approved amount is as follows: Petitioner's revised cost as presented in rebuttal of \$562,797, which includes the \$18,800 for Peabody GST dismantling costs, less a reduction for the CS&W invoice of \$71,700 equals \$491,097.

Concerning total costs for South GST, which was placed in service in 2014 and the proposed cost was included in Cause No. 44388, the OUCC recommended limiting the cost to \$650,000, the amount proposed by Petitioner in that Cause. Mr. Parks also testified about questionable CS&W invoices and a lack of explanation regarding significant capitalized time by Petitioner on South GST. Mr. Lubertozi testified that the construction costs on South GST were similar to the costs on the new North GST and Petitioner did not accept Mr. Parks's recommendation to limit the cost to \$650,000. Mr. Kersey ultimately said if the Commission were to limit Petitioner's recovery of South GST project, Petitioner suggested isolating cost components that were not included in the Company's Cause No. 44388 forecast of \$650,000.

After reviewing the evidence in this Cause, the Commission is concerned about the OUCC's assertion that some CS&W charges were for work that was not in the original design drawings and some costs seemed inflated. Additionally, the OUCC stated that Petitioner did not provide a detailed explanation of the capitalized time of employees who worked on South GST. Accordingly, the Commission finds that the increase to rate base for construction of South GST is limited to \$650,000, the amount approved in Cause No. 44388. For South GST, the calculation of the total approved amount is as follows: Petitioner's proposed \$715,318 less a reduction of \$65,318 equals \$650,000, the amount approved in Cause No. 44388.

### **C. Manhole Rehabilitation.**

1. OUCC's Evidence. Mr. Parks testified regarding contractors' invoices to Petitioner for manhole rehabilitation work. Mr. Parks testified that Petitioner initiated a confidential investigation into invoices from CS&W that were prepaid by Petitioner. He testified that contractors performed manhole re-inspections and interior lining work in 2016 in response to Petitioner's investigation. He further testified that three to five weeks after Petitioner determined that the manhole work totaling \$80,750 on Invoice No. 4018 was not performed, additional contractor work was performed. All 21 re-inspected manholes and newly located manholes had their interiors lined or were repaired by Spectra-Tech LLC ("Spectra-Tech") at a total cost of \$52,448. Mr. Parks discussed his review of manhole sealing and lining work invoiced by CS&W and Spectra-Tech. He testified that his review indicated that \$149,001 of the \$160,627 paid to CS&W for manhole work was not performed and the costs were in rate base prior to 2015.

Mr. Parks discussed CS&W Invoice Nos. 3114 and 3115 and stated that six manholes that were shown on invoices as being excavated from the outside also showed evidence of interior lining performed by Spectra-Tech. He stated that it does not make financial sense for Petitioner to pay one contractor to excavate and seal manhole exteriors and then pay a second contractor to line the interiors of the same manholes. He further stated that he identified 17 manholes that were



reportedly repaired by CS&W and also lined by Spectra-Tech. He stated that his review of the invoices gave him a negative view of Petitioner's management. Mr. Parks further discussed the costs associated with rehabilitating manholes shown on Invoice Nos. 3111, 3112, 3114, and 3115 and stated that constructing a new manhole would have cost less than the \$13,000 plus of rehabilitation costs paid by Petitioner to seal and line certain manholes. Mr. Parks said that Invoice Nos. 3111, 3112, 3114, and 3115 were dated at year end, and it appeared to him that \$60,490 of the invoiced work was not completed.

Mr. Parks recommended that the Commission continue to require semi-annual reports from Petitioner and order Petitioner to prepare and submit a more comprehensive wastewater lateral and manhole repair tracking form with its semi-annual reports to prevent future issues from occurring. Mr. Parks further recommended that the Commission require a person from upper management to sign the semi-annual reports verifying under oath that the reports had been prepared under their direction or supervision and that the information submitted is, to the best of their knowledge and belief, true, accurate, and complete.

2. Petitioner's Rebuttal. Mr. Lubertozi responded to the OUCC's criticisms related to CS&W invoices. Despite Mr. Parks's contention that no work invoiced on Nos. 3111, 3112, 3114, and 3115 was performed, Mr. Lubertozi testified that Petitioner investigated Invoice Nos. 3114 and 3115. Petitioner obtained four invoices from a restoration contractor showing restoration work was performed. Petitioner's local operating personnel also recalled being at Manhole No. 93 and confirmed that the work was completed. To minimize the contested issues in this Cause, Petitioner agreed to remove \$41,750 of manhole work and accepted the OUCC's adjustments to certain other CS&W invoices.

3. Commission Discussion and Findings. The OUCC recommended disallowance of \$60,490 associated with Invoice Nos. 3111, 3112, 3114, and 3115. In rebuttal, Mr. Lubertozi explained that Petitioner's physical audit reviewed two invoices specifically challenged by the OUCC and determined, in some instances, that the work actually was performed. We note that Petitioner's evidence specific to CS&W's Invoice Nos. 3114 and 3115 was invoices from a third-party contractor and recollections of Petitioner's personnel. We find that the evidence presented by Petitioner to show that some of the work billed by CS&W was actually performed is weak and unconvincing. Accordingly, the Commission accepts the OUCC's recommendation that \$60,490 be removed from rates.

The Commission is also concerned about Petitioner's lack of supervision over contractor work performance and inadequate financial controls over contractor invoices. The Commission notes that Petitioner did not identify that it paid CS&W for manhole work that was not performed until the OUCC identified the errors in its review. Petitioner should have identified the errors during its own review of invoices in the regular course of business. The Commission finds that Petitioner did not properly monitor the work performance of contractors performing manhole work and Petitioner did not maintain adequate financial controls over the invoices of manhole contractors. The Commission will direct Petitioner to improve oversight of projects performed by contractors and improve financial controls over invoices in the section titled Use of Three-Way-Match Process.

Moreover, the Commission is concerned about Petitioner’s lack of technical review over the manhole work by contractors. Based upon the OUCC’s testimony, it is not reasonable for Petitioner’s management to allow contractors to perform external and internal lining of the same manhole because these are redundant activities. Additionally, the OUCC testified that it would have been cheaper for Petitioner to use one contractor for the work and also that construction of a new manhole is sometimes more cost efficient than a repair. The Commission finds in this instance that Petitioner did not properly plan its repairs of manholes and its use of contractors to effectively control costs. To focus Petitioner on improving in these areas, in the section of this Order titled Wastewater and Water Service Quality and Communications with LOFS, we require Petitioner to submit detailed wastewater lateral and manhole repair tracking forms to the Commission on a quarterly basis.

**D. Capital Projects.**

1. Petitioner’s Evidence. Mr. Lubertozzi provided a summary of additional capital improvements Petitioner has invested in already or plans to invest in as part of this Cause.

<b>Petitioner’s Capital Project Descriptions</b>	<b>Estimated Amount</b>
Supervisory Control and Data Acquisition at Water Treatment Plant	\$ 87,170
Second Sludge-Storage Tank at Wastewater Plant	539,159
500,000-Gallon Water-Storage Tank Replacement (North GST)	507,443
Wastewater Treatment Plant Headworks	1,072,503
WSCI Hydro-Tank Replacement at Water Plant	161,211
2015 Sewer Capital Improvement Project	435,775
2016 Sewer Capital Improvement Project	443,202
2017 Sewer Capital Improvement Project	228,112
Total	\$ 3,474,575

Mr. Lubertozzi stated that installing Supervisory Control and Data Acquisition (“SCADA”) controls will provide continuous monitoring and automated operations of the water treatment facilities and will allow automatic operations to maintain levels within the distribution system along with the existing ground-storage tanks.<sup>5</sup>

Concerning the Second Sludge-Storage Tank at the wastewater treatment plant (“WWTP”), Mr. Lubertozzi stated that Petitioner currently operates with one 400,000-gallon sludge-storage tank. However, with increasingly more stringent phosphorous limits, a second tank is needed. He testified that a second tank will also provide needed additional storage as well as redundancy and allow one tank to be taken out of service for inspection or maintenance.

Regarding the WWTP Headworks Upgrades, he explained that the sewage grinder originally in operation at the headworks structure failed and a manual bar screen is being

<sup>5</sup> We note that Petitioner’s Exhibit 15 reflects that \$34,539 of the \$87,170 amount for SCADA is allocated to wastewater operations.

temporarily used. He further explained that a new structure will be added to the head of the plant that will use a mechanical step screen to remove the non-biodegradable solids from wastewater. The new structure will also have a grit removal system to remove sand-like debris from wastewater before it enters the plant. Mr. Lubertozi explained that the removal of these two types of solids will allow for more efficient solids removal and reduce future maintenance requirements within the WWTP as well as aid in the reduction of potential blockages and backups within the WWTP.

For the WSCI Hydro-Tank Replacement at the water treatment plant, Mr. Lubertozi testified that Petitioner inspected the existing hydro-tank in 2014 and determined that the tank reached the end of its useful life and posed a safety risk to nearby residents and operations staff. He testified that a new tank was installed and placed in service in October 2015.

Regarding Petitioner's proposed 2015, 2016, and 2017 Sewer Capital Improvement Projects ("SCIP"), Mr. Lubertozi stated that Petitioner is required by the Commission in Cause No. 43128 S1 to clean and televise a minimum of 10% of its sewer collection system each calendar year and to make the necessary repairs and replacements of deficiencies. Mr. Kersey explained in the February 6, 2017 Docket Entry Response 4-40 that \$148,122 of SCIP for 2015 was included in Petitioner's UPIS at February 29, 2016 balance.

2. OUCC's Evidence. Mr. Parks testified regarding Petitioner's plans to install a SCADA communication system at the Twin Lakes water division to link both water treatment plants and the elevated water tower. He testified that he was not able to review project specifics or the reasonableness of the project because Petitioner's case-in-chief did not provide this information. He said that the OUCC requested this information but did not receive it. He recommended that the Commission disallow the SCADA project in its entirety due to lack of information provided by Petitioner for the OUCC to review whether the project is prudent and reasonable.

Regarding Petitioner's proposal to install a Second Sludge-Storage Tank at Petitioner's WWTP, Mr. Parks testified the estimated cost is \$539,150. He further testified that Petitioner completed minimal planning regarding the tank's construction and that he requested additional information regarding project specifics, but he did not receive it. He stated that he did not believe Petitioner needed to construct a second sludge-storage tank in 2017 because the phosphorus limits Petitioner used to justify the project would not take place until 2021. Mr. Parks recommended that the Commission disallow Petitioner's Second Sludge-Storage Tank project in its entirety.

Mr. Parks also testified regarding Petitioner's proposed WWTP Headworks Upgrades. He testified that Petitioner proposed to construct new grit removal, mechanical step screening, and raw sewage odor control in a new Headworks Building. He further discussed the need for the WWTP Headworks project and stated that he requested additional information from Petitioner regarding project specifics, but he did not receive the information. He testified that despite Petitioner's contention that the Headworks Upgrades will benefit ratepayers, the cost savings were not quantified. He recommended that the Commission disallow the Headworks Upgrades in their entirety.

Mr. Parks testified regarding Petitioner’s Hydro-Tank Replacement Project at the water treatment plant. Mr. Parks explained generally what a hydro-tank is and explained why Petitioner needed to replace its original hydro-tank. Mr. Parks testified that Petitioner estimated a cost of \$110,000, but based on his review, actual costs associated with the Hydro-Tank Project were \$183,239. Mr. Parks further testified that, while he agreed with Petitioner that the Hydro-Tank Replacement project was needed, he was unable to verify that the higher project cost was reasonable.

The OUCC recommended adjustments to Petitioner’s initial SCIP estimates for 2016 and 2017 to remove costs for televising, cleaning, and mapping because those costs are more appropriately classified as operating expenses rather than as capital projects. The OUCC’s rate base schedules reflect revised SCIP amounts of \$180,903 for 2016 and \$361,806 for 2017.

3. Petitioner’s Rebuttal. Mr. Kersey provided an update on Petitioner’s proposed capital projects and responded to the OUCC’s suggested adjustments. As shown in Table 7, Petitioner removed the SCADA system for the Water Treatment Plant, Second Sludge-Storage Tank, and WWTP Headworks Upgrade projects from rate base. Pet. Ex. R2 at 31. Mr. Kersey also revised the cost estimates for the remaining capital projects. Petitioner provided a revised Table 7 in its February 6, 2017 Docket Entry Response 4-43 that correctly tabulated its case-in-chief and rebuttal amounts as shown in the table below.

Petitioner’s Rebuttal Amounts, Table 7, Adjustments to Forecasted Projects

Petitioner’s Revised Capital Project Description Per Rebuttal Testimony	Case-in-Chief	Rebuttal Amount	Change
Supervisory Control and Data Acquisition at Water Treatment Plant	\$ 87,170	N/A	\$ (87,170)
Second Sludge-Storage Tank at Wastewater Plant	539,159	N/A	(539,159)
500,000-Gallon Water-Storage Tank Replacement (North GST)	507,443	\$ 491,097	(16,346)
Wastewater Treatment Plant Headworks	1,072,503	N/A	(1,072,503)
Hydro-Tank Replacement at Water Plant	161,211	184,151	22,940
2015 Sewer Capital Improvement Project	435,775	148,122	(287,653)
2016 Sewer Capital Improvement Project	443,202	180,903	(262,299)
2017 Sewer Capital Improvement Project	228,112	361,806	\$133,694
Total	\$ 3,474,575	\$ 1,366,079	\$(2,108,496)

Regarding the Hydro-Tank Replacement, Mr. Kersey testified that Petitioner does not agree with the OUCC’s recommendation to remove the Hydro-Tank Replacement costs from Petitioner’s rate base. He testified that despite Mr. Parks agreeing that the Hydro-Tank Project was needed to replace the original hydro-tank, the OUCC proposed limiting project costs to \$110,000. He further testified that the OUCC arrived at the \$110,000 threshold based on a figure that was communicated to Mr. Parks by Mr. Lubertozzi. Mr. Parks admitted he did not know the cost detail used to arrive at the \$110,000. Mr. Kersey testified that the completed project cost was \$184,151; \$155,609 in construction costs for engineering, material, and contract labor, \$20,582 in capitalized

time, and \$7,959 in AFUDC. Petitioner does not agree that any of these costs should be removed from rate base because the OUCC failed to provide which of the higher costs were unreasonable and failed to base its recommendation on costs that are on record in this Cause.

Mr. Lubertozi stated that capitalized time and interest costs during the Hydro-Tank construction were not included in the original \$110,000 estimate communicated to Mr. Parks. Mr. Lubertozi further stated that despite Mr. Parks's contention that he was unable to verify that the higher project costs were reasonable, he admitted that he was able to review project specifics, the reasonableness of the project, and the project costs. Mr. Lubertozi stated that the OUCC was aware that Petitioner's original tank failed inspection and a significant investment would need to be made to replace it. He testified that the OUCC agreed that the project was necessary and did not identify any costs associated with the Hydro-Tank that it believed were imprudent or unreasonable. For these reasons, Mr. Lubertozi recommended that the Commission reject the OUCC's proposed cap of \$110,000 on Petitioner's Hydro-Tank Project.

4. Commission Discussion and Findings. The OUCC identified concerns with several of the forecasted capital projects Petitioner proposed to include in rate base. In rebuttal, Petitioner removed several of those projects. Thus, the only remaining challenged capital projects (excluding North GST, which is discussed separately) are the Hydro-Tank Replacement and SCIP.

For the Hydro-Tank Replacement, the OUCC agreed that this project is necessary but questioned the increase in costs above the preliminary cost estimate provided to the OUCC. The record shows that the preliminary estimate of \$110,000 for the Hydro-Tank Replacement project did not include capitalized time and interest during construction. While the OUCC agreed with Petitioner that the Hydro-Tank Replacement project was needed, Mr. Parks said that he was unable to verify that the higher project cost was reasonable. Because the OUCC did not identify any specific costs which it considered unreasonable or imprudent, we decline to accept the OUCC's position regarding the Hydro-Tank project and accept Petitioner's updated Hydro-Tank Replacement cost of \$184,151.

Regarding SCIP, the Commission finds that Petitioner's rebuttal testimony amount of \$180,903 for 2016, which does not include work scope that is properly classified as operating expense, should be reduced to \$107,404 based on Petitioner's 2017 Monthly Project Update. The Commission finds that 2017 SCIP should be limited to \$180,903, subject to the adjustment in the Rate Base Update Mechanism section. We note that while Petitioner's 2017 SCIP shown in Mr. Kersey's rebuttal testimony agrees with the OUCC's supplemental rate schedules, the \$361,806 included in the OUCC's schedules is inconsistent with Mr. Parks's written testimony and appears to be an error. Further, Petitioner's rebuttal testimony never explains the proposed increase to \$361,806. We note that Petitioner's SCIP 2015 proposed amount of \$148,122 was already included in Petitioner's \$19,091,095 UPIS at February 29, 2016 balance. Accordingly, no amount should be added to rate base for SCIP in 2015.

<b>IURC's Findings: Capital Projects To Be Included in Rate Base</b>	<b>Amount</b>
Hydro-Tank Replacement at Water Plant	\$ 184,151
2016 Sewer Capital Improvement Project	107,404
2017 Sewer Capital Improvement Project	180,903
500,000-Gallon Water-Storage Tank Replacement (North GST)	491,097
Total	\$ 963,555

**E. Non-Capital Costs.**

1. OUCC's Evidence. Ms. Stull expressed concern that Petitioner was excessively capitalizing operating expenses and Petitioner's Capitalized Time Guidelines encouraged this practice. Pub. Ex. 1 at 23. She said Petitioner consistently capitalizes costs such as well cleaning, geographic information system ("GIS") mapping, televising of sewer mains, smoke testing of sewer mains, and other routine maintenance expenses of its water and wastewater systems if that activity led to a capital project. She said in the short run, it may appear to be less expensive to capitalize a cost rather than expense it. She said doing so reduces operating expenses today, but over the long run, ratepayers could pay both a return *on* and a return *of* that cost for 40 to 50 years or longer. Moreover, she stated the return *on* these costs will be grossed up for state and federal taxes. She provided an example of a \$1,000 repair expense and argued that after ten years, ratepayers would pay a higher annual revenue requirement if the item was capitalized versus expensed.

For Petitioner's water utility plant, Ms. Stull proposed to exclude \$171,845 of costs related to maintenance that should have been expensed. Ms. Stull also proposed to exclude \$77,272 of capitalized time, of which \$18,124 was associated with the operational activities identified below.

Well Cleaning Costs	\$	150,235
Filter Media Replacement		2,735
Well Maintenance		15,775
Other Misc. Non-Capital Costs		3,100
TOTAL	\$	171,845

For Petitioner's wastewater plant, Ms. Stull proposed to exclude \$4,222 of costs that were not properly classified. In addition, Ms. Stull also proposed to exclude \$41,405 of capitalized time, of which \$6,052 was associated with the operational activities identified below.

Blower Repair	\$	1,521
Tree Removal		484
NPDES Land App Permit		2,000
Other Plant		217
TOTAL	\$	4,222

Ms. Stull said that to the extent the costs removed should be considered a recurring operating expense and that operating expense is not already included in test year operating expenses, she proposed an upward adjustment to maintenance and repair expense as appropriate. Ms. Stull recommended that Petitioner be required to properly record operating expenses in its

general ledger. More specifically, she said that whether an activity is booked as an operating expense depends on the nature of the activity and not on whether a capital project follows the activity.

Ms. Stull also asserted Petitioner capitalized a disproportionately large percentage of employee time, sometimes 50% - 90% of an employee's time, including the time of high-level managers. She stated that, based on her experience, high-level manager time is not typically capitalized in material amounts. Ms. Stull noted that during January 2011 through September 2015, Petitioner capitalized allocations of \$490,659 to its consolidated water operations, including \$88,599 of capitalized-employee time, which represents 18.0% of total capital additions. Ms. Stull considered that percentage to be high since Petitioner hires contractors to perform all capital work except meter installations. Ms. Stull stated Petitioner's employees do not perform capital work themselves because it is against corporate policy for an employee to enter a trench or confined space. Therefore, Petitioner's employees capitalize time spent supervising contractors, conducting site reviews, working with contractors and engineers during construction, preparing project status updates, ordering materials, obtaining permits, and other similar administrative functions.

As an example, Ms. Stull noted the capitalized time for South GST was \$34,773, representing 756 hours. Five employees capitalized their time to South GST, including 704 hours charged by supervisory and management employees for time spent reviewing sites, making inspections, working with contractors, and attending meetings. One management employee charged 432.5 hours to South GST. The OUCC proposed to reduce excessive capitalization of management's time by \$24,183 for the water operations and \$35,353 for the wastewater operations.

Mr. Parks also expressed concern with Petitioner's tendency to capitalize its staff costs. Mr. Parks noted that capitalized emergency-leak repairs and capitalized time was an issue in the Twin Lakes Distribution System Improvement Charge ("DSIC") application under Cause No. 44646 in 2015. Mr. Parks said capitalized time charges are supposed to be for time spent by Petitioner's staff on capital projects during planning, design, construction, and start-up. Mr. Parks testified costs to acquire and put long-term assets into service are typically considered capital costs, while ongoing costs incurred for daily operations or to maintain the current condition of a long-lived asset are typically expensed. Mr. Parks said it appears Petitioner capitalizes almost every leak repair whether for water-main breaks or service-line leaks, and whenever any length of pipe is replaced instead of using a clamp, the cost is capitalized.

Mr. Parks noted that in Cause No. 44646, Twin Lakes indicated that it cost \$91,161 to replace 124 feet of distribution main as a result of nine main breaks. Mr. Parks noted that more than one-third of the cost was for employee-capitalized time even though the utility's employees do not perform any of the labor on those jobs. Mr. Parks stated that fundamentally, the capitalized time charged by Petitioner was excessive. He explained that the total number of capitalized hours Twin Lakes charged against water main repairs was 801 hours spread primarily among five utility staff members. At a cost of \$43.65 per hour, he said this equates to 89 hours for each of the nine water-main breaks, most of which were completed by the contractor with a three-or four-person crew within one day. He said total crew repair time would range from 18 to 40 hours per leak repair compared to 89 hours per leak repair for capitalized time. Mr. Parks recommended all

reasonable and prudent Petitioner staff time spent addressing water-main breaks and service-line leaks be expensed and not capitalized. The OUCC proposed to disallow \$34,965 for capitalized time associated with DSIC leak repairs, which should have been expensed.

2. Petitioner's Rebuttal. Mr. Kersey explained that the well cleaning costs, filter media replacement, and well maintenance costs the OUCC proposed to disallow from rate base should be set-up as a net-deferred charge component of rate base with a proposed recovery of these costs over a span of three years. Mr. Kersey explained that a three-year amortization period for well cleanings and rehabilitations is appropriate because the three-year period was chosen to reflect the above-normal corrosiveness of the water which requires well reconditioning at an above-normal frequency. Mr. Kersey further explained that without frequent reconditioning of Petitioner's wells, the risk of failure would increase and would result in otherwise unnecessary capital spending in the future. Mr. Kersey explained that Ms. Stull proposed an adjustment of (\$171,845) to operating expense based on the transactions the OUCC proposed to exclude in Public's Exhibit No. 1, Attachment MAS-4. However, no adjustment to operating expense was made. Petitioner recommended \$44,145 remain in rate base and the remaining \$127,700 be amortized through maintenance expense over a three-year period. The total amount of incremental amortization per year would be \$42,567 ( $\$127,700 / 3$ ).

Mr. Lubertozi testified that Ms. Stull's comparison of an annual expense to a capital item only looked at the costs over a ten-year period. He said that if the expense item was truly ongoing, those costs would continue past the ten years and then customers would clearly pay more than what Ms. Stull depicts. Mr. Lubertozi asserted, "[I]t is a commonly understood practice that a regulatory utility should trade expense for capital whenever possible." Pet. Ex. R1 at 27.

With respect to the OUCC's comments regarding capitalized time, Mr. Lubertozi stated Petitioner uses a very straightforward and commonly accepted method when deciding whether to expense or capitalize costs when there is a main break or a leak. He said this method is common in the water and wastewater industry, even in Indiana. Furthermore, he said Petitioner's method is similar to what was discussed in Mr. Parks's testimony. Mr. Lubertozi explained that when there is a leak or main break and Petitioner installs one clamp to repair a leak, those costs are expensed. He said when there is a leak or main break and Petitioner replaces any portion of the transmission or collection system, Petitioner capitalizes all of the costs associated with that replacement. He said Petitioner's approach is consistent with Petitioner's internal policies as well as generally accepted accounting principles and the National Association of Regulatory Utility Commissioners ("NARUC") Uniform System of Accounts ("USoA"), and he identified the specific NARUC USoA instructions that supported Petitioner's approach.

Mr. Kersey also responded to Mr. Parks's testimony and explained how Petitioner distinguishes capital costs from operating costs. He noted that Mr. Parks based his claim on the USoA, but in discovery, Mr. Parks did not offer an opinion on whether the accounting treatment of water main replacement under the USoA is dependent on whether the activity was planned or unplanned, or whether the accounting treatment of water main replacement under the USoA is dependent on the length of the replaced main. He further noted that the OUCC did not propose any rate recovery to implement their recommendation to treat main replacements as an expense. Mr. Kersey identified the annual forecasted expense that would need to be added to Petitioner's



operating expenses if the OUCC's position was adopted. Mr. Kersey explained that \$137,331 should be added to Petitioner's operating expenses, which consists of \$101,777 for pipe, replacement, and site restoration and \$35,554 in capitalized time from Petitioner's operations.

Further, Mr. Kersey explained that although he believes the Company prudently capitalizes time when applicable, to limit the number of contested issues, Petitioner accepts the OUCC's adjustments and has included corresponding adjustments related to capitalized time expense. However, Petitioner did not accept the OUCC's adjustment for capitalized time associated with DSIC leak repairs. Mr. Kersey explained capitalized time for water main leak repairs is still eligible for recovery, per the Company's Settlement with the OUCC in Cause No. 44646. Mr. Kersey opined that if the OUCC proposes that Petitioner cease capitalizing time for water main leak repairs, the OUCC should likewise propose a corresponding adjustment to Petitioner's forecast of capitalized-time expense, similar to the OUCC's proposed adjustments to excessive capitalization of management time and non-capital activities.

3. Commission Discussion and Findings. Under the capitalization policy section of Mr. Lubertozi's rebuttal testimony, he asserted that it is a commonly understood practice that a regulatory utility should trade expense for capital whenever possible. The Commission disagrees with that premise. A regulated utility should follow accounting principles and the NARUC USoA when classifying transactions. The business decision to either capitalize or expense a cost should be based upon the nature of the activity. Instead, Petitioner appears to capitalize its maintenance costs if the activity leads to a capital project and elects to perform a capital activity in lieu of a repair. If a utility were allowed to capitalize expenses, a utility would generate higher costs to ratepayers through an inappropriate return on expenses and an unnecessary increase in state and federal income taxes on the increased return generated by capitalizing expenses. Moreover, capitalizing maintenance expenses would create intergenerational rate inequities because ratepayers in the future would pay for operating costs that occurred in the past.

While the OUCC was critical of Petitioner and provided examples with cost information, the OUCC did not propose adjustments to remove any amount of main repairs from rate base. However, we note that based on Petitioner's 2015 Annual Report for the Twin Lakes water operations (the largest of Petitioner's three divisions), 40 main breaks occurred in that year. It was undisputed that Petitioner averages only one clamp repair annually. However, Petitioner's practice of encouraging capitalization whenever possible appears to have affected Petitioner's decision whether to repair a main leak with a clamp or replace a section of pipe. It seems unreasonable that more than 95% of all main breaks resulted in capital projects.

We find Petitioner's practices of capitalizing maintenance activities and opting for a capital project versus a repair to be inappropriate, and those practices violate proper accounting procedures and the NARUC USoA. Therefore, we direct Petitioner to properly expense maintenance and other operating costs as incurred regardless of the frequency of the occurrence or whether a capital project eventually results from the performance of the maintenance activity. We find that \$171,845 of routine maintenance, which includes well cleanings and maintenance, filter media replacement, and other miscellaneous non-capital items, should be disallowed from Petitioner's consolidated water rate base. An expense adjustment associated with this finding is

explained below. We also find that \$4,222 of non-capital activities identified by the OUCC should be disallowed from Petitioner's consolidated wastewater rate base.

We now address Petitioner's capitalization of labor related to management time and the capitalization of non-capital activities. Ms. Stull provided Petitioner's Capitalized Time Guidelines, which states, in part, the following:

Capitalized time refers to internal labor costs directly related to a capital expenditure or a capital project. The "cost" of your salary and benefits associated with the time you worked on a capital item is allocated to that item and becomes part of its overall cost basis. Capitalized time adds to rate base or our investment basis and improves our net income. Any missed capitalized time artificially inflates our expenses and reduces our rate base. Pub. Ex. 1, Attach. MAS-5.

Ms. Stull and Mr. Parks provided evidence that showed Petitioner capitalized more hours on capital projects than the time spent by contractors performing the actual work. We believe Petitioner's practice led to excessive capitalization of employee time. It is evident from the examples provided by the OUCC, as well as Petitioner's Capitalized Time Guidelines, that employees and management personnel have inappropriately capitalized their time. We find that Petitioner should revise its Capitalized Time Guidelines to avoid inappropriate capitalization of employee time and specifically management time. We also find that Petitioner should implement the related requirements in the section titled Use of Three-Way-Match Process.

Accordingly, we accept the OUCC's adjustments to remove capitalized time associated with non-capital activities, excessive management time, and DSIC leak repairs of \$77,272 from consolidated water rate base and \$41,405 from consolidated wastewater rate base. The impact of these adjustments on Petitioner's pro forma operating expense are explained below.

Finally, we address Mr. Kersey's position that \$137,331 should be added to Petitioner's operating expenses if the Commission disallows it as a capital cost. We agree with Mr. Kersey that a certain level of expense should be allowed given our finding regarding Petitioner's capitalization practices. However, Petitioner provided no supporting evidence for the \$137,331 adjustment. Therefore, we decline to include Petitioner's proposed adjustment. For future cases, we encourage Petitioner to provide adequate support for its proposed adjustments. Additionally, Petitioner might respond to our finding here by initiating a comprehensive main-replacement program, which may reduce the number of emergency-leak repairs, improve service to customers, and if prudently implemented, provide an opportunity to earn a return.

#### **F. Water Service Lines and Wastewater Laterals.**

1. OUCC's Evidence. Ms. Stull proposed to exclude capitalized costs incurred to install or replace water service lines and wastewater laterals. She explained that Petitioner installed two water service lines at a total cost of \$19,899 and four wastewater laterals at a total cost of \$50,748. She explained that the service lines and wastewater laterals in question are the property of the customers, not the property of the water and wastewater utilities,

respectively. She explained that the capital costs should not be included in rate base for all customers to pay a return *on* and *of* property the utility does not own.

2. Petitioner's Rebuttal. Mr. Kersey disagreed with the OUCC's proposed service line and wastewater lateral adjustments. He explained that the OUCC neglected to consider whether these costs were associated with bringing service to the customer's property line or if any of the customers made cash contributions consistent with the connection charges in Petitioner's tariffs. Mr. Kersey explained that these costs are investments made by Petitioner for the provision of retail utility service. Because no consideration was given to draw a distinction between Petitioner's and customer's service lines, the OUCC's proposed adjustments should be disallowed.

However, Mr. Kersey explained that if the OUCC's position was adopted, consideration must also be given to offsetting amounts recorded to Petitioner's Contributions in Aid of Construction ("CIAC") accounts. Mr. Kersey explained that for water, certain invoices should not be removed because contributions from the customer were received. Additionally, regarding Invoice No. 4015, extensive work on the Company-owned portion of the line was required to bring service to the customer's property line. Regarding the wastewater operations, Mr. Kersey explained that cash was received from the customer, which was associated with Invoice No. 3190. Regarding Invoice No. 3357, Mr. Kersey explained that although the OUCC considered the pipe as a wastewater lateral, it is actually a pipe that runs between two manholes for which Petitioner is responsible. Thus, he argued that these invoiced costs should not be removed from rate base. With regard to Invoice Nos. 4028 and 4218, he argued that these invoices should also not be removed due to the extensive work on Petitioner's portion of the line that was required to bring service to the customer's property line.

For its water service lines, Petitioner indicated in discovery that it received \$16,184 in contributions, which leaves \$3,715 in water utility plant that Petitioner disputes should be excluded from capital costs. For its wastewater, Petitioner received contributions of \$12,832 for its wastewater laterals, which leaves \$37,916 in wastewater utility plant that Petitioner disagrees should be excluded from capital costs.

3. Commission Discussion and Findings. We agree with the OUCC that service lines and wastewater laterals owned by customers should not be included in rate base. While the Commission concurs with Petitioner's witness Mr. Kersey that consideration needs to be given if costs were associated with bringing service to the customer's property line, Petitioner did not identify which of the costs or how much of those costs were associated with the utility's portion of the service line. A review of Invoice No. 4015 shows that the invoice does not identify which costs are related to Petitioner's portion of the line extension and which costs are related to the customer's portion. Because Petitioner did not adequately support its position, the Commission finds that service lines and wastewater laterals should not be included in rate base.

Further, to the extent the OUCC's proposed plant reductions to rate base were funded by CIAC, a corresponding CIAC reduction should also be made. Thus, the Commission finds that \$19,899 should be disallowed in UPIS for Petitioner's water operations and \$50,748 should be disallowed in UPIS for Petitioner's wastewater operations because those amounts representing

customer-owned property should not have been included in Petitioner's rate base. Additionally, customers made CIAC payments toward the cost of the water service lines and wastewater laterals. Accordingly, based on the OUCC's Cross-Examination Exhibit 22, we also find a reduction of \$16,184 to CIAC for Petitioner's water operations and an \$11,732 reduction to CIAC for Petitioner's wastewater operations should be made.

**G. Scrap Value of Retired Meters.**

1. OUCC's Evidence. Ms. Stull testified that Petitioner recently stripped metals from meters retired in 2013 and Petitioner received a salvage value for the metals. Ms. Stull proposed a reduction to rate base of \$8,513 to consolidated water operations to reflect this salvage value.

2. Petitioner's Rebuttal. Mr. Kersey indicated he agreed with Ms. Stull's recommendation to remove the proceeds for stripped salvage metals from meters in 2013 from rate base. However, he indicated that the meters were scrapped in multiple installments and the total proceeds in 2013 was \$13,023.

3. Commission Discussion and Findings. Rate base should be reduced by the value of salvaging any items that have been retired. Here, the OUCC found that Petitioner retired meters in 2013 and salvageable metal from the meters was sold. Petitioner initially indicated the proceeds were \$8,513; however, this was revised by Mr. Kersey to \$13,023. The Commission finds that Petitioner's rate base shall be decreased by \$13,023 due to the proceeds from salvaged metal from meters in 2013.

**H. General Plant.**

1. Petitioner's Evidence. Testimony regarding Petitioner's Phase I and Phase II general plant additions was not provided and was not listed in Petitioner's rate schedules set forth in Petitioner's Exhibit 2, Attachment JPK-1.

2. OUCC's Evidence. The OUCC explained that Petitioner forecasted general rate base additions of \$919,319 for water and \$491,112 for wastewater. In her supplemental testimony, Ms. Stull explained that Phase II general plant additions of \$476,929 for water and \$189,857 for wastewater should be included in rate base. It appears that the OUCC accepted the embedded amount for Phase I plant additions for water and wastewater as of February 29, 2016; however, the OUCC did not reflect in its schedules an amount for Phase I general plant additions.

3. Petitioner's Rebuttal. Mr. Kersey explained that although it appeared that the OUCC had proposed inclusion of general plant additions for Phase II, it did not appear that any consideration was given for general plant additions from March 1, 2016, through September 30, 2016. The OUCC provided no testimony as to why general plant additions recorded from March 1, 2016, through September 30, 2016, should be excluded from its September 30, 2017 updated rate base. Petitioner's Exhibit R2, Attachment JPK-R1 at pages 8 and 17 reflected \$0 for general plant additions to be included in Phase I rates for water and wastewater operations,

respectively. For Phase II, Petitioner proposed \$755,138 (\$278,209 +\$476,929) in general plant additions for water operations and \$300,607 (\$110,750 + \$189,857) for wastewater operations.

4. Commission Discussion and Findings. Petitioner's forecasted general plant for water is \$953,858 per its Supplemental Response to IURC Docket Entry Dated February 2, 2017, and it was not \$919,319 as indicated by the OUCC. On February 6, 2017, Petitioner filed Attachment 4.2 and 4.4 that provided a breakout of Petitioner's forecasted Net Pro Forma Plant, which included \$953,858 for water operations combined and \$379,715 for wastewater operations combined. Petitioner explained that its forecasted \$953,858 included \$476,929 for both Phase I and Phase II for water operations and \$379,715 included \$189,857 for both Phase I and Phase II for wastewater operations. However, when the parties agreed to change the rate base cutoff date for Phase I from September 30, 2015, to February 29, 2016, \$198,720 of the \$953,858 was included in the February 29, 2016 balance for its combined water operations and \$79,107 was included in the February 29, 2016 balance for its combined wastewater operations. We agree with Petitioner that no testimony from the OUCC was provided disputing the general plant amounts proposed by Petitioner. Therefore, we accept Petitioner's proposed general plant rate base additions, with the additions proposed in Phase II being subject to the adjustment described in the Rate Base Update Mechanism section.

**I. Allowance for Funds Used During Construction.**

1. OUCC's Evidence. Ms. Stull testified that Petitioner used various rates during the period 2013 through 2015 to record AFUDC as follows:

January 2013 – March 2013	8.36%
April 2013 – May 2013	8.15%
June 2013 – December 2015	9.15%

Ms. Stull explained that Petitioner's AFUDC rate should be limited to the weighted costs of capital allowed in Petitioner's most recent rate case. Thus, the appropriate rates for each utility are: (1) Twin Lakes – 8.213% (Cause No. 44388); (2) WSCI – 8.31% (Cause No. 44104); and (3) IWSI – 8.31% (Cause No. 44097). Ms. Stull testified that the AFUDC rates through May 2013 appear reasonable for each utility. However, Petitioner's use of a 9.15% rate used since June 2013 is excessive. The 9.15% rate used is approximately 10% higher than the weighted cost of capital rate approved by the Commission. In supplemental testimony, Ms. Stull ultimately proposed to reduce AFUDC by \$8,426 for water operations and \$1,575 for wastewater operations.

2. Petitioner's Rebuttal. Mr. Kersey explained that Petitioner did not entirely agree with the OUCC's proposed water operations adjustment. Within the proposed adjustment, AFUDC was accrued to project 2013069, which was not closed and placed into service and was not requested in rate base. Therefore, the \$72 in AFUDC associated with this project should not be adjusted from rate base. Petitioner's proposed adjustment to water rate base is \$8,061 (\$8,354 - \$293). Petitioner corrected the AFUDC rate from 9.15% to 8.23%. Pet. Ex. 2R at 40. However, Petitioner accepted the OUCC's wastewater operations adjustment for AFUDC.

3. Commission Discussion and Findings. Petitioner did not disagree with the OUCC's use of Petitioner's weighted cost of capital as allowed in Petitioner's most recent

rate cases. Thus, the Commission finds Petitioner's adjustment to reduce AFUDC by \$8,354, which includes the modification of \$72 associated with project 2013069, for consolidated water operations and the OUCC's reduction of \$1,575 for consolidated wastewater operations are accepted.

## **J. Utility Plant Retirements.**

1. OUCC's Evidence. Ms. Stull explained that Petitioner proposed utility plant retirements through September 30, 2017, consisting of: (1) ground-storage tank (\$212,519), (2) hydro-pneumatic tank (\$19,979), (3) general plant (\$36,298), (4) vehicles (\$44,100), and (5) computers (\$556,877) for a total of \$869,773 for Petitioner's water operations.<sup>6</sup> Pub. Ex. 1 at 20. For its wastewater operations, Petitioner proposed a total of \$529,873 in retirements for: (1) general plant (\$135,491); (2) vehicles (\$28,940); and (3) computers (\$365,442). Ms. Stull also explained that most of the retirements forecasted by Petitioner had been recorded and are included in its February 29, 2016 general ledger balance. However, \$353,166 for the retirement of computers forecasted by Petitioner for its consolidated water operations had not occurred. Ms. Stull proposed an adjustment to remove \$310,450 for Phase I retirements of computers and \$353,166 for Phase II retirements of computers and vehicles from UPIS and accumulated depreciation as of September 30, 2017, for consolidated water operations. Further, Ms. Stull proposed \$336,538 for Phase I retirements of computers and \$364,570 for Phase II retirements of computers and vehicles from UPIS and accumulated depreciation as of September 30, 2017, for consolidated wastewater operations.

2. Petitioner's Rebuttal. No rebuttal testimony was provided by Petitioner on utility plant retirements. However, Petitioner reflects a removal from rate base of \$514,161 for Phase I retirements and a removal of \$556,877 for Phase II retirements from UPIS and accumulated depreciation for consolidated water operations. Pet. Ex. 2R, Attach. JPK-R1 at 8. Petitioner also reflects a removal of \$336,538 for Phase I retirements and a removal of \$364,570 for Phase II retirements from UPIS and accumulated depreciation for consolidated wastewater operations. Pet. Ex. 2R, Attach. JPK-R1 at 17.

3. Commission Discussion and Findings. Regarding wastewater plant retirements, the parties appear to agree that \$336,538 represents Phase I retirements and \$364,570 represents Phase II retirements. We note that the \$28,032 increase from Phase I to Phase II is associated with vehicle retirements. There is no longer a need to phase-in Petitioner's rates due to the time delays in this case. Therefore, we include \$364,570 in rate base for plant retirements for consolidated wastewater operations.

However, a difference exists for water plant retirements as shown on Petitioner's Exhibit 2R, Attachment JPK-R1 of \$203,711 (\$514,161 less \$310,450 equals \$203,711, and this is the difference between Petitioner's rebuttal and the OUCC's supplemental schedules for Phase I). We note that the difference appears to be related to the OUCC multiplying Petitioner's 60.38% Equivalent Residential Connection ("ERC") factor to the \$514,161 in computer retirements allocated to Petitioner's water operations. Petitioner proposed a total of \$922,319 in retirements

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<sup>6</sup> We note that based on Petitioner's February 6, 2017 Docket Entry response, the \$36,298 general plant retirement is actually associated with Petitioner's SCADA system, which Petitioner removed in rebuttal from its proposed projects to be included in rate base.

for computers, which if one multiplies this amount by Petitioner's ERC allocation factor of 60.38% for its water operations, equates to the \$514,161 Phase I allocation and additional \$42,716 allocation for Phase II. Therefore, we disagree with the OUCC's further allocation of computer retirements because it is not necessary. We find Petitioner's plant retirements for computers of \$514,161 for Phase I and for Phase II for Petitioner's water operations should be approved. We also find the \$42,716 Phase II increase in retirements associated with vehicles should be approved.

Further, we note that in response to the Commission's docket entry questions, Petitioner indicated that \$212,519 in retirements associated with North GST and \$19,979 associated with the Hydro-Tank Replacement were included in its net pro forma plant additions for its water operations, and both projects were approved for recovery in rate base as described above. Thus, these associated retirements should also be reflected in rate base. However, based on the OUCC's docket entry responses submitted at the hearing, Petitioner retired \$59,761 associated with Peabody GST in the February 29, 2016 UPIS balance of \$13,445,342. Thus, the Commission finds further retirements of \$19,979 associated with the replacement of Petitioner's Hydro-Tank and \$152,758 (\$212,519 - \$59,761) associated with the demolition of Peabody GST for North GST construction should be included in rate base. Given there is no longer a need to phase-in Petitioner's rates, we reflect in rate base the retirement of \$729,614 in plant for consolidated water operations.

**K. Accumulated Depreciation.** Both Petitioner and the OUCC made adjustments to accumulated depreciation based on their respective positions regarding Petitioner's UPIS issues described above. Moreover, we note that both Petitioner and the OUCC included Remaining Phase I Depreciation Expense in the Phase I column of their respective rate schedules. However, the OUCC used a September 30, 2016 cutoff date, which would make such an adjustment necessary, but Petitioner's rebuttal Phase I cutoff date is February 29, 2016. Thus, for Petitioner, any remaining Phase I depreciation after Petitioner's cutoff date is properly reflected in its Phase II accumulated depreciation balance. If there were a need for phased rates, the Commission would have found accumulated depreciation for Phase I and Phase II based on a Phase I cutoff date of February 29, 2016, as follows:

<b>Combined Water Operations</b>		
	<b>Phase I</b>	<b>Phase II</b>
Accumulated Depreciation at 2/29/2016	\$ 2,684,682	\$ 2,684,682
Add: Remaining Phase I Depreciation Expense		148,558
Phase II Depreciation Expense	-	269,886
Less: A/D on Disallowed Capital Costs	12,601	12,601
Retirements	686,898	729,614
<b>Total Accumulated Depreciation</b>	<b>\$ 1,985,183</b>	<b>\$ 2,360,911</b>

<b>Combined Wastewater Operations</b>		
	<b>Phase I</b>	<b>Phase II</b>
Accumulated Depreciation at 2/29/2016	\$ 6,256,180	\$ 6,256,180
Add: Remaining Phase I Depreciation Expense		270,149
Phase II Depreciation Expense	-	477,927
Less: A/D on Disallowed Capital Costs	14,176	14,176
Retirements	336,538	364,570
<b>Total Accumulated Depreciation</b>	<b>\$ 5,905,466</b>	<b>\$ 6,625,510</b>

However, given the time delays to this Cause, we find the accumulated depreciation for Petitioner's consolidated water and wastewater operations to be \$2,360,911 and \$6,625,510, respectively. These amounts are subject to the Rate Base Update Mechanism described below.

**L. Contributions in Aid of Construction.**

1. Petitioner's Evidence. Mr. Kersey testified that Petitioner's forecast for amortization of CIAC reflected the removal of Twin Lakes CIAC amortization expenses incorrectly recorded to Petitioner's general ledger during the base period. Mr. Kersey stated that because Petitioner does not amortize Twin Lakes CIAC for ratemaking purposes, it was necessary to reverse these base year transactions. Mr. Kersey also testified that forecasted amortization of CIAC for IWSI and WSCI was annualized based on Petitioner's recommended depreciation rates.

For consolidated water operations, Petitioner forecasted net CIAC of \$2,319,597 as of September 30, 2017. This forecast reflects a decrease of \$16,871 from base year net CIAC of \$2,336,468. Petitioner proposed an increase of \$17,561 to its water net acquisition adjustment to reflect the removal of accumulated amortization of its Twin Lakes CIAC. Petitioner also forecasted a decrease of \$34,432 to reflect additional amortization of WSCI and IWSI CIAC.

For consolidated wastewater operations, Petitioner forecasted net CIAC of \$3,773,299 as of September 30, 2017. This forecast reflects an increase of \$32,657 from base year wastewater net CIAC of \$3,740,642. Petitioner proposed an increase of \$33,342 to wastewater net CIAC to reflect the removal of accumulated amortization of the Twin Lakes CIAC. Petitioner also forecasted a decrease of \$685 to reflect additional amortization of WSCI wastewater CIAC.

2. OUCC's Evidence. Ms. Stull explained that CIAC is a reduction to rate base. Ms. Stull rejected Petitioner's proposed forecasted CIAC because she believes it is not needed and instead used Petitioner's actual CIAC balance as of the general rate base cut-off of February 29, 2016.

3. Petitioner's Rebuttal. Mr. Kersey testified that Petitioner did not agree with the OUCC's removal of the impact of Petitioner's newly recommended depreciation rates on CIAC amortization. Therefore, Petitioner did not agree with the OUCC's proposed CIAC amortization using the Commission's composite-depreciation rates.



4. - Commission Discussion and Findings. In light of our finding below requiring Petitioner to continue using the Commission's composite-depreciation rates, we find the Commission's composite-depreciation rates shall also be used to establish the net CIAC to be included in rate base. Further, similar to the issue described above with regard to accumulated depreciation, based on the use of a Phase I cutoff date of February 29, 2016, any accumulated amortization expense accrued from March 1, 2016, through the end of Petitioner's test period would be recorded in Phase II subject to the Rate Base Update Mechanism.

Net CIAC for Consolidated Water Operations			
		Phase I	Phase II
Contributions in Aid of Construction, net as of 2/29/16		\$ 2,342,255	\$ 2,342,255
Less: Disallowed Plant		16,184	16,184
Amortization of CIAC Phase I			8,568
Amortization of CIAC Phase II		-	14,687
Contributions in Aid of Construction, net		<u>\$ 2,326,071</u>	<u>\$ 2,302,816</u>

Net CIAC for Consolidated Wastewater Operations			
		Phase I	Phase II
Contributions in Aid of Construction, net as of 2/29/16		\$ 3,748,895	\$ 3,748,895
Less: Disallowed Plant		11,732	11,732
Amortization of CIAC Phase I			457
Amortization of CIAC Phase II		-	783
Contributions in Aid of Construction, net		<u>\$ 3,737,163</u>	<u>\$ 3,735,923</u>

However, given the time delays to this Cause, we find net CIAC for Petitioner's consolidated water and wastewater operations to be \$2,302,816 and \$3,735,923, respectively. These amounts are subject to the Rate Base Update Mechanism described below.

**M. Accumulated Deferred Income Taxes.**

1. Petitioner's Evidence. Petitioner explained that the forecasted changes to accumulated deferred income taxes related to projected differences between book and tax depreciation. Attachment JPK-1, page 6 reflects pro forma proposed combined accumulated deferred income taxes of \$1,313,021.

2. OUC's Evidence. Ms. Stull explained in a footnote that the difference between Petitioner's and OUC's accumulated deferred income taxes was primarily due to the difference between Petitioner's allocation of rate base based on customer counts and the OUC's allocation methodology shown on Attachment MAS-3. Ms. Stull's supplemental testimony reflects the OUC's revised accumulated deferred income tax balances for Phase II of \$1,043,121 for consolidated water operations and \$1,010,994 for consolidated wastewater operations.

3. Petitioner's Rebuttal. No rebuttal testimony was provided regarding this issue. However, in Rebuttal Schedule 8W, Petitioner proposed Phase II accumulated deferred income tax of \$949,410 for consolidated water operations and \$962,307 for consolidated wastewater operations.

4. Commission Discussion and Findings. Accumulated deferred income taxes is the difference between book and tax depreciation for Petitioner's depreciable plant. We also take into consideration our findings regarding total depreciable utility plant. We find accumulated deferred income tax for Petitioner's Phase I rates for its consolidated water operations to be \$944,945 and for Phase II to be \$1,041,204. For Petitioner's consolidated wastewater operations, the Commission finds accumulated deferred income tax to be \$887,594 for Phase I rate base and \$987,305 for Phase II rate base. However, given the delay in this Cause, there is no need to phase-in Petitioner's rates. Therefore, based on our findings for Petitioner's UPIS above, we find accumulated deferred income taxes to be \$1,041,204 for consolidated water operations and \$987,305 for consolidated wastewater operations.

We note that both parties deducted vehicles and computers from their accumulated deferred income tax calculations, but they did not explain why the deduction was made. Based on the work papers filed in Petitioner's rebuttal testimony, vehicles and computers are reflected in Petitioner's general ledger trial balance as of February 29, 2016, which is inconsistent with Mr. Kersey's statement that "computer software and transportation, are held on affiliate books." Pet. Ex. 2R at 24. Vehicles and computers are included in rate base to be depreciated using the Commission's approved composite-depreciation rates as discussed herein. Therefore, for ratemaking purposes, vehicles and computers should be included in Petitioner's accumulated deferred income tax calculations. However, because neither Petitioner nor the OUCC included computers and vehicles in their deferred income tax calculations, we also removed these assets. We find for future rate cases, Petitioner shall describe its deferred income tax calculation in its case-in-chief testimony and provide a supporting rate schedule.

#### N. Working Capital.

1. Petitioner's Evidence. Mr. Kersey explained that Petitioner's forecasted working capital was calculated based on forecasted operations and maintenance expenses ("O&M") as well as forecasted taxes other than income expense.

2. OUCC's Evidence. Ms. Stull explained that Petitioner used the Federal Energy Regulatory Commission ("FERC") 45-day method to estimate working capital and proposed to earn a return on working capital of \$194,043 for consolidated water operations and \$136,167 for consolidated wastewater operations. Ms. Stull stated that for ratemaking purposes, working capital generally is defined as the average amount of capital provided by investors, over and above the investment in plant, to bridge the gap between the time expenditures are required to provide service and the time collections are received for that service. In other words, working capital is the money a utility needs to provide utility service before it receives payment for that service. She added that while some expenses are paid after the related service revenues have been collected, some expenses are incurred and paid before the related revenues have been collected such as chemical expense, rent, and salaries. She testified that expenses paid in arrears include

taxes, purchased water, and purchased power. She said working capital is the net amount of money needed on an ongoing basis to fund daily utility operations. Working capital is considered the investment necessary for providing utility service and is included in rate base for investor-owned utilities.

Ms. Stull noted that in its calculation of working capital, Petitioner included expenses that are known to be paid in arrears. She identified taxes as well as purchased power and purchased water as items paid at the time or after Petitioner has received revenues from its customers for the utility service provided, noting many taxes are paid on a quarterly basis in arrears and property taxes are paid up to two years in arrears. Therefore, she proposed the exclusion of all taxes as well as purchased power and purchased water expense from the calculation of operating expenses on which the FERC 45-day method is applied. Ms. Stull noted these types of downward operating expense adjustments have been approved by the Commission in previous rate cases involving Twin Lakes, WSCI, and IWSI. Finally, Ms. Stull recommended the Commission require Petitioner to perform a lead-lag study or otherwise support its proposed working capital in its next base rate case.

3. Petitioner's Rebuttal. Mr. Kersey accepted the adjustments proposed by the OUCC and said Petitioner will exclude the suggested expenses paid in arrears to calculate its working capital requirements. However, Mr. Kersey said Petitioner does not agree to perform a lead-lag study, and he proposed to continue using the FERC 45-day method because it is a low-cost calculation and is commonly accepted. He noted the Commission has accepted this method in each of the prior cases for Petitioner's individual territories. However, he added Petitioner would agree to perform and file a lead-lag study if it were to request a working capital allowance greater than 1/8<sup>th</sup> of its operating expenses.

4. Commission Discussion and Findings. We agree with the OUCC's proposed expense adjustments used under the FERC 45-day method and given the time delay in this Cause, the Commission finds that Petitioner's forecasted working capital for purposes of establishing rate base is as follows:

Consolidated Water Working Capital

			Total
Maintenance Expense			\$ 918,267
General Expense			448,200
Less: Purchased Water			380,353
Purchased Power			78,115
Adjusted Operation & Maintenance Expense			907,999
Times: 45 Day Factor			0.125
Working Capital Requirement			<u>\$ 113,500</u>

Consolidated Wastewater Working Capital

	Total
Maintenance Expense	\$ 711,329
General Expense	295,327
Less: Purchased Water	-
Purchased Power	214,266
Adjusted Operation & Maintenance Expense	792,390
Times: 45 Day Factor	0.125
Working Capital Requirement	\$ 99,049

Regarding Petitioner's use of the FERC 45-day method to approximate its cash working capital needs, the Commission finds no evidence that would dispute the results as a reasonable approximation of Petitioner's billing and payment practice or Petitioner's actual cash needs. We agree with the OUCC that a lead-lag study provides transparency and precision. However, there is no evidence to suggest that the results of a lead-lag study would support spending the additional cost to perform the study. Thus, we decline to require Petitioner to perform a lead-lag study in its next rate case.

**O. Rate Base Determination.** Based on the foregoing, the Commission finds Petitioner's rate base for consolidated water operations to be \$7,778,960 as shown below, subject to the Rate Base Update Mechanism. We note that given the context of this Cause and the time delay issue, we included Phase I rate base for the sole purpose of clarity to readers of this Order.

	<b>Do Not Use Phase I 2/29/2016</b>	<b>Final 9/30/2017</b>
South GST* (Included in UPIS at 9/30/15 total)	\$ 715,318	\$ 715,318
Utility Plant in Service at 9/30/15	12,470,720	12,470,720
Reduction to South GST	(65,318)	(65,318)
Vehicle Additions	54,340	54,340
Vehicle Retirements	(15,889)	(15,889)
Hydro-pneumatic Tank	184,151	184,151
North GST	562,797	562,797
Reduction to North GST	(71,700)	(71,700)
Peabody Retirement	(59,761)	(59,761)
General Plant	198,720	198,720
Difference from 2/29/16 Trial Balance	50,264	50,264
Utility Plant in Service at 2/29/2016	13,308,324	13,308,324
Reestablished Values for Computers and Vehicles	516,923	559,639
Vehicles	-	5,611
General Plant Additions Phase I**	-	278,209
General Plant Additions Phase II	-	476,929
Less: Retirements	686,898	729,614
Non-Capital Costs	171,845	171,845
AFUDC	8,354	8,354
Scrap Value of Meters	13,023	13,023
Water Service Lines	19,899	19,899
Additional Capitalized Time	42,307	42,307
Capitalized Time for DSIC Leak Repair	34,965	34,965
Gross Utility Plant in Service	12,847,956	13,608,704
Less: Accumulated Depreciation at 2/29/2016***	2,684,682	2,684,682
Less: Remaining Phase I Depreciation Expense		148,558
Phase II Depreciation Expense	-	269,886
Add: A/D on Disallowed Capital Costs	12,601	12,601
Retirements	686,898	729,614
Restb. Values for Computers and Vehicles	162,710	131,384
Less: Contributions in Aid of Construction, net	2,342,255	2,342,255
Add: Disallowed Plant	16,184	16,184
Amortization of CIAC Phase I		8,568
Amortization of CIAC Phase II	-	14,687
Net Utility Plant in Service	8,699,412	9,076,361
Less: Accumulated Deferred Income Taxes	944,945	1,041,204
Acquisition Adjustment, net	339,291	332,047
Customer Deposits	37,650	37,650
Add: Net Deferred Charges	-	-
Working Capital	105,541	113,500
Total Original Cost Rate Base	\$ 7,483,067	\$ 7,778,960

\*The South GST is included in Petitioner's September 30, 2015 Utility Plant in Service balance of \$12,470,720.

\*\*Petitioner presented its "Phase I" adjustments in its proposed Phase II column in its Rebuttal rate schedules. In Petitioner's Docket Entry response 4-39 received on February 6, 2017, Petitioner explained that with the change to agreed a rate base cutoff for Phase I of February 29, 2016 from September 30, 2016 that portion for Petitioner's original Phase I adjustments from March 1, 2016 through September 30, 2016 was pushed to Phase II.

\*\*\* Included in the \$2,684,682 is an adjustment of \$59,761 for the retirement of the Peabody tank and \$15,889 for the retirement of vehicles

The Commission finds Petitioner's rate base for consolidated wastewater operations to be \$8,040,181 as shown below, subject to the Rate Base Update Mechanism. We note that given the context of this Cause and the time delay issue, we included Phase I rate base for the sole purpose of clarity to readers of this Order.

	<b>Do Not Use</b>	
	<b>Phase I</b>	<b>Final</b>
	<b>2/29/2016</b>	<b>9/30/2017</b>
Utility Plant in Service at 9/30/15	\$ 18,675,607	\$ 18,675,607
Add: Allocation of Vehicles	25,213	25,213
GIS Mapping	42,359	42,359
2015 Sewer Capital Improvement Project	148,122	148,122
General Plant Additions Phase I	79,107	79,107
Difference from 2/29/16 Trial Balance	120,688	120,688
Utility Plant in Service at 2/29/2016	19,091,095	19,091,095
Add: Restb. Values for Computers and Vehicles	339,223	367,254
Add: 2016 Sewer Capital Improvement Project	-	107,404
2017 Sewer Capital Improvement Project	-	180,903
Vehicles	-	3,682
General Plant Additions Phase I	-	110,750
General Plant Additions Phase II	-	189,857
Less: Retirements	336,538	364,570
Non-Capital Costs	4,222	4,222
Sewer Laterals	50,748	50,748
Manhole Repairs	60,490	60,490
CS&W Invoices	230,113	230,113
RedZone Robotics Invoices	26,555	26,555
Capitalized Time (Management and Repairs)	41,405	41,405
Retirement Reversal	(873)	(873)
AFUDC	1,575	1,575
Gross Utility Plant in Service	18,679,545	19,272,140
Less: Accumulated Depreciation	6,256,180	6,256,180
Less: Remaining Phase I Depreciation Expense		270,149
Phase II Depreciation Expense	-	477,927
Add: A/D on Disallowed Capital Costs	14,176	14,176
Retirements	336,538	364,570
Restb. Values for Computers and Vehicles	85,872	41,490
Less: Contributions in Aid of Construction, net	3,748,895	3,748,895
Add: Disallowed Plant	11,732	11,732
Amortization of CIAC Phase I		457
Amortization of CIAC Phase II	-	783
Net Utility Plant in Service	9,122,788	8,952,198
Less: Accumulated Deferred Income Taxes	887,594	987,305
Acquisition Adjustment, net	-	-
Customer Deposits	23,759	23,759
Add: Net Deferred Charges	-	-
Working Capital	90,885	99,049
Total Original Cost Rate Base	<u>\$ 8,302,319</u>	<u>\$ 8,040,181</u>

**P. Rate Base Update Mechanism.**

1. Petitioner's Evidence. In its case-in-chief, Petitioner did not provide a proposed Rate Base Update Mechanism; however, Petitioner proposed implementation of Phase II to occur one year after implementation of Phase I rates.

2. OUC's Evidence. Ms. Stull explained that by using actual rate base as of February 29, 2016, for Phase I rate base, it eliminated the need for Petitioner to affirm in a future filing that UPIS is used and useful. Regarding Phase II, the rates should continue to be based on projected rate base as of September 30, 2017. However, before Phase II rates can be implemented, Petitioner should file an affirmation that additional capital costs are in service and used and useful. Petitioner should also file a general ledger trial balance reflecting account balances as of September 30, 2017. Ms. Stull stated that only the capital additions that are identified as specific projects in Petitioner's case-in-chief should be eligible for phase-in treatment.

Ms. Stull stated that the rate base update for each project should not exceed Petitioner's projected construction costs for that project for ratemaking purposes. Petitioner should also provide a certification that the new plant is in service and verification that the construction costs have been incurred and paid. Petitioner should provide a general ledger transaction listing for each project reflecting all costs Petitioner seeks to include in rate base along with all supporting documentation. The supporting documentation should include invoices, time sheets, contracts, and other applicable documents, for each line item that is greater than 10% of the project's total value. Further, Petitioner should submit the following: (1) updated UPIS by asset account incorporating the eligible plant additions, (2) updated annual depreciation expense incorporating the eligible plant additions, (3) updated accumulated depreciation on Petitioner's authorized rate base, (4) updated contributions-in-aid of construction by account, including accumulated amortization, (5) a revised revenue requirement, as necessary, and (6) updated tariffs.

3. Petitioner's Rebuttal. Mr. Kersey explained that Petitioner agreed with a Phase I rate base cut-off of February 29, 2016. However, Petitioner disagreed with the OUC's proposed Phase II rate base update. Petitioner argued that it should be allowed to include in its Phase II update all general ledger rate base transactions with corresponding adjustments to September 30, 2017, forecasted expenses. Mr. Kersey explained that adjustments to forecasted expenses would include expense items that are dependent on rate base, such as depreciation expense, interest expense, property tax expense, and income tax expense. Petitioner would allow the OUC a period for discovery to confirm Petitioner's revenue requirement for Phase II rates. Mr. Kersey stated that the OUC's discovery should be limited to confirming Petitioner's updated September 30, 2017, rate base, as well as adjustments to fiscal year-end September 30, 2017 operating income for Phase II rates.

4. Commission Discussion and Findings. Because the parties agreed to a Phase I rate base cutoff of February 29, 2016, there is no need to true-up Phase I rates because all plant that was under review is already in service. However, for rate base adjustments that were proposed for Phase II, a Rate Base Update Mechanism is necessary, and we believe that a discovery process is appropriate for Petitioner's Phase II update. We also agree that confirmation of rate base updates should be part of the process. However, while the OUC provided a list of specific



information Petitioner should provide with the Phase II update, Petitioner did not provide a list of the information that it agreed to submit. Moreover, the parties disagreed as to whether all utility plant through the end of the test period should be included or if only major projects should be included in Petitioner's Phase II update.

In Cause No. 44450, the Commission addressed the issue of a phase-in mechanism related to Indiana-American Water Company Inc.'s ("Indiana-American") rate base projected to be placed in service due to the use of a future test period. In that Cause, the Commission approved a settlement that described a two-phase certification process for Indiana-American's proposed future utility plant investments. The Rate Base Update Mechanism we describe below is based on consideration of both parties' positions in this Cause and the documentation and review period process approved in Cause No. 44450.

Rates approved in this Cause are based on UPIS and other components of rate base projected through the end of the test period, September 30, 2017. To be consistent with the intent of Ind. Code § 8-1-2-42.7, total plant additions, including major projects, should be included in Petitioner's Rate Base Update. However, total plant additions may not exceed Petitioner's proposed rate base as of September 30, 2017, as determined by the Commission in this Order based on the evidence presented. If we were to allow material plant additions in Petitioner's update that were not included in Petitioner's forecasts, the Commission would have nothing in its record to support the reasonableness of the additional plant. Further, Petitioner represents that its forecasts are a reasonable representation of the costs, including the plant addition costs that it will incur. Thus, based on Petitioner's testimony, the recommendation to cap Petitioner's total plant to the amounts proposed in this Cause should not harm Petitioner. Moreover, to the extent Petitioner's actual net original cost rate base as of September 30, 2017, exceeds the amount proposed in Petitioner's case-in-chief, Petitioner is not foreclosed from including those additional investments in rate base in a future general rate case.

The rates approved herein are effective upon approval of a filed tariff as described below. However, within 30 days of the effective date of this Order, Petitioner shall certify under this Cause that all UPIS to be included in rates is used and useful as of September 30, 2017. The certification shall include a schedule of actual values for all components of rate base. Petitioner shall also provide the following schedules: (1) actual UPIS by account, (2) updated calculations of depreciation expense based on the original cost of UPIS and deferred depreciation as of September 30, 2017, (3) a revised revenue requirement, as necessary, and (4) an updated tariff.

In addition, because of our separately-discussed concerns regarding Petitioner's need to improve its oversight of projects performed by contractors and its financial controls over invoices, Petitioner shall also provide a listing for each project in a general ledger transaction that reflects all costs Petitioner is seeking to include in Phase II rate base. Petitioner shall provide supporting documentation, including invoices, time sheets, contracts, and other applicable documents, for each line item of the general ledger transaction listing that is greater than \$7,500 of that project's total cost. The OUCC and LOFS will have 30 days to review and submit objections to Petitioner's rate base update compliance filing. If objections cannot be resolved informally, any party may request a hearing on the issue.

8. **Weighted Average Cost of Capital.** Mr. Lubertozi testified that Petitioner and OUCC entered into a settlement agreement that resolves all components to the Weighted Average Cost of Capital (“WACC”). He explained that customer interests are best served when the authorized rate of return on rate base is neither higher nor lower than the overall cost of capital; thus, Petitioner and OUCC reached agreement on a WACC that is equal to 8.18%. He testified that the agreed-upon return on equity and capital structure is reasonable and was the result of an arms-length negotiation after considerable discussion between knowledgeable parties. Mr. Lubertozi further testified that a 9.75% return on equity (“ROE”) is consistent with the Commission’s Order in Cause No. 44450, and is lower than the ROEs previously approved for Petitioner’s Indiana operating divisions. He also indicated that the 50/50 ratio for the capital structure is reasonable and consistent with the actual capital structure of Utilities, Inc.

At the hearing, the Presiding Officers asked Mr. Lubertozi and Mr. Kaufman about the stipulated cost of equity, a component of WACC, that the parties recommended. Mr. Lubertozi testified that Petitioner looked at the approved cost of equity in other states and also looked at the cost of engaging a cost of capital expert and determined it was beneficial to avoid bringing an expert in to testify. When asked to compare the relative cost of equity for a utility that has no service issues with one that does, Mr. Lubertozi explained that most utilities are going to have some type of sanitary system overflow or manhole overflow or some surcharges. He acknowledged that cost of equity could be used as a tool to send a message to a utility regarding whether its service is adequate or not. Tr. at B-132, 133. During questioning from the bench, Mr. Kaufman acknowledged that in the last Order concerning Twin Lakes, the Commission approved a reduction of 50 basis points to express their concern about service quality issues. Tr. at E-18, 19. Mr. Kaufman declined to express an opinion as to whether a reduction would be warranted in this proceeding because of the agreement between the parties.

Petitioner experienced operational difficulties as a result of certain employees, and Petitioner indicated that it has renewed its focus in conjunction with replacing those employees. It is our hope that along with their new personnel, Petitioner will improve internal controls. Additionally, Petitioner has made some progress with service quality issues; however, there is still room for Petitioner to improve service quality. It is also our hope that Petitioner will continue to make measureable improvements in service quality. To support these goals, the Commission designates detailed requirements in the sections of this Order titled as follows: (1) Internal Investigation and Use of Three-Way-Match Process, and (2) Wastewater and Water Service Quality and Communications with LOFS.

With an expectation and goal of eliminating controversy and avoiding rate case expense, prior to the filing of its case, Petitioner reached agreement with the OUCC on cost of equity and capital structure to establish weighted cost of capital. The Commission finds that the agreed upon cost of equity and capital structure percentages to establish weighted cost of capital are reasonable and prudent, and these amounts are as follows:

<u>Class of Capital</u>	<u>Percent of Total</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Long Term Debt	50.00%	6.60%	3.30%
Common Equity	50.00%	9.75%	4.88%
Total	<u>100.00%</u>		<u>8.175%</u>

9. **Revenue Adjustments.** Base year revenues through September 30, 2015, were \$2,073,096 for consolidated water and \$2,200,545 for consolidated wastewater. The parties proposed various pro forma adjustments to revenues associated with accruals, surcharges, miscellaneous, and declining usage. Petitioner agreed with many of the OUCC's adjustments to consolidated water operations, including the following: \$22,107 for Service Revenues for Water, (9,711) for Accrued Water Revenues, (\$5,771) for IWSI Water Tracker, and (\$22,107) for Other Miscellaneous Revenues for Water. Petitioner agreed with the OUCC's adjustment to consolidated wastewater operations, including the following: (\$10,185) for Accrued Wastewater Revenues. We find the adjustments agreed to by the parties to be reasonable. The remaining disagreements, which are associated with Declining Usage, Customer Normalization, and Surcharge revenues, are discussed below.

**A. Declining Usage and Customer Normalization Adjustments.**

1. **Petitioner's Evidence.** Mr. Kersey testified that Petitioner proposed a decrease of \$133,301 to base year water revenues and a decrease of \$12,641 to base year wastewater revenues to reflect declining usage. These overall adjustments to water and wastewater service revenues include declining usage, customer normalization, and surcharge revenue adjustments. He explained that the usage normalization adjustment was calculated specifically for each territory and customer class and was developed by averaging the annual change in consumption per customer from June 2009 through June 2015. He further stated that Petitioner analyzed consumption patterns during the winter months of December through February over the same period to determine whether the declining usage was weather neutral. He testified that a similar level of decline in usage was seen during the winter months, suggesting that the decline is not a weather-related phenomenon.

2. **OUCC's Evidence.** Mr. Kaufman proposed removal of Petitioner's declining usage adjustment in its entirety because he said that Indiana Senate Enrolled Act No. 383, System Integrity Adjustments, diminished the need to make a declining consumption adjustment to revenues. He explained that Senate Bill 383 allows a utility to track the difference between its authorized revenues and collected revenues thereby insulating a utility from under-collecting its authorized revenues. Additionally, he said that estimated usage in the Year One Forecasted Revenues should not be used when Petitioner now has actual usage figures. The OUCC did not propose any customer growth or customer normalization adjustments.

3. **Petitioner's Rebuttal.** Mr. Kersey noted that the OUCC did not dispute Petitioner's declining usage forecast or supporting data. Pet. Ex. R2 at 2-3. Mr. Kersey testified regarding the effect of declining usage data, and he said he did not believe that Petitioner should update its Year One Forecasted Revenues with billings for periods where actual usage data

now exists. He reasoned that a significant amount of time went into reconciling the bill frequency distribution by Petitioner's cost-of-service consultants, and because there was no significant change to the customer base or in weather patterns, an update using actual usage data would not materially change the proposed rates. He testified that an update was an inefficient use of resources. Mr. Kersey further testified that he did not agree with Mr. Kaufman's suggestion that any under-collection should be recovered via Senate Bill 383. He explained that relying on the mechanism provided via Senate Bill 383 would conflict with the purpose for utilizing a future test year and would not guarantee full recovery of Petitioner's revenue requirement. *Id* at 3-4.

Petitioner also presented customer normalization adjustments based on its cost-of-service analysis, which was further explained in Petitioner's February 6, 2017 Docket Entry Response 4-38. For water, Petitioner proposed a pro forma customer normalization reduction of \$2,495. Pet. Ex. R2, Attach. JPK-R1. For wastewater, Petitioner proposed a pro forma customer normalization increase of \$13,085.

4. Commission Discussion and Findings. The OUCC's objection to Petitioner's declining usage adjustment appeared to be primarily based on new legislation that allows utilities to file for system integrity adjustments. We find the OUCC's reliance on Senate Bill 383 unpersuasive. Setting a utility's rates lower than they would otherwise be on the theory that the utility can subsequently seek to true-up their rates through some future mechanism is not consistent with sound ratemaking principles which are based on a revenue requirement that is reasonable, necessary, and prudent.

The record shows a measurable decline in usage by Petitioner's customers, which did not appear to be weather related. The OUCC did not dispute the declining usage forecast. Indeed, the OUCC argued that declining consumption justified its proposal to deny recovery of the second ground-storage tank. We find it reasonable to take this decline into consideration in establishing rates, particularly where the utility is using a forecasted test period. While the OUCC noted that predicting consumption usage can be difficult, we do not believe this renders Petitioner's proposed adjustment faulty. On this point, we note that the OUCC's comparison between Petitioner's initially proposed Year One Forecasted Revenues to actual revenues for the same period does not present an apples-to-apples comparison. More specifically, the OUCC's analysis did not recognize the fact that Petitioner's Year One Forecasted Revenues excluded all surcharges, whereas the actual revenue included all surcharges. Accordingly, this makes the OUCC's proposed usage inaccurate for this purpose.

The record shows Petitioner's analysis included detailed work papers providing adjustments for each customer class for each of Petitioner's operating divisions. We find this analysis is transparent and provides a suitable basis to adjust future consumption. Accordingly, the Commission finds Petitioner's proposed usage adjustment, which reduces pro forma water and wastewater revenues by \$68,976 and \$17,315, respectively, is reasonable and should be approved. Similarly, we find Petitioner's proposed customer normalization revenue reduction of \$2,495 for water and increase of \$13,085 for wastewater to be reasonable and should be approved.

**B. Surcharge Revenues.**

1. OUCC's Evidence. Ms. Stull included forecasted revenues and pro forma adjustments for all of Petitioner's surcharges in determining her recommended level of revenues. These include the IWSI water tracker pro forma reduction of \$5,771, IWSI DSIC pro forma adjustment of \$4,683, and a Twin Lakes wastewater utility infrastructure improvement charge ("USIC") pro forma adjustment of \$87,608, of which the latter two include revenues to be recovered in the DSIC and USIC reconciliation process. Pub. Ex. 1 at 59-62 and 65-67.

2. Petitioner's Rebuttal. Mr. Kersey explained that Petitioner did not initially consider it necessary to include surcharges in its forecasted revenues because Petitioner's proposed tariff resets the surcharge rates to \$0 and are therefore a non-factor when determining rates for Petitioner's total revenue requirement. Pet. Ex. R2 at 10. However, he testified that Petitioner agreed with Ms. Stull's recommendation to include Petitioner's surcharge revenues in its forecast, but Petitioner proposed a different calculation method. *Id.* at 9. He said Petitioner annualized surcharge revenues based on base year and forecasted usage and customer counts; therefore, Petitioner proposed an IWSI DSIC pro forma adjustment of \$2,679 and a Twin Lakes USIC pro forma adjustment of \$76,063. *Id.* at 10.

3. Commission Discussion and Findings. We note that the difference in Petitioner's proposed surcharge revenue and the OUCC's proposed amount is associated with the DSIC and USIC reconciliation process, which we believe should be included. Thus, the Commission agrees with the OUCC's IWSI and Twin Lakes surcharge revenue pro forma adjustments, noting that due to the DSIC and USIC reconciliation process, Petitioner is guaranteed to recover this level of revenue.

**C. Pro Forma Present Rate Revenues.** Based on the above, the Commission finds Petitioner's pro forma water and wastewater revenue at present rates for the 12 months ended September 30, 2017, are \$1,990,826 and \$2,273,738, respectively.

10. Operating Expenses. Mr. Kersey described generally how the forecasted changes to O&M were determined. He explained O&M may be directly billed to Petitioner or allocated to Petitioner from its affiliate services company, Water Service Corporation ("WSC"), or represent a combination of direct and allocated expense. Mr. Kersey said whenever possible, WSC will directly allocate costs that are identified with a specific operating company or prorate the allocations based on the functionality or proximity of the overhead cost, which are distinguished by utilizing overhead cost centers. He explained that costs that are not directly assignable to a specific subsidiary are allocated to the subsidiaries of Utilities, Inc. monthly. He said allocations are based on September 30, 2015, weighted ERC counts for each cost type, as shown in WP-JPK-01 (ERC Allocations).

Several of the O&M items were either not challenged by the OUCC or the OUCC's proposed adjustments were accepted by Petitioner in rebuttal. The adjustments agreed to by the parties, which the Commission finds to be reasonable, are as follows:

Description	Water Adjustments	Wastewater Adjustments
Salaries and Wages	\$ 58,708	\$ 38,507
Maintenance Testing	3,726	(862)
Maintenance Repair	1,261	57,950
Transportation	(9,652)	(6,334)
Outside Services - Other	(34,323)	(22,522)
<i>General Expenses</i>		
Salaries and Wages	18,549	Disputed Adj.
Office Expense	7,430	4,876
Regulatory Commission	6,656	4,956
Pension & Other Benefits	5,664	3,717
Rent	3,973	2,606
Insurance	7,805	5,120
Office Utilities	3,615	2,372
Miscellaneous	3,890	2,435
Amortization - Abandoned Meter	33,906	-
Amortization - Acq. Adj.	(1,083)	(2,819)

We discuss the remaining disputed operating expense adjustments below.

**A. Purchased Power and Water Expenses.**

1. Petitioner's Evidence. Mr. Kersey testified regarding Petitioner's forecasted purchased power and water expenses. He explained that electric power costs are forecasted by month based on the historical levels of electric power costs. Fiscal year forecasts for 2016 and 2017 are based on the latest four years of supplier invoices for the service periods June 1, 2011, through May 30, 2015. He further stated that the latest twelve months, June 1, 2014, through May 30, 2015, service costs were used as a base, and an average annual growth rate from the historical periods was applied to all forecast periods. It was assumed that any seasonality from the four years analyzed will continue. Based on the calculations, Mr. Kersey testified that purchased power costs were forecasted to increase by approximately 1% from \$290,042 in the base period to \$292,381 in the test year, including the forecasted reduction in usage.

Mr. Kersey explained that purchased water costs were forecasted by month based on respective levels of forecasted purchased water and water rates. He stated that forecasted purchased water rates of \$2.90 per thousand gallons were based on current charges by Petitioner's supplier, Indiana-American, of \$2.83 with an anticipated increase of \$0.07. He further stated that forecasted purchased water volumes were calculated based on an average of the prior 9-10 years of purchased water volumes, discounted by 1% annually. The 1% discount assumes both consumer conservation and changes in water losses. The volume used to calculate purchased water expense was based on pumped water and not sold water. Mr. Kersey stated that purchased water costs were forecasted to increase by approximately 12% from \$341,794 in the base period to \$381,398 in the test year. The increase is due to increased supplier rates and a one-time sales tax refund credited

to Petitioner in the base period in the amount of \$24,155.53 for the period ending December 31, 2013.

2. OUCC's Evidence. Ms. Stull disagreed with Petitioner's use of a year-over-year growth rate to forecast purchased power expense because she said it showed unusual fluctuations and inconsistencies among its assumptions. Ms. Stull proposed removal of \$2,339 in purchased power expenses and recovery based on Petitioner's fiscal year ending September 30, 2015. Additionally, she disputed Petitioner's growth rate projections for electric costs and suggested that Petitioner did not factor in its proposed declining consumption. She proposed no change to base year purchased power of \$290,042, which consists of \$77,830 for consolidated water and \$212,212 for consolidated wastewater.

With respect to purchased water expense, Ms. Stull disagreed with Petitioner's forecast. She said that purchased water expense should be comprised of a monthly meter charge and a volumetric charge; however, Petitioner's estimate did not incorporate a monthly meter charge. Additionally, she said that Petitioner proposed declining consumption for operating revenues but forecasted increased purchase water volumes as compared to base year levels. She said these two assumptions conflict. She stated that it was not necessary for Petitioner to forecast purchased water because Petitioner can file a water tracker for any increases in purchased water costs. Additionally, Ms. Stull said that Petitioner included forecasted costs to file a water tracker in 2017. Ms. Stull proposed a reduction of \$4,033 and further proposed a new forecasting method wherein separate metered and volumetric charges are utilized instead of using one effective rate.

3. Petitioner's Rebuttal. Mr. Kersey testified that Petitioner did not agree to the negative adjustment of \$2,339 to the purchased power expense. Mr. Kersey stated that Petitioner considered all aspects of electric cost trends in its proposed declining usage when forecasting for purchased power expense. He further stated that historical cost trends take all components into consideration, including weather impacts, cost changes by electric providers, and consumption changes by both Petitioner and its customer base.

With respect to purchased water expense, Mr. Kersey testified that while Petitioner agreed with the OUCC's proposed forecasting method, which included metered and volumetric charges, it did not agree to the negative adjustment of \$4,033. He explained that Petitioner's forecast for purchased water is based on a long-term average of purchased volume at 1% annually and not on purchased volumes in the base year. This accounts for the difference in proposal between the OUCC and Petitioner of 127,178,000 and 131,418,000 for purchased water volumes, respectively. He proposed an adjusted forecast for purchased water expense of \$380,353, which is an increase of \$2,988 to the OUCC's proposal but \$1,045 less than Petitioner's original proposal.

4. Commission Discussion and Findings. Petitioner calculated its forecasted purchased power expense by taking into account weather impacts, cost changes by electric providers, and consumption changes by Petitioner and its customer base. Petitioner's forecasted growth rates are based on the average year-over-year historical purchased power expense change. The OUCC argued that variations in the year-over-year growth rates for water and wastewater purchased power expense meant Petitioner's methodology was flawed. However, the record shows average growth rates are dependent on historical costs recognized in each of the service periods analyzed by Petitioner. Historical cost trends take into consideration all

components that historically changed costs, including weather impacts, cost changes by electric providers, and consumption changes by the utility and its customer base. We find Petitioner's forecasted purchased power expenses to be reasonable and should be approved. Purchased power expenses are \$78,115 for Petitioner's consolidated water operations and \$214,266 for Petitioner's consolidated wastewater operations, a base year increase of \$285 and \$2,054, respectively.

Further, the record shows that Petitioner updated its forecasted purchased water expense to account for the OUCC's proposed change in methodology. The revised purchased water expense properly included both metered and volumetric charges as agreed upon by Petitioner and OUCC. We find Petitioner's forecasted purchased water expense to be reasonable and is approved. Purchased water expense of \$380,353 is applicable to Petitioner's water operations, a base year increase of \$38,559.

### **B. Salaries and Wages Expense.**

1. OUCC's Evidence. Mr. Richard Corey, Utility Analyst with the OUCC, proposed removal of \$7,976 from salaries and wages expense that Petitioner proposed for its consolidated wastewater operations due to an incorrect expense recognition in Petitioner's general ledger trial balance for the fiscal year ending September 30, 2015.

2. Petitioner's Rebuttal. Mr. Kersey testified that Petitioner did not agree to the OUCC's proposed removal of \$7,976 from salaries and wages expense. He explained that one employee's cost was incorrectly booked to Petitioner's general ledger in its base year. However, Petitioner's forecast should not be adjusted because that employee was not included in the forecast of salaries and wages expense. He further explained that the forecast was calculated on an individual employee basis.

3. Commission Discussion and Findings. The record shows the salaries and wages expense was calculated on a per employee basis and based upon current and anticipated levels of staffing. The adjustment proposed by the OUCC failed to recognize that the employee's cost at issue was not included in Petitioner's forecast. Accordingly, the OUCC's proposed adjustment would cause salaries and wages expense to be understated. We thus find Petitioner's calculation of salaries and wages expenses to be reasonable. We find that Petitioner's salaries and wages expense is \$734,850, which includes \$443,699 for water operations, a \$77,257 base year increase, and \$291,151 for wastewater operations, a \$50,678 increase over base year.

### **C. Capitalized Labor.**

1. OUCC's Evidence. Mr. Corey explained that Petitioner's capitalized labor in the test year was calculated based on anticipated capital investments. He stated that the OUCC proposed removing the capitalized labor from Petitioner's Leadership/President cost center ("Leadership") and Indiana operations cost centers. Ms. Stull explained that Petitioner proposed capitalizing 50% - 90% of an employee's time in some instances. This includes the time of high-level managers. Ms. Stull said that the time of high-level managers is not typically capitalized in material amounts. Petitioner's employees do not perform the actual capital work because it is against corporate policy for an employee to enter a trench or confined space. Petitioner appears to be over-capitalizing time spent on capital projects, especially the time of management



employees. Ms. Stull proposed a total reduction to capitalized labor of \$42,307 for Petitioner's consolidated water operations.<sup>7</sup> The adjustment is comprised of \$24,183 to remove excessive capitalization of management time and \$18,124 of specific non-capital. For Petitioner's consolidated wastewater operations, Ms. Stull proposed a total reduction of capitalized labor of \$41,405 that includes \$6,052 for specific non-capital and \$35,353 for excessive capitalization of management time. The OUCC proposed capitalized labor and benefits of \$101,319 for consolidated water operations and \$66,484 for wastewater operations for capitalized labor.

2. Petitioner's Rebuttal. Mr. Kersey accepted the adjustment proposed by the OUCC to remove capitalized labor from Leadership and Indiana operation centers. Additionally, Mr. Kersey stated that because Petitioner agreed to remove certain projects (SCADA, Second Sludge-Storage Tank, and WWTP Headworks Upgrade) from its capital project forecast, it is necessary to remove the capitalized time associated with these projects. Mr. Kersey proposed to exclude capitalized labor of \$5,550 for consolidated water operations and \$45,787 for consolidated wastewater operations as shown on Rebuttal Schedule 6-E.

3. Commission Discussion and Findings. Petitioner agreed with the OUCC to exclude capitalized labor for Leadership and the Indiana operation center. We find it is appropriate to adjust the capitalized labor as agreed upon by Petitioner and the OUCC. We also agree with Petitioner's proposal to remove forecasted capitalized labor on projects that were eliminated. However, we note that Petitioner made an additional adjustment on its Rebuttal Schedule 6-E to include in capitalized labor time associated with the SCADA project and the WWTP Headworks Upgrade, both of which have been removed from rate base. Therefore, we deny Petitioner's rebuttal position, in part, and we find that Petitioner's forecasted capitalized labor expense is \$95,769 for the consolidated water operations and \$20,698 for the consolidated wastewater operations.

#### **D. Chemical Expense.**

1. Petitioner's Evidence. Mr. Kersey explained how forecasted chemical costs were determined. He testified that chemical costs were forecasted by month based on historical levels of chemical costs and usages. He further testified that, based on this evaluation, chemical expenses were forecasted to decrease from \$84,799 in the base period to \$80,790 in the test year, and the decrease was primarily due to projected decreases in consumption, which resulted in less need for chemicals.

2. OUCC's Evidence. Ms. Stull proposed an increase of \$4,009 to Petitioner's forecasted chemical expense of \$80,790 to eliminate Petitioner's forecasted decrease in consumption, which the OUCC rejected. Ms. Stull proposed using the 2015 base year chemical expense as the 2017 projected chemical expense to be consistent with the OUCC's recommendations regarding operating revenues.

3. Petitioner's Rebuttal. Mr. Kersey explained that Petitioner does not accept the OUCC's proposed increase of \$4,009 to Petitioner's original forecasted amount of

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<sup>7</sup> We note the OUCC also proposed a \$34,965 reduction to rate base associated with capitalized labor for DSIC leak repairs from April 2013 – May 2015.

\$80,790. Petitioner also does not accept the OUCC's removal of Petitioner's declining usage adjustment. Mr. Kersey explained that Petitioner revised its original forecasted amount of \$80,790 because Petitioner should not have originally relied on ERC to apportion forecasted expenses between water and wastewater. Accordingly, Petitioner's revised allocation is \$17,556 for water and \$63,235 for wastewater for a total of \$80,790 for chemical expenses.

4. Commission Discussion and Findings. The Commission previously approved Petitioner's proposed declining usage and customer normalization adjustments. Thus we reject the OUCC's proposal to remove that same adjustment. We find Petitioner's original forecasted amount of \$80,790 and the revised allocation are reasonable and supported by the evidence of the record. Therefore, we accept Petitioner's chemical expense of \$17,556 allocated to water operations and \$63,235 allocated to wastewater operations.

#### **E. Deferred Maintenance in Rate Base.**

1. Petitioner's Evidence. Mr. Kersey explained that forecasted Net Deferred Charges were adjusted to remove both Twin Lakes' and IWSI's loss of prudent abandonment of plant. Other adjustments to Net Deferred Charges include the incremental amortization of book assets and the addition of a forecasted tank inspection project in the Twin Lakes service territory. Petitioner decreased Net Deferred Charges for its consolidated water operations by \$331,393 and \$229,504 for its consolidated wastewater operations.

2. OUCC's Evidence. Ms. Stull opposed Petitioner's proposal to include deferred maintenance in its rate base. She said that Petitioner referred to these expenses as deferred charges. She explained that they represent maintenance costs that are amortized over the expected life of the deferred cost. She said that these costs do not represent an investment in utility plant and should not be included in rate base. Pub. Ex. 1 at 33. Ms. Stull noted Petitioner forecasted \$41,318 of water deferred charges and \$33,681 of wastewater charges as of September 30, 2017. She explained Petitioner's forecasted water deferred charges primarily consisted of deferred maintenance costs, including tank painting, volatile organic chemical testing, tank maintenance and repair, and sludge hauling. Ms. Stull also explained that Petitioner's wastewater deferred charges primarily consisted of deferred maintenance costs, including sludge hauling, tank maintenance and repair, and sewer master planning.

3. Petitioner's Rebuttal. Mr. Kersey noted that the OUCC did not propose any maintenance and repair adjustments in its case-in-chief testimony. Mr. Kersey explained that the well cleaning costs, filter media replacement, and well maintenance costs that the OUCC proposed to disallow from rate base should be set up as a net deferred charge component of rate base with a proposed recovery of these costs over a span of three years. Mr. Kersey explained that a three-year amortization period for well cleanings and rehabilitations is appropriate because the three-year period was chosen to reflect above normal corrosiveness of the water, which requires well reconditioning at an above normal frequency. Mr. Kersey further explained that without frequent reconditioning of Petitioner's wells, the risk of failure would increase and would result in otherwise unnecessary capital spending in the future.

4.- Commission Discussion and Findings. We find Petitioner's practice of capitalizing maintenance activities is inappropriate and violates proper accounting procedures and NARUC's USoA. Therefore, we have removed the costs associated with well cleanings and filter media replacement from Petitioner's rate base. However, these costs should be recovered through operating expense. The OUCC explained in its response to a February 3, 2017 Docket Entry that Petitioner's maintenance expense as detailed in Petitioner's work paper JPK-5 does not include any costs for well cleaning or filter media replacement. Pub. Ex. 8, Response 2. The OUCC agreed that well cleaning and filter media replacement costs should be recovered but disagreed with Petitioner's proposed amount and amortization period. The OUCC recommended an amortization period of five years for well cleaning costs and ten years for filter media replacement costs. The OUCC did not provide any explanation for its recommended amortization period of five years for the well cleaning costs. Petitioner, however, explained that a three-year amortization is necessary due to raw water quality. Thus, the Commission finds a three-year amortization for well cleanings is reasonable and supported by the evidence. Regarding filter media replacement costs, Petitioner proposed a three-year amortization period, while the OUCC recommended a ten-year amortization. Neither party provided an explanation in support of their proposed amortization period. Thus, the Commission finds that an average of the two proposed amortization periods should be used. Based on the foregoing, the Commission finds \$60,782 should be included in operating expense for the water utility maintenance costs.

Total Well Cleaning	\$164,320
Divided by: 3 years	<u>3</u>
Sub-total	<u>54,773</u>
Total Filter Media Replacement	39,060
Divided by: 6.5 years	<u>6.5</u>
Sub-total	<u>6,009</u>
<i>Total</i>	<u><u>\$60,782</u></u>

**F. Taxes Other Than Income Expense.**

1. Petitioner's Evidence. Mr. Kersey explained how taxes other than income taxes were determined. He explained that these expenses were forecasted to increase from \$380,465 in the base period to \$420,929 in the test year and that the adjustments were based on forecasted levels of salaries, revenues, and UPIS. He testified that Utility Commission Taxes were forecasted to increase from \$64,368 in the base period to \$73,589 in the test year, and the increase was calculated at 1.50% of revenue.

2. OUCC's Evidence. Mr. Corey proposed removing Petitioner's Utility Commission Taxes based on a rate of 1.5% and replacing it with the current rate of 1.4% rate for Utility Receipts Tax. He proposed including the IURC Fee expense based on the IURC fee rate of 0.1077802% that became effective on July 1, 2015, and reducing the forecasted payroll taxes in the amount of \$903, which he specifically related to the proposed salary reduction of \$7,976.

Ms. Stull proposed a reduction to Petitioner's forecasted property tax expense in the amount \$44,507 but agreed Petitioner's forecast method was appropriate. She said the OUCC's

property tax expense adjustment was solely related to the reductions to Petitioner's forecasted net utility plant balance.

3. Petitioner's Rebuttal. Mr. Kersey testified that he agreed to the adjustment methods used by the OUCC, but Petitioner does not agree to the payroll tax reduction of \$903. Mr. Kersey stated that because the OUCC's proposed \$7,976 salary adjustment was inappropriate, the associated \$903 payroll tax adjustment was also in error.

4. Commission Discussion and Findings. Because of our determination regarding salaries and wages expense above, the Commission rejects the OUCC's proposed reduction in forecasted payroll taxes of \$903. We find Petitioner's payroll tax expense to be \$40,145 for its consolidated water operations and \$26,343 for its consolidated wastewater operations. In addition, we find Petitioner's taxes other than income tax expense should be calculated using the current rates as of the filing date of Petitioner's Petition as follows: 1.4% Utility Receipts Tax rate and a 0.1077802% IURC Fee rate.

The record shows the OUCC agreed to Petitioner's forecast method for property expense. We find the methodology used by the parties to determine property tax expense to be reasonable. As a result of our previous determination regarding UPIS, the Commission finds property tax expense for Petitioner's consolidated water and wastewater utilities to be \$125,700, a \$35,149 decrease over base period, and \$140,604, a \$45,930 increase over base period, respectively. We further find property taxes shall be updated as part of Petitioner's Rate Base Update filing.

#### **G. Sales Tax Refund.**

1. OUCC's Evidence. Ms. Stull discussed an issue related to sales tax paid by IWSI. She explained that, until recently, IWSI paid sales tax on all water purchased from Indiana-American because IWSI neglected to file the necessary paperwork for the sales tax exemption. She said this was corrected when IWSI filed the proper paperwork in 2014. Petitioner received a \$24,156 refund from the Indiana Department of Revenue on November 6, 2014, and a \$29,040 credit from Indiana-American in July 2014. She explained that although IWSI revised its water tracker downwards in January 2015 to reflect this decrease in purchased water expense, the prior period amount of \$53,196 should be refunded or credited to IWSI customers who paid these taxes.

2. Petitioner's Rebuttal. Mr. Lubertozzi disagreed with the OUCC's proposal that sales tax refunds should be credited to customers. In his opinion, a Commission-ordered refund would be retroactive ratemaking. Mr. Lubertozzi also stated the OUCC's proposal would constitute a taking of utility property. Just as Petitioner's returns are not guaranteed, expenses are not guaranteed to stay the same, increase, or decrease. In other words, the test year represents a snap shot of expenses and revenues. Thus, the OUCC only identified one area in which expenses were lower than otherwise expected but ignored other instances in which expenses increased. Therefore, he argued, it is unreasonable in this instance to retroactively adjust rates to capture one issue while ignoring the rest.

3. Commission Discussion and Findings. The OUCC proposed requiring Petitioner to refund customers \$53,196 for refunds paid to Petitioner for sales tax in late

2014. The Commission previously authorized IWSI's revenue requirement, which included the recovery of projected sales tax on purchased water. Therefore, it would be unreasonable for the Commission in this Order to require Petitioner to refund to customers amounts previously authorized by the Commission and occurring outside of the adjustment period. The Commission finds that the OUCC's proposal is not an appropriate adjustment, and the Commission declines to direct Petitioner to refund sales tax amounts in this instance.

However, the Commission is troubled by the underlying issues here including Petitioner's failure to properly monitor its costs and to file its tax exemption form in a timely manner. We note that Petitioner needs to make improvements to its management oversight. The Commission requires Petitioner to make improvements in the section titled Internal Investigation and Use of Three-Way-Match Process herein.

#### **H. Depreciation Rates and Depreciation Expense.**

1. Petitioner's Evidence. John F. Guastella, President of Guastella Associates, LLC, performed a depreciation analysis of Petitioner's water and wastewater utility systems and recommended depreciation rates. He stated that Petitioner's water and wastewater systems are comprised of relatively small utilities that do not have sufficient retirement data readily available to perform either an actuarial or simulated plant balance method for determining average-service lives for his depreciation study. He said, therefore, he undertook a comparative analysis to establish appropriate average-service lives.

For his comparisons, Mr. Guastella looked at ten utilities, NARUC guideline depreciation rates, California Public Utilities Commission Standard Practice depreciation rates, and Florida Public Service Commission rules and regulations on depreciation rates. The most recent comparative depreciation study he performed was on behalf of Utility Services of Illinois, Inc., a sister company to Petitioner, in connection with a rate application to Illinois Commerce Commission. He noted he has prepared similar comparative studies, which were accepted in other jurisdictions in recent years. Mr. Guastella recommended a depreciation rate for individual plant accounts. Mr. Guastella did not present evidence showing how each recommended depreciation rate is reasonable based on Petitioner's actual assets.

Mr. Guastella described the comparative data he collected and identified the basis for the negative-net-salvage values used in his study. He testified that net-salvage-value is the salvage value of property retired less the cost of removal. Negative-net-salvage value occurs when the cost of retirement or removal exceeds gross-salvage value. He explained that to develop the relationship between original and current construction costs he used the ratio of the current-year Handy-Whitman Index ("Handy-Whitman") to the vintage-year index, which supports the use of negative-net-salvage values. The vintage years were determined by the number of years of the respective average-service life of Petitioner's water and wastewater systems. He said Handy-Whitman is commonly used in construction-cost comparisons like the one he prepared for Petitioner. Mr. Guastella testified that the average-service lives of Petitioner's systems he recommended are not only reasonable in general but are reasonable for determining depreciation rates for Petitioner.

2. OUCC's Evidence. Mr. Kaufman testified in opposition to Petitioner's proposal to dispense with the Commission's composite-depreciation rates to determine Petitioner's depreciation expense. Mr. Kaufman noted that in past cases Petitioner's various divisions have used the Commission's composite-depreciation rates for its water and wastewater utilities. However, in this case, Petitioner proposed to use depreciation rates on an account-specific basis, based on the results of Mr. Guastella's study. Mr. Kaufman explained that Mr. Guastella's estimated depreciation rates range from 1.47% for Lake, River, and Other Intakes to 14.29% for Back-Flow-Prevention Devices. Mr. Kaufman stated that Mr. Guastella's proposed depreciation rates are not based on the actual condition of Petitioner's plant. In fact, Mr. Kaufman noted, Mr. Guastella did not physically inspect the condition of Petitioner's plant.

Mr. Kaufman stated that Petitioner's alternative depreciation rates are not more reliable than the Commission's composite-depreciation rates. Mr. Kaufman explained that a water or wastewater utility has the option of relying on the Commission's composite-depreciation rate or conducting its own depreciation study. Mr. Kaufman explained that Mr. Guastella's study is not specific to the conditions in Indiana or Petitioner's plant. In the absence of a utility-specific depreciation study, Mr. Kaufman testified that the Commission's composite-depreciation rates should be used to determine depreciation expenses. Mr. Kaufman explained that Petitioner's proposed depreciation expense is 3.03% for its water operations and 2.79% for its wastewater operations compared to the Commission's composite-depreciation rates of 2.0% for a complete water system, 1.7% for a water system that purchases its water, 2.5% for a wastewater system with a treatment plant, and 2.2% for a wastewater system without a treatment plant.

Mr. Kaufman also rejected Mr. Guastella's use of negative-net-salvage value. He argued that Petitioner provided no documentation that Petitioner incurs the removal or dismantling costs indicated by Mr. Guastella's depreciation study. He added that including negative-net-salvage value attempts to recognize the current cost of dismantling and removing assets, such as structures, storage facilities, pumps, mains, and service laterals. He also stated that Mr. Guastella's examination of the relationship between original and current construction costs is not utility-specific and does not provide an accurate approach to estimate or infer negative-net-salvage values. Mr. Kaufman stated that if Petitioner's proposed negative-net-salvage values are removed from Petitioner's effective depreciation rates, Petitioner's depreciation rates would be reduced from 3.03% to 2.40% for water operations and from 2.79% to 2.12% for wastewater operations.

He explained that Petitioner's proposal to recognize negative-net-salvage value increases depreciation rates. Mr. Kaufman said that if negative-net-salvage values were removed from Petitioner's depreciation calculations, the annual depreciation expense for water operations would be reduced by \$82,443 to \$311,292 and the annual depreciation expense for wastewater operations would be reduced by \$136,459 to \$421,125. Mr. Kaufman noted that Mr. Guastella assumes a negative-net-salvage value ratio of 70% for Transmission and Distribution Mains and 100% for Services; however, utilities typically do not incur significant expenses to remove or dismantle these plant assets. He explained that when service lines are replaced, the retired plant is typically destroyed or left in the ground.

Mr. Kaufman disagreed with Mr. Guastella's assertion that Mr. Kaufman's evaluation confirms the reasonableness of the negative-net-salvage rates Mr. Guastella proposed. Mr.

Kaufman did not dispute that the cost to construct and install water utility plant has progressively become more expensive over the last 75-100 years, but he asserted Mr. Guastella's study did not provide a reasonable basis to estimate removal and dismantling costs. Mr. Kaufman added it is an inaccurate approach to estimate or infer negative-net-salvage rates.

Mr. Kaufman noted Mr. Guastella uses average-service life to calculate a multiplier of original cost to current cost. For example, Mr. Guastella assumes transmission and distribution mains have an average-service life of 70 years, a time span Mr. Kaufman did not dispute. Mr. Guastella then calculates a multiplier of current versus original cost by comparing the cost to install transmission and distribution mains 70 years ago to the cost of installing transmission and distribution mains using the 2015 Handy-Whitman, and this results in a cost multiplier of 25.96. Mr. Kaufman asserted that this approach is not reasonable. He said this relationship might make sense if the average age of Petitioner's transmission and distribution mains was 70 years. Hypothetically, if the average age of Petitioner's transmission and distribution mains is only 30 years old, the relationship of the cost of mains today compared to 70 years ago is irrelevant. Mr. Kaufman asserted this age-price relationship does not provide a reasonable basis to determine a negative-net-salvage value. Mr. Kaufman explained that Mr. Guastella calculates negative-net salvage-value multipliers that assume all of Petitioner's plant has an age equal to its estimated life. This type of analysis is inaccurate, and it overstates negative-net-salvage value multipliers and Petitioner's depreciation expense.

Mr. Kaufman asserted Mr. Guastella's estimate of the negative-net-salvage ratios will be the same for all water and wastewater utilities regardless of their actual age. Mr. Kaufman explained this type of analysis distorts estimated depreciation expense and overstates the cost of negative-net-salvage for newer plant. He explained that newer plant will have a higher construction cost than parts of a similar, older utility. Thus, using the same multiplier results in the newer utility having a higher estimated cost to remove the same plant. Mr. Kaufman stated there is no basis to estimate that it costs more to remove plant constructed in 2015 than plant constructed in 1990, which is the effect of Mr. Guastella's negative-net-salvage study. He asserted that the cost of removal, if there is any, should be the same for similar plant, regardless of the cost to install the plant that is being removed.

Mr. Kaufman noted that approximately \$218,900 of Petitioner's proposed depreciation expense relates to its estimated negative-net-salvage. To ensure that these funds are available for plant removal, funds collected for negative-net-salvage should be segregated in a separate account to pay for future removal costs. Petitioner should then be required to track its actual costs for removal and dismantling as those costs are incurred. Petitioner can use the funds in the separate account to pay for the actual cost of removal.

3. LOFS's Evidence. Mr. Theodore Sommer, a Partner with London Witte Group, LLC, testified on behalf of LOFS and disagreed with the depreciation study performed by Mr. Guastella. Mr. Sommer agreed that there are cost savings associated with doing a desk analysis of the plant that Petitioner has on its books, but he questioned the accuracy of Mr. Guastella's result and testified Petitioner's proposed depreciation study should not be accepted.

Regarding Petitioner's proposed negative-net-salvage values, which are embedded in its proposed depreciation rates, Mr. Sommer explained that the cost of removal must represent an accurate estimate of the actual cost to remove an asset. He stated that Mr. Guastella relied on the net-salvage values established some years ago to determine the costs of removal, but Mr. Sommer explained that current technology includes the in situ method, which is likely more appropriate given the character of Petitioner's system.

Mr. Sommer testified that the in situ method, which repairs assets in place, eliminates the cost of removal for some collection and transmission lines. Mr. Sommer referenced the pipe-bursting method of gravity wastewater main remediation and how it was applied to 2,200 linear feet of main in the Twin Lakes system. Mr. Sommer testified that his understanding is that the pipe-bursting method allows for a replacement of existing pipe without removing any of the old pipe. Mr. Sommer stated that Petitioner's system contains a great deal of mains that contain asbestos, which suggests that the in situ method for replacement of mains in Petitioner's system is appropriate. Mr. Sommer concluded that Mr. Guastella's use of negative-net-salvage rates that did not consider the impact of new technology would result in depreciation rates that are too high. He recommended that the Commission reject Mr. Guastella's depreciation study.

4. Petitioner's Rebuttal. Mr. Kersey testified that, while Petitioner agreed to recalculate depreciation expense based on UPIS as of February 29, 2016, and September 30, 2017, it did not agree to the continued use of the Commission's composite rates. Mr. Kersey stated that not only are the Commission's composite rates outdated, they prevent Petitioner from earning its authorized return. He testified that the composite rates are outdated because they were adopted approximately 30 years ago and do not accurately reflect the greatly changed industry landscape. He further testified that the Commission's composite rates do not allow Petitioner to adjust depreciation rates for assets that are not held on its books. He stated that if the Commission is going to reject the depreciation rates proposed, Petitioner must be allowed to re-establish plant values for such short-lived assets. Mr. Kersey provided tables showing the impact of re-establishing these plant values for both water and wastewater. Table 6 reflects a Net- Gross Plant-in-Service adjustment amount of \$408,744 for consolidated wastewater operations as of September 30, 2017. Table 4 reflects a Net-Gross Plant-in-Service adjustment amount of \$691,023 for consolidated water operations as of September 30, 2017.

Mr. Guastella also responded to Mr. Kaufman and Mr. Sommer. He stated that their criticisms do not reflect reasonable assessments of his study or his comparative analysis, which used a methodology that has been accepted by utility regulatory jurisdictions throughout the country for thousands of small water and wastewater utilities. He said their criticisms also do nothing to support the continued use of the fixed-composite depreciation rates.

Mr. Guastella testified that the application of a composite-depreciation rate is the least-preferred method of satisfying the purpose of depreciation, namely, intergenerational equity. He testified that an arbitrary 2% composite-depreciation rate for a water system is the least-accurate way to determine depreciation expense as compared with any of the other methods used to estimate the most likely average-service life of each asset. Mr. Guastella explained that the percentages for net salvage that he recommended reflect reasonable estimates that result in depreciation rates to achieve intergenerational equity. He said failure to include net salvage at all is not reasonable. Mr.



Guastella also stated that Mr. Kaufman's recommendation that the funds collected for negative-net-salvage be segregated in a separate account was unnecessary and speculative.

Mr. Guastella concluded that both Mr. Kaufman and Mr. Sommer recommended the continued use of composite-depreciation rates that were apparently established 28 years ago for water systems and 32 years ago for wastewater systems. He said neither Mr. Kaufman nor Mr. Sommer showed how the composite rates were calculated for the utilities under consideration and if plant data was used. He added that both witnesses focused on their assumptions of the physical condition of certain assets, apparently absent any recognition of such other causes of depreciation such as obsolescence and changes in regulatory requirements. He said that on the basis of the magnitude of those composite rates, it is likely that they do not reflect any consideration of net-salvage values. He said Mr. Kaufman and Mr. Sommer offered no opinion as to the reasonableness of the depreciation rates for individual accounts that he recommended. Mr. Guastella concluded that the depreciation rates for individual accounts that he recommended have been generally accepted and are considerably more accurate than the Commission's composite rates, and most importantly, best accomplish the goal of intergenerational equity.

5. Commission Discussion and Findings. Depreciation allows utilities to recover the original cost of assets that are used and useful in providing service at a level that spreads recovery of the cost over the estimated life of assets. As a result, each generation of customers pays its fair share of cost according to their use of the assets.

NARUC in its Uniform System of Accounts for Class A Water Utilities, published in 1996, defined depreciation as:

Depreciation, as applied to depreciable utility plant, means the loss in service value not restored by current maintenance, incurred in connection with the consumption or prospective retirement of utility plant in the course of providing service from causes which are known to be in current operation and against which the utility is not protected by insurance. Among the causes to be given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand, and requirements of public authorities. Pet. Ex. 5 at 2.

The Commission has the responsibility pursuant to Ind. Code § 8-1-2-19 to ascertain and determine the proper and adequate rates of depreciation of the several classes of property of each public utility. Historically, the Commission's composite rate is used, unless the Commission decides that a utility's proposed rate schedule is more proper and adequate for the public utility's property.

The Commission is presented with two options to determine the appropriate depreciation expense for Petitioner: (1) Accept Petitioner's proposed depreciation rates, which designate a depreciation rate for each individual plant account and include an embedded cost of removal and salvage value; or (2) Re-approve Petitioner's use of the Commission's composite rates for water and wastewater utilities in Indiana.

We previously addressed applicable depreciation rates for Petitioner's Twin Lakes division. In Cause No. 43957, the Commission rejected Petitioner's proposed depreciation rates wherein Petitioner proposed to change the depreciation rates for only vehicles and computer equipment and software systems, explaining that the Commission's composite rate takes into consideration the total plant. *Twin Lakes Utilities, Inc.*, 2012 WL 641631, Cause No. 43957 at p. 21 (IURC Feb. 22, 2012). The Commission in its Order directed Petitioner to use the Commission-developed depreciation rates for water and wastewater and "if Petitioner believes that a composite rate provides inaccurate information, it should have conducted and submitted for Commission approval its own depreciation study to more accurately reflect the expense." *Id.*

To be approvable, Petitioner's proposed depreciation rates need to be proper and adequate per the statute and *more accurately reflect the expense* for depreciation than the Commission-developed depreciation rates. Therefore, we consider what constitutes an approvable depreciation study and resulting rates, and we begin our analysis by comparing a previous Commission-approved depreciation study to Petitioner's study. We then consider evidence regarding whether Petitioner's proposed rates more accurately reflect Petitioner's depreciation expense. If Petitioner's proposed rates do not more accurately reflect depreciation expense, we must re-approve the Commission's composite rates.

For instance, the Commission approved the use of Indiana-American Water's proposed depreciation rates rather than the Commission's composite rates in Cause No. 43081. *Indiana-American Water Co. Inc.*, 2006 WL 3877352, Cause No. 43081 (IURC Nov. 21, 2006). Indiana-American provided the testimony of Mr. John J. Spanos of Gannett Fleming, Inc. who explained his depreciation study. Regarding the thoroughness of his study, Mr. Spanos filed an approximately 300-page report that included annual and accrued depreciation, the statistical support for the life and net-salvage values, and the detailed tabulation of annual and accrued depreciation for water plant and a much shorter report for wastewater plant, primarily based on the depreciation study for the water plant. Importantly, he also indicated that he physically observed the condition of Indiana-American's plant and equipment. Mr. Spanos used his extensive experience to determine service lives and net-salvage values, and he discussed these issues with Indiana-American personnel. Pet. Ex. JJS-1 at I-4.

Unlike the Indiana-American study above, Mr. Kaufman testified that Petitioner's study was not based on a depreciation study specific to the actual condition of Petitioner's plant. Petitioner retained a consultant to prepare a depreciation *comparative* analysis by individual plant account but not a study of Petitioner's actual assets. In the Indiana-American study, their consultant observed the condition of the plant and equipment; however, Mr. Guastella did not inspect Petitioner's plant and equipment. Additionally, Indiana-American's consultant discussed the service lives and net-salvage values of the plant with Indiana-American personnel, and Mr. Guastella said that he did not do this. We conclude that there are significant differences between Indiana-American's approved study and Mr. Guastella's study and these differences indicate that Mr. Guastella's proposed rates are less likely to be more accurate for Petitioner's plant than the Commission's composite rates.

Mr. Guastella's argument for providing a comparative-depreciation study instead of a full-depreciation study is because, in part, he lacked sufficient data to complete a full-depreciation

study or to provide actual costs incurred for retirements and removals. Mr. Guastella testified that Petitioner has not experienced sufficient retirements to perform either an actuarial or simulated-plant balance method for determining average-service lives. However, Mr. Guastella did not provide detailed evidence supporting his recommended rates by individual plant account. Petitioner's lack of data does not justify using unsupported depreciation rates rather than the Commission's composite-depreciation rates.

Mr. Guastella also testified that the Commission's composite rates are outdated because they were developed approximately 30 years ago and do not accurately reflect the greatly changed industry landscape. However, Mr. Guastella's statement was conclusory, and he did not provide detailed evidence to specifically show how the rates are outdated or how the industry landscape in Indiana has changed. Accordingly, we are unconvinced that Mr. Guastella's proposed rates, albeit developed more recently, are more accurate than the Commission's composite rates.

Mr. Guastella testified that he prepared similar comparative studies for utilities in other states and his studies were accepted by those jurisdictions. Mr. Kaufman explained that Mr. Guastella's study is not specific to the conditions in Indiana or to Petitioner's plant. Mr. Guastella did not provide evidence to show that conditions such as typical plant age, types of plant, and terrain in Indiana are similar to conditions in the states that approved Mr. Guastella's rates. The fact that other states approved Mr. Guastella's composite-depreciation rates is not evidence that the rates are more accurate for Petitioner's utilities in Indiana than the Commission's composite rates.

As a component of its proposed rates, Mr. Guastella embedded net-salvage values, and we now consider whether inclusion of net-salvage values could possibly increase the accuracy of Petitioner's proposed rates. By including net-salvage values in rates, Petitioner is attempting to recover the current cost of dismantling and removing assets like structures, storage facilities, pumps, and other facilities and selling those assets for salvage value. Mr. Guastella did not produce any evidence of the actual cost to remove any plant or equipment for his proposed net-salvage value. Mr. Kaufman also noted that in Indiana, when transmission and distribution plants are replaced, the retired plant is typically destroyed or left in the ground. Mr. Guastella offered no evidence that explains the common practices in Indiana regarding removal or abandonment of obsolete assets and how those practices support Petitioner's proposed net-salvage rates. Petitioner acknowledged in response to discovery by the OUCC, Petitioner does not separately track actual costs to remove retired assets, thereby preventing further review. The Commission finds there is insufficient evidence to support use of Petitioner's proposed net-salvage values as a component of their proposed depreciation rates because we are not convinced of the accuracy for Petitioner's plant.

Our inquiry above indicates that Petitioner's proposed rates are not more accurate than the Commission's composite rates for calculating the depreciation expense applicable to Petitioner's plant. Additionally, because Petitioner embedded net-salvage values into its depreciation rates and we do not accept the accuracy of Petitioner's net-salvage values, we cannot accept Petitioner's depreciation rates. The Commission finds that Petitioner's proposed study does not more accurately reflect Petitioner's expense for depreciation. Using the Commission's composite rates

based on the depreciable plant, the Commission finds the following depreciation expense adjustments to be reasonable, subject to the Rate Base Update Mechanism discussed herein:

	Water	Wastewater
	2017	2017
Utility Plant in Service	\$ 13,608,704	\$ 19,272,140
Less: Land and Land Rights	114,404	155,076
Depreciable UPIS	13,494,300	19,117,064
Times: Composite Depreciation Rate	2.00%	2.50%
Pro forma Depreciation Expense	269,886	477,927
Less: Base Year Depreciation Expense	352,735	492,427
Pro forma Adjustment	\$ (82,849)	\$ (14,500)

Rejecting Petitioner’s proposed depreciation rates leaves this Commission with the issue of re-establishing plant values for short-lived assets, which are still in service but have no book value. We agree and accept Mr. Kersey’s proposed re-establishment of plant values for short-lived assets that are in service but have no book value. As a result, Net-Gross Plant-in-Service is increased to \$408,744 for the consolidated wastewater operations and \$691,023 for the consolidated water operations.

**I. Maintenance and Repair Expense.**

1. Petitioner’s Evidence. Mr. Kersey stated that maintenance and repair expense were forecasted based on an evaluation of historical data and estimated operations. Mr. Kersey stated that Petitioner forecasted an increase from base year maintenance and repair expense of \$129,797 to test year expense of \$189,009. Mr. Kersey explained maintenance and repair expense consisted of: (1) deferred maintenance, (2) sewer rodding, (3) sludge hauling, (4) permits, (5) uniforms, and (6) other.

2. OUCC’s Evidence. Ms. Stull accepted Petitioner’s projected maintenance and repair expense as presented in its case-in-chief testimony. However, Ms. Stull proposed the removal from rate base of costs that were capitalized in error and stated that, to the extent the costs removed should be considered a recurring operating expense and were not already included in test year operating expense, she proposed an adjustment to maintenance and repair expense as appropriate. The \$171,845 of water rate base costs eliminated by Ms. Stull consisted of well cleaning, rehabilitation costs, and filter media maintenance. The costs eliminated were incurred during 2011 through 2015. The \$4,222 of wastewater rate base costs eliminated by Ms. Stull consisted of repair costs, tree removal, and renewal of a National Pollutant Discharge Elimination System land application permit. The costs eliminated were incurred during 2013 through 2015.

3. Petitioner’s Rebuttal. Mr. Kersey noted that no maintenance and repair expense adjustments were proposed by the OUCC. Mr. Kersey asserted that Ms. Stull goes so far as to clarify that the OUCC proposed an adjustment for operating expense based on the transactions it proposes to exclude in Public’s Exhibit No. 1; however, no adjustment to operating expenses was made by the OUCC. Mr. Kersey explained Petitioner believes the costs Ms. Stull removed from rate base should be amortized over three years, which would result in additional forecasted

maintenance amortization expense. Mr. Kersey stated that Attachment JPK-R2 of Petitioner's Exhibit R2 breaks down Ms. Stull's proposed rate base adjustment for non-allowed costs between costs which Petitioner believes should remain capitalized and those that should be amortized. Mr. Kersey stated the total amount of incremental amortization per year proposed by Petitioner is \$42,567 (\$127,700/3). Mr. Kersey explained the three-year amortization period proposed by Petitioner was chosen to reflect the above-normal corrosiveness of the water, which requires well reconditioning at an above-normal frequency.

4. Commission Discussion and Findings. Petitioner's proposed annual maintenance and repair expense of \$189,009 as of September 30, 2017 included \$34,710, which represented periodic maintenance costs that are not incurred on an annual basis. The \$34,710 of periodic maintenance expense represents the amortization of deferred charges Petitioner proposed in rate base. Because the parties agreed to the initial maintenance and repair expense adjustments proposed by Petitioner in its case-in-chief testimony, we will limit our discussion to the adjustments proposed by Petitioner in its rebuttal case, which represent the annual amortization of non-capital costs Ms. Stull removed from Petitioner's rate base. First, we note Mr. Kersey misstates Ms. Stull's testimony regarding the need for adjusting entries. Mr. Kersey states that Ms. Stull went so far as to clarify that the OUCC is proposing an adjustment to operating expense based on the transactions the OUCC proposed to exclude in Attachment MAS-4. However, Ms. Stull's actual testimony was, "To the extent the costs I remove should be considered a recurring operating expense and that operating expense is not already included in test year operating expenses, I propose an upward adjustment to maintenance and repair expense *as appropriate*." Pub. Ex. 1 at 23. Ms. Stull did not make any additional adjustments to maintenance and repair expense, and therefore, must have determined that no further adjustments were appropriate. Having reviewed the evidence before us, we agree with Ms. Stull and find that Petitioner's forecasted maintenance and repair expense is \$189,008, of which \$48,864 represents water operations maintenance and repair expense and \$140,144 represents wastewater operations maintenance and repair expense.

J. Authorized Operating Expense. Based on the above, the Commission finds Petitioner's pro forma present rate water and wastewater operating expenses for the 12 months ending September 30, 2017, are \$1,801,004 and \$1,820,752, respectively.

11. Net Operating Income at Present Rates.

A. Water Utility's Net Operating Income under Present Rates. Based on the evidence and the determinations made above, the Commission finds Petitioner's water utility adjusted forecasted operating results under present rates are as follows:

	Water
Operating Revenues	\$ 1,990,826
O&M Expense	918,268
General Expenses	448,200
Depreciation Expense	269,886
Amortization Expense	9,784
Taxes Other Than Income	193,577
Federal Income Taxes	(33,993)
State Income Taxes	(4,717)
Total Operating Expenses	1,801,004
Net Operating Income	<u>\$ 189,822</u>

We further find that the net operating income available to Petitioner for return under its present rates for consolidated water utility service of \$189,822 is insufficient to provide a fair return on the fair value of its properties used and useful in providing water service for the convenience of the public, and is therefore unjust and unreasonable and shall be increased.

**B. Wastewater Utility's Net Operating Income under Present Rates.** Based on the evidence and the determinations made above, we find Petitioner's wastewater utility adjusted forecasted operating results under present rates are as follows:

	Wastewater
Operating Revenues	\$ 2,273,738
O&M Expense	711,329
General Expenses	295,327
Depreciation Expense	477,927
Amortization Expense	19,612
Taxes Other Than Income	198,727
Federal Income Taxes	97,175
State Income Taxes	20,656
Total Operating Expenses	1,820,752
Net Operating Income	<u>\$ 452,986</u>

We further find that the net operating income available to Petitioner for return under its present rates for wastewater utility service of \$452,986 is insufficient to provide a fair return on the fair value of its properties used and useful in providing wastewater service for the convenience of the public, and is therefore unjust and unreasonable and should be increased.

12. **Authorized Rate Increase.**

A. **Water Utility.** The Commission finds Petitioner is permitted to increase its water rates and charges by 37.53% to produce additional operating revenue of \$734,268, total annual operating revenues of \$2,725,095, and net operating income of \$635,930 as depicted below:

	Total
Operating Revenues	\$ 2,725,095
O&M Expense	918,268
General Expenses	451,538
Depreciation Expense	269,886
Amortization Expense	9,784
Taxes Other Than Income	203,817
Federal Income Taxes	195,820
State Income Taxes	40,052
Total Operating Expenses	2,089,165
Net Operating Income	\$ 635,930

The determinations in the preceding table reflect the effect of additional revenue on federal and state income taxes, Utility Receipts Tax, Bad Debt Expense, and the IURC Fee.

The calculation of Petitioner's water utility authorized percent increase subject to the Rate Base Update Mechanism described herein is depicted below:

	Total
Original Cost rate Base	\$ 7,778,960
Times: Weighted Cost of Capital	8.175%
Net Operating Income Required for Return on Rate base	635,930
Less: Adjusted Net Operating Income	189,822
Net Revenue Requirement	446,108
Gross Revenue Conversion Factor	164.594545%
Recommended Revenue Increase	\$ 734,268
Recommended Percentage Increase	37.53%

B. **Wastewater Utility.** The Commission finds Petitioner is permitted to increase its rates and charges by 14.82% to produce additional operating revenue of \$336,266, total annual operating revenues of \$2,610,004, and net operating income of \$657,285 as depicted below:

	Total
Operating Revenues	\$ 2,610,004
O&M Expense	711,329
General Expenses	296,856
Depreciation Expense	477,927
Amortization Expense	19,612
Taxes Other Than Income	203,417
Federal Income Taxes	202,420
State Income Taxes	41,158
Total Operating Expenses	1,952,719
Net Operating Income	\$ 657,285

The determinations in the preceding table reflect the effect of additional revenue on federal and state income taxes, Utility Receipts Tax, Bad Debt Expense, and the IURC Fee.

The calculation of Petitioner's wastewater utility authorized percent increase subject to the Rate Base Update Mechanism described herein is depicted below:

	Total
Original Cost rate Base	\$ 8,040,181
Times: Weighted Cost of Capital	8.175%
Net Operating Income Required for Return on Rate base	657,285
Less: Adjusted Net Operating Income	452,986
Net Revenue Requirement	204,300
Gross Revenue Conversion Factor	164.594540%
Recommended Revenue Increase	\$ 336,266
Overall % of Revenues Subject to Increase	14.82%

**C. Ultimate Finding.** Based on the evidence and giving appropriate weight to the need for Petitioner to discharge its public duties, the Commission finds that the rates authorized above, subject to Rate Base Update Mechanism described herein, are just and fair and should allow Petitioner the opportunity to earn a reasonable return on its property dedicated to providing water and wastewater utility services to the public.

**13. Other Tariff Issues and Non-Recurring Charges.** In compliance with the Commission's Order in Cause No. 44587, Petitioner clarified the tariff language of the WSCI division's wastewater reconnection fee to match the Twin Lakes division's description. Also, to achieve synchronization of non-recurring charges, Petitioner increased the Twin Lakes division's



wastewater reconnection fee from \$25 to \$37.50 to match the WSCI division's reconnection fee, and Petitioner increased its new customer charge from \$20 to \$25 to match the WSCI and IWSI divisions' new customer charge. The OUCG agreed with these changes. Accordingly, the Commission finds these changes comply with the Commission's Order in Cause No. 44587, and are approved.

**14. Internal Investigation and Use of Three-Way-Match Process.**

**A. Internal Investigation of Contractor Invoices.**

1. Petitioner's Supplemental Evidence. Mr. Lubertozi testified regarding Petitioner's internal investigation into invoices from CS&W. He explained that while preparing portions of Petitioner's rebuttal testimony Petitioner engaged in an internal investigation after he and Mr. Kersey discovered issues with CS&W invoices. Mr. Lubertozi testified that the answers provided by Petitioner's operations management regarding the invoices were vague and untimely. After a series of questions, one of Petitioner's then-current employees admitted that certain of these invoices were prepaid and that work for these prepaid invoices was either not started or not completed. Mr. Lubertozi stated that based on this information, he contacted Utilities, Inc.'s CEO, Ms. Lisa Sparrow, regarding his concern about possible fraud. The resulting investigation was conducted by Ms. Sparrow and Mr. John Stover, General Counsel and Corporate Secretary of Utilities, Inc., and Petitioner's Vice President.

Petitioner engaged in an internal investigation that involved physical inspection or auditing of invoices related to hard assets in four phases. Phase Two was a random sample of capital invoices, and it revealed that one invoice, CS&W Invoice No. 4018, had been prepaid for work that had not been started. Mr. Lubertozi explained that, due to this inconsistency, Petitioner engaged in Phase Three of the investigation, which consisted of a physical inspection of all CS&W invoices over \$10,000 from 2012 to present. While Phase Three revealed no inconsistencies, Petitioner again expanded the scope of the audit to include additional invoices in Phase Four. Phase Four revealed no inconsistencies.

Mr. Lubertozi testified that the internal investigation identified nine invoices covering approximately \$230,000 of capital projects that had been invoiced, but the work had either not been started or not been completed. The invoices were issued at the request of Petitioner's former employee, who then falsely receipted them for payment. Additionally, the investigation did not reveal a widespread issue and showed that only Indiana customers were impacted.

He testified that Petitioner completely removed the impact of the prepaid invoices from its rate filing and prepared updated schedules reflecting the corrections Petitioner identified. Mr. Lubertozi further testified that Petitioner intends to provide bill credits for the over-collection associated with its sewer infrastructure charge approved in Cause No. 44646. Additionally, the investigation revealed that the former employee falsely reported the status of certain projects in the January and July 2015 semi-annual reports filed in Cause No. 44388. Petitioner will file corrected semi-annual reports to address the investigation's findings.

Mr. Kersey testified regarding Petitioner's internal investigation. He provided detailed explanations of the adjustments Petitioner made to remove the impact of the prepaid \$230,000 capital projects invoices that were discovered during the internal investigation. Mr. Kersey explained that Petitioner proposed a pro forma rate base reduction of \$246,394 to account for the prepaid invoices. He discussed in detail the steps used by Petitioner to calculate this adjustment. He further testified that Petitioner compared its pro forma proposed wastewater revenue requirement in its case-in-chief to its revised revenue requirement to calculate a reduction of \$32,497 or 1.15% in Phase II rates, and a \$32,483 or 1.17% reduction in Phase I rates, because of the investigation. Mr. Kersey said that Petitioner takes all allegations of fraud very seriously and Petitioner will take steps to remind all employees of Utilities, Inc.'s Code of Business Conduct and Ethics Policy.

2. OUCC's Supplemental Evidence. Mr. Parks testified regarding OUCC's investigative field review of invoices. Mr. Parks testified that he identified four invoices from late 2011 wherein CS&W invoiced for work at manholes and he found no on-site evidence that the work was performed. Mr. Parks testified regarding his site visit, and he referenced his detailed analysis of invoices in Table 2 of his supplemental testimony.

Ms. Stull outlined Petitioner's internal investigation process and stated that Petitioner's internal inquiry was insufficient to find all instances where Petitioner paid for work that was not completed. Ms. Stull stated that her concerns included: (1) the limited time-period reviewed, (2) the insufficiency of the review conducted, and (3) the lack of further investigation or verification of information provided by Petitioner's terminated employees and CS&W.

Ms. Stull used the OUCC's field review of CS&W manhole work as an example of the insufficiency of Petitioner's investigation. Ms. Stull further testified that she had concerns regarding the lack of further investigation or verification of information provided by Petitioner's terminated employees and CS&W, specifically the lack of verification that no one benefitted financially from the improperly paid invoices. Ms. Stull ultimately testified that, while she agreed that the adjustments proposed by Petitioner in its supplemental testimony were necessary, she did not agree with Petitioner that the Commission should conclude that Petitioner's problems were limited to the invoices and issues uncovered during its internal investigation.

3. LOFS's Evidence. Mr. Richard Cleveland, Community Manager of LOFS, addressed Petitioner's internal investigation. Mr. Cleveland testified that it was alarming that Petitioner's management and culture allowed for a trusted supervisory employee to engage in dishonest behavior that, if left undiscovered, likely would have resulted in customers paying for work that was never done. Mr. Cleveland expressed concern that this latest incident raises questions about Petitioner's management like those raised by the Commission in its Order in Cause No. 43957. In that Cause, the Commission analyzed Twin Lakes' longstanding history of service quality deficiencies and noted "an apparent lack of continuity among the individuals operating Twin Lakes, which we consider an obstacle to meaningful improvement." Cause No. 43957, Order at 24. Mr. Cleveland testified that after Employees A and B were terminated because of the latest incident, he was notified that Mr. Charles Alexander resigned. Mr. Alexander served in a supervisory capacity over the operations personnel assigned to the system that serves LOFS.

4. Petitioner's Rebuttal. Mr. Lubertozzi responded to the OUCC's criticisms of Petitioner's internal investigation. He emphasized the seriousness with which Petitioner took the investigation and the speed at which Petitioner instituted its investigation upon being made aware of a potential problem. He again discussed the four-phase process constituting the internal investigation and described the inquiries that took place at each stage. He stated that Petitioner confirmed that some of the work referenced by Mr. Parks was actually completed; thus, the OUCC's investigation identified only two invoices that had not been previously identified by Petitioner. He further stated that using three different methods, Petitioner confirmed that some work identified in Mr. Parks's Table 2 was also completed. He concluded that Mr. Parks's thorough review in large part confirmed Petitioner's conclusions.

5. Commission Discussion and Findings. While the OUCC criticized the scope of Petitioner's investigation and its decision to only review invoices since 2012, the record shows that Petitioner began its investigation with a scope intended to uncover whether additional invoices and work were questionable. Based on the findings of that initial phase, Petitioner expanded its review, both in terms of the period reviewed and the dollar amount of the audited invoices. Petitioner expanded its investigation into Phases Three and Four to gain greater certainty that it had identified the reasonable scope of the potential issues. The investigation involved both financial auditing and physical inspections. The record shows that in a handful of instances, it was not always feasible or easy to physically inspect and confirm that certain work was done. Further, while the OUCC performed an exhaustive review of Petitioner's records and engaged in substantial discovery, it only identified two additional invoices that had not already been identified in Petitioner's investigation. Both invoices were dated prior to January 2012. Given the passage of time, the Commission finds the scope of invoices and years considered in Petitioner's review to be reasonable.

We note that Petitioner appropriately removed approximately \$230,000 of capital projects that had been invoiced but the work had either not been started or not been completed. Petitioner also acted promptly to provide bill credits for the over-collection associated with its sewer infrastructure charge approved in Cause No. 44646. We find Petitioner's remedial financial actions to be reasonable and prudent under the circumstances.

**B. Use of Three-Way-Match Process.**

1. OUCC's Evidence. Mr. Parks testified that Petitioner's three-way match process for matching purchase orders, receipts, and invoices was ineffective because it allowed payments to be made to contractors when work was not performed, allowed payment of inflated invoices for both North and South GSTs, and allowed inflated invoices to be paid for other sewer repair work. He further testified that Petitioner's three-way match permitted these things to happen because the process allowed a single Petitioner employee to control or influence all parts of the three-way match. He stated that Petitioner's processing of the prepaid sewer repair invoices also caused him concern. He stated that Petitioner's management and accounts payable failed to question year-end clustering of the prepaid invoices and other characteristics that would make the invoices suspect. Mr. Parks further stated that while Petitioner claimed that its investigation uncovered pre-billing for only nine 2015 invoices, the OUCC found additional invoices that were questionable.

Ms. Stull testified that Petitioner maintained insufficient internal controls and undue reliance on the three-way match process. She further stated her concerns regarding Petitioner's internal management controls, including its lack of an internal auditor position, lack of segregation of duties with respect to its internal control procedures, and lack of adequate cost control measures. Ultimately, Ms. Stull recommended that the Commission order Petitioner to evaluate its internal controls and accounting procedures.

2. Petitioner's Rebuttal. Mr. Lubertozi testified regarding Petitioner's three-way match process. He said the three-way match process is a payment verification technique used to ensure that all purchases have been approved or authorized and that payments to contractors are complete and accurate. The matches refer to the comparison of the purchase order to the contractor's invoice and a confirmation that the goods or services are received. After the third step, the contractor's invoice is paid. He explained that a significant amount of Petitioner's capital spending relates to capital projects that are reviewed by a Capital Projects Review Team ("Projects Team"). Mr. Lubertozi said due to Petitioner's organizational structure and Projects Team, there are instances when purchase orders are created after the order has been requested or placed with the contractor. He stated that while this may not coincide with the three-way match best practice, the goal of the three-way match was achieved as well as the overall integrity of the process.

Mr. Lubertozi further testified that Petitioner is not opposed to hiring an internal auditor, as the OUCC suggested; however, he is not convinced that an internal auditor would have uncovered the prepayment situation. He said no audit or auditor could detect all instances of potential fraud. Mr. Lubertozi further questioned whether the benefits of hiring a dedicated internal auditor would outweigh the costs. He pointed out that the OUCC had not included any salary and benefit expense in its schedules for this new employee.

3. Commission Discussion and Findings. The OUCC was critical of Petitioner's operations because of its three-way match process and its failure to prevent payment on several occasions of invoices for work that was not performed, and we agree with the OUCC's assessment of this issue. Petitioner has in place a three-way match process to ensure that all purchases have been approved or authorized and that payments to contractors are complete and correct. However, on several occasions, a single employee was responsible for multiple parts of the three-way match, and this defeated the purpose of the three-way match. A three-way match wherein multiple matches and approvals are conducted by the same person cannot prevent fraudulent activities. We also note that the OUCC initially detected the fraudulent invoices, and not Petitioner. We agree with the OUCC that Petitioner's past three-way match process was insufficient because it did not include a division of duties among multiple people or measures to prevent payment for unperformed work. Although we understand that Petitioner has a small number of local staff, it is important that Petitioner creates a division of duties within its three-way-match process to ensure that contractor invoices are accurate.

While Petitioner did not oppose hiring a full-time internal auditor as recommended by the OUCC, the Commission finds such a requirement to be insufficiently supported at this time, particularly given the additional expense that would be incurred to employ an auditor. Pet. Ex. R1 at 7 (identifying annual revenue requirement of \$74,754 for an Internal Auditor I position). Most importantly, a proper three-way match process, which includes a division of duties, would

eliminate the need to hire a full-time internal auditor to monitor accuracy and adequacy of contractor invoices and payments to contractors.

Regarding Petitioner's oversight of work performance of contractors, the OUCC testified above regarding Petitioner's minimal oversight and project planning on the manhole work performed by contractors. We agree with the OUCC that Petitioner needs to make operational improvements in its oversight of contractor invoices and work performance. Accordingly, the Commission identifies below several specific improvements Petitioner must make. Within 90 days of the effective date of this Order, Petitioner shall file under this Cause a report explaining how it is implementing the improvements below:

a. Improve Management's Oversight of Projects Performed by Contractors. Develop best practices for management oversight of contractors and effective invoice review procedures, which includes (1) creating a scope of work for each project, (2) performing inspections of contractor-performed construction, and (3) implementing a policy requiring contractors to list materials, equipment, and quantity of labor on invoices.

b. Improve Financial Controls Over Invoices Submitted to Petitioner. Integrate a division of duties into Petitioner's three-way matching policy to decrease the risk of fraud and potential for clerical errors in the review, approval, and payment of contractor invoices. Consult with Petitioner's internal audit resources or external consultants as prudent to identify material risks in Petitioner's current controls and develop policies and practices to decrease material risks.

c. Properly Classify Expenses and Capital Work for Accounting Purposes. Modify Petitioner's Capitalized Time Guidelines regarding classification of capital and expenses as discussed in the Non-Capital Costs section. Develop a written policy for how expenses and capital work related to both contractor invoices and employee time will be properly categorized in Petitioner's books and records. Make policy consistent with applicable guidance from the NARUC USoA.

Petitioner shall pursue these steps and others that it believes will help it to minimize the possibility of fraudulent activity in the future, to improve its management and control over contractors and invoices, and to comply with acceptable practices regarding the classification of expenses and capital work.

15. Wastewater and Water Service Quality and Communication with LOFS.

A. Petitioner's Evidence. Concerning Petitioner's wastewater collection system, Mr. Lubertozzi testified that Petitioner complied with the 10% annual inspection, televising, and pressure cleaning ordered by the Commission in Cause No. 43128 S1. Petitioner also performed additional work within the last five years to identify and resolve issues within its wastewater system. He said these steps included implementing a Sewer Capital Improvement Program and utilizing RedZone Robotics technology to produce a web-based GIS map of Petitioner's entire wastewater collection system. He further testified that Petitioner has additional plans to replace the wastewater system infrastructure in the next five years, and he provided a general outline of those plans.

Mr. Lubertozzi stated that the backups and overflows which occurred during 2015 in the Twin Lakes wastewater system were a result of unprecedented rainfall events and flooding throughout Indiana. He further stated that Petitioner takes these situations very seriously and has taken additional steps toward eliminating these events, including upgrades and improvements consistent with the Commission's Order in Cause No. 43128 S1. He said that the record rainfall events which occurred in the spring and summer of 2015 allowed Petitioner to locate previously unidentified points where surface water impacted the wastewater system. Mr. Lubertozzi stated that Petitioner is working closely with customers, including LOFS, to help mitigate these issues in the future and reduce any impact rain events have on Petitioner's wastewater system.

Mr. Lubertozzi explained that it would take significant investment of probably \$7 million in the wastewater system to stop the backups from occurring from manholes and in basements of homes. Tr. B-26, 27. He said that all rain downspouts need to be permanently disconnected from the sewer system and all ditches that run through Lakes of the Four Seasons need to be cleared out. He said that he did not have direct evidence of whether customers in the past year were asked to disconnect their downspouts. He said he did not have specific knowledge of an instance when Petitioner asked Lakes of the Four Seasons to clear a ditch and they did not do it, but he had evidence of ditches with rain water collecting in them.

Mr. Lubertozzi testified during cross examination that Petitioner began developing a comprehensive asset management plan in 2015 and continues to work on it in 2017. *Id.* at 15. Mr. Lubertozzi explained that the plan is a list of all system assets and the plan addresses consequences of asset failure, status of assets, and guidelines for asset maintenance. *Id.* at 19.

Regarding drinking water quality, Mr. Lubertozzi testified that Petitioner has taken additional steps to improve service, including making improvements within the water system. He said that aggressive flushing and some additional capital spent at the water treatment plant could help remedy the water discoloration problem. *Id.* at 27. Mr. Lubertozzi stated that Petitioner is in compliance with all applicable water quality regulations and standards. He testified that Petitioner recently implemented vigorous and comprehensive uni-directional flushing and hydrant maintenance programs. Mr. Lubertozzi testified that these programs reduced the number of customer complaints regarding water quality. He stated that there were 47 customer complaints regarding water quality in 2015; however, only four of the complaints were regarding utility-side issues. He noted that, while there is always room for improvement, he believed the reduced number

of complaints demonstrated the significant efforts undertaken in the past several years to improve water quality for Petitioner's customers.

Mr. Lubertozi discussed Petitioner's communication with LOFS about the water and wastewater service provided within the community. He explained that the majority of the communication took place between Mr. Charles Alexander, former Area Manager for Petitioner, and Mr. Rick Cleveland. Mr. Lubertozi further stated that Petitioner meets periodically with various LOFS personnel to discuss work being done within the community, updates to ongoing activities, future scheduled work, as well as other issues arising in the LOFS community.

B. LOFS's Evidence. Mr. Cleveland testified regarding service quality and Petitioner's communication with LOFS. Mr. Cleveland testified that for the past 25 years, there have been problems with sewage backing up into LOFS residents' homes and manholes overflowing during rain events. He testified that these issues were recognized by the Commission in previous cases. In particular, Mr. Cleveland said that in Petitioner's 2006 rate case, Cause No. 43128, there was testimony that Petitioner received at least 45 complaints of sewage backing up into customers' homes. *Twin Lakes Utilities, Inc.*, Cause No. 43128, 2008 WL 294523 at p. 13 (IURC Jan. 16. 2008).

In this Cause, Mr. Cleveland presented records from the Indiana Department of Environmental Management ("IDEM") showing 16 manhole overflows between April 2014 and December 2015, with eight of these overflows occurring at Manhole No. 329. He stated that sewer backups and manhole overflows were not acceptable and recommended that the Commission impose specific performance metrics on Petitioner. Mr. Cleveland said he was concerned that Petitioner's wastewater treatment facility may not be able to accommodate and treat flows in heavy rain events. He recommended that the Commission require Petitioner to address these decades-old wastewater discharge problems and order, as a condition of the rate increase, that Petitioner replace or repair the system in reasonable, measurable increments that eliminate wastewater overflows. He also recommended that the Commission not authorize additional rate increases until Petitioner has operated for a suitable period of time without sewage backups, manhole overflows, or discolored water and has achieved acceptable customer satisfaction ratings.

Mr. Cleveland expressed his concerns regarding Petitioner's drinking water quality. Mr. Cleveland recounted the testimony of Ms. Carol Karpen in a field hearing in February 2011 in Cause No. 43957. The Karpens experienced brown water in wash cycles and would not drink the water due to quality issues. Mr. Cleveland testified that the Karpens reported to him that despite more frequent flushing by Petitioner since 2012, they continue to have damaged clothing because they do not always know when brown water will appear in the wash cycle, and they continue to buy bottled water. He recounted other specific examples of quality issues experienced by LOFS residents. He testified that he received numerous complaints over the years that water delivered by Petitioner required softening and filtration and the water shortened the expected useful life of household appliances.

Regarding communication between Petitioner and LOFS, Mr. Cleveland testified that the Commission in the October 5, 2017 Order in Cause No. 44646 found that Petitioner needed to improve communication with LOFS. The Commission directed Petitioner to meet with LOFS quarterly to discuss issues. Mr. Cleveland testified that Petitioner has not complied with the

Commission's Order to meet quarterly and Petitioner has not responded to e-mails requesting meetings to discuss quality issues or potential rate case filings.

Mr. Cleveland provided supplemental testimony in this Cause in response to Petitioner's internal investigation. Mr. Cleveland testified that it is alarming that Petitioner's management and culture allowed for a trusted supervisory employee to engage in dishonest behavior that would have resulted in customers paying for work that was never done. He further stated that Petitioner's supplemental testimony suggested that Petitioner's management and culture encourages the attainment of financial goals without regard to basic principles of fairness and honesty.

C. Petitioner's Rebuttal. Mr. Lubertozi responded to Mr. Cleveland's testimony regarding 16 manhole overflows. He pointed out that, with the exception of two events, all of the sewer discharges identified by Mr. Cleveland involved instances of significant rainfall, ranging from 1.3 inches within 40 minutes to over 4 inches within 60 minutes. He further explained that, absent the unprecedented rainfall experienced on June 8, 2015, and August 18, 2015, there would only have been a single overflow event in the past three years. Mr. Lubertozi discussed past instances when the Commission recognized that Petitioner's wastewater system, as an older gravity system, was prone to inflow and infiltration issues. Mr. Lubertozi stated that Petitioner has adopted a more proactive approach to cleaning and televising the wastewater system and explained this approach.

Mr. Lubertozi addressed the concerns raised regarding Petitioner's drinking water quality. He stressed that any water leaving Petitioner's treatment plant meets or exceeds all applicable state and federal water quality standards. He stated that he understands some customers have concerns about water quality at their residences and Petitioner continues to work with these customers to address brown water at their residences. In the case of the Karpens' residence, Mr. Lubertozi stated that Petitioner routinely flushes a hydrant located in the vicinity of their residence and will continue to work with them to address any quality issues. He said testing performed at the Karpens' residence showed that the water coming into their residence was clear with extremely low or non-measurable iron concentrations, even when discolored water was experienced in their faucets. He also explained that the issue of water hardness is not unique to Petitioner and would be present at any water utility using similar groundwater sources. He disagreed with Mr. Cleveland's suggestion that the need for softening Petitioner's water is an indication of water service quality issues.

Mr. Lubertozi responded to Mr. Cleveland's testimony regarding communications with LOFS. He stated that while there is always room for improvement, correspondences showed that there was plenty of communication between Petitioner and LOFS. He agreed with Mr. Cleveland's comments that Petitioner did not meet with LOFS on a quarterly basis. He stated that this failure was due to Petitioner incorrectly relying on the Commission's Order in Cause No. 44388, which required meetings on a semi-annual basis and a meeting at least 60 days prior to filing its next general rate case. As Petitioner's President, he took full responsibility for not complying with the Commission's Order and apologized to the Commission and LOFS for the oversight. However, Mr. Lubertozi disagreed with Mr. Cleveland's comments that Petitioner failed to advise LOFS of Petitioner's intention to file a rate case. He stated that Petitioner's representatives met with LOFS on September 30, 2015, and informed LOFS of its intention to file a rate case. He further stated that in the future it would be advisable to have these communications in writing so each party would have a record.



Mr. Lubertozi testified regarding criticisms by LOFS of Petitioner's management. He responded to Mr. Cleveland's statement that the management and culture at Petitioner encourages attainment of the utility's financial goals without regard to basic principles of fairness and honesty. He testified that the culture at Utilities, Inc. and its operating companies is one of safety and integrity. Mr. Lubertozi explained that the terminated employee's actions decreased Petitioner's opportunity to achieve its financial goals, not *encouraged the attainment* of Petitioner's financial goals as Mr. Cleveland suggested.

D. Commission Discussion and Findings. As referenced in the testimony by LOFS, Petitioner has faced service challenges with its utilities for many years, particularly in regard to sewage backups, manhole overflows, and drinking water discoloration. Additionally, there have been concerns regarding Petitioner's on-going communication with LOFS. In more recent years, Petitioner has taken some steps to improve performance as noted in the Commission's Orders.

In the October 7, 2015 Order in Cause No. 44646, the Commission denied LOFS's request for a subdocket to address overflows at Twin Lakes because the Commission believed that Petitioner was making appropriate improvements in its collection system and Petitioner's older gravity system was prone to inflow and infiltration issues. The Commission discussed these issues as follows:

We have previously initiated a subdocket in Cause No. 43128 SI to address similar (sanitary sewer overflow) issues, and in fact, sanitary sewer overflows at the same manholes that recently overflowed. As part of that subdocket, Petitioner is televising and smoke testing 10 percent of its system annually. Petitioner is also providing semi-annual reporting of the inspections and improvements it is making to its collection system. While it is troubling that sanitary sewer overflows are reoccurring at the same manholes at issue in Cause 43128, Petitioner's system is an older gravity system prone to inflow and infiltration issues. We also note that the recent sanitary sewer overflows occurred during a statistically historic rain event. We believe that Petitioner is making the appropriate improvements in its collection system based on the reports filed under Cause No. 43128 SI. Accordingly, we decline LOFS's request for another subdocket. However, we do believe that Petitioner needs to improve the communication of its planning with LOFS, and direct Petitioner to meet with LOFS on a quarterly basis to discuss any issues with Petitioner's water or wastewater systems, and provide LOFS any filings made to IDEM related its collection system. *Twin Lakes Utilities, Inc.*, Cause No. 44646, 2015 WL 5920879 at p. 8 (IURC Oct. 7, 2015).

In the April 23, 2014 Order in Cause No. 44388, the Commission approved a Stipulation and Settlement Agreement with the OUCC and LOFS and discussed Petitioner's improvements. In that Cause, Mr. McIntosh, on behalf of the OUCC, testified regarding Petitioner's wastewater operations, and he noted that the odor controls implemented by Petitioner appear to have been effective. Mr. McIntosh recommended that Petitioner continue to make repairs on defective manholes to reduce inflow and infiltration of ground water and storm water. In the Order, the Commission stated the following regarding Petitioner's service quality and customer relations:

While Petitioner still has room for improvement, it appears that many of the service quality and customer relation issues raised in Petitioner's last rate case have been addressed or improved by Petitioner. We encourage Petitioner to continue to improve service quality and proactively manage its water and wastewater systems, and further encourage the parties to continue to work together to proactively identify issues and work to reach mutually agreeable solutions. *Twin Lakes Utilities, Inc.*, Cause No. 44388, 2014 WL 1712265 at p. 9 (IURC April 23, 2014).

In the current Cause, regarding wastewater bypasses and overflows, the record shows that in nearly every instance, significant and heavy precipitation was present when bypasses and overflows occurred. To address those issues, Petitioner is actively gathering data and taking steps to prevent bypasses and overflows. For instance, Mr. Lubertozi stated that Petitioner was making capital improvements and implementing a web-based GIS map. Indeed, the record showed a decline in the percentage of complaints in 2015 that were determined to be due to utility-side issues. Going forward, Mr. Lubertozi testified that Petitioner would probably need to invest \$7 million in the wastewater system to stop overflows from occurring from manholes and backups in basements of homes. He said that downspouts need to be permanently disconnected, ditches should be cleaned, and the system needs to be aggressively flushed.

Based upon our review of the evidence, Petitioner is making strides in decreasing wastewater bypasses and overflows as shown by the decline in complaints and that most incidences occurred when there was significant and heavy precipitation. We find that there is still room for Petitioner to further decrease the incidences of wastewater bypasses and overflows. We encourage Petitioner to incorporate their proposed investments and actions to decrease wastewater bypasses and overflows into the Commission required System Improvement Plan ("SIP") discussed below.

Regarding drinking water quality and discoloration, Mr. Lubertozi stated that the water leaving Petitioner's treatment plant meets or exceeds all applicable state and federal water quality standards, and he said that Petitioner continues to work with customers to address discolored water. Mr. Cleveland testified regarding brown water in wash cycles and that Petitioner's water requires softening and filtration. Mr. Lubertozi said that Petitioner continues to work with customers who have discolored water. He also explained that water hardness would be present at any water utility using similar groundwater sources, and he disagreed with Mr. Cleveland's conclusion that the need to soften water indicates water quality issues.

Based upon our review of the evidence, Petitioner is working with residents to address discolored water concerns. We find that Petitioner shall renew its focus on flushing the drinking water system and making strategic capital improvements to decrease water discoloration concerns. Petitioner shall also continue to communicate with residents about discolored water and to work with residents to resolve concerns. Accordingly, as discussed in Paragraph 7 below, we find that Petitioner shall meet with LOFS on a quarterly basis as required in Cause No. 44646.

Regarding rate increases for the wastewater and water systems, Mr. Cleveland recommended that the Commission not authorize additional rate increases until Petitioner has operated for a suitable period of time without sewage backups, manhole overflows, or discolored water and has achieved acceptable customer satisfaction ratings. We disagree. The evidence shows that Petitioner has already been making progress on decreasing bypasses and overflows and has

been working with residents regarding discolored water complaints. We believe that following the recommendation from LOFS to withhold additional rate increases to a future date when Petitioner meets certain performance criteria would be unfair and unreasonable to Petitioner and not in the best interest of customers over the long-term.

In summary, based on our review of the evidence, we believe Petitioner is making strides to improve service quality and Petitioner generally knows what it needs to do to continue improving service quality. However, Petitioner needs to create a master plan to decrease total incidences of wastewater backups in homes and manhole overflows and to decrease total complaints about discoloration of drinking water. That master plan, the SIP, should be well documented and include feedback from the OUCC and LOFS, and then, most importantly, must be implemented and progress measured and reported. The Commission finds the following process reasonably addresses our desire to see continued cooperation among the parties and the development and implementation of a comprehensive and thoughtful strategy by Petitioner to create lasting improvements in wastewater and water service quality, value, and accountability:

1. Develop and Implement a System Improvement Plan Focused on Three Keys Aspects of Service Quality for Petitioner’s Water and Wastewater Systems. Based on our consideration of the evidence, we find that Petitioner still needs to improve three key aspects of service quality and Petitioner shall develop and implement the SIP to ensure that it makes these improvements. Accordingly, we direct Petitioner to develop the SIP to achieve the following goals: (a) to decrease total incidences of wastewater backups in homes, (b) to decrease total incidences of manhole overflows, and (c) to decrease total complaints of discoloration of drinking water (“Three Key Aspects”).

In the SIP, Petitioner shall provide detailed plans to measurably improve performance in the Three Key Aspects through use of two primary components: a comprehensive inflow and infiltration (“I&I”) program and a multi-faceted program to decrease incidences of discolored water, as described below. The detailed plans shall include descriptions of the activities, measureable outcomes, cost-benefit analyses, and timelines. Additionally, Petitioner shall propose capital investments that require Commission approvals and suggested timetables for the filings and approvals. For proposed significant capital investments, Petitioner shall provide proper documentation of engineering studies and detailed competitive bids from contractors to support Petitioner’s proposals.

a. Develop a Comprehensive Inflow and Infiltration Program to Decrease Total Incidences of Wastewater Backups and Manhole Overflows. Petitioner shall develop a comprehensive I&I program to decrease wastewater backups in homes and manhole overflows and to eliminate water inflow and ground water infiltration into Petitioner’s wastewater collection system. The I&I program shall specifically address how Petitioner will decrease inflow of rain and storm water into the wastewater system by working with LOFS to eliminate improperly installed residential sump pumps and roof downspouts and illegally connected drains. The I&I program shall also utilize Petitioner’s comprehensive asset program to decrease infiltration of groundwater into the wastewater system through leaky joints, cracked pipelines, and deteriorated manholes.

b. Develop a Multi-Faceted Program to Decrease Total Complaints of Discoloration of Drinking Water. Petitioner shall develop a thorough program to decrease complaints of discolored drinking water through implementation of a comprehensive asset program to prudently maintain, repair, flush, and replace Petitioner's water infrastructure. Additionally, Petitioner shall communicate with leadership and residents of LOFS regarding causes of discolored drinking water, steps Petitioner is taking to decrease complaints, and how residents can help prevent discolored water.

2. Measure and Achieve Annual Improvements in Three Key Aspects of Service Quality. To quantify and improve service quality, Petitioner shall measure and improve performance on the Three Key Aspects annually during 2018-2022. Accordingly, Petitioner shall develop a proposed plan to measure performance on the Three Key Aspects, and Petitioner shall report on actual performance on a quarterly and annual basis ("Performance Plan"). The Performance Plan shall designate percentage goals to decrease incidences and complaints annually as compared to the previous year, and Petitioner shall define how achievement of the percentage goals will be calculated and documented. Petitioner shall file the proposed Performance Plan as a compliance filing under this Cause at least five days before the technical conference discussed below. Petitioner shall discuss the proposed Performance Plan during the technical conference, and the Commission will provide written recommendations regarding the proposed Performance Plan within ten days following the technical conference. Petitioner shall incorporate the recommendations and file a revised Performance Plan in Petitioner's next Quarterly Status Report, as defined in Paragraph 5 below. Thereafter, Petitioner shall implement the Performance Plan and report performance in the Quarterly Status Report.

3. Present Proposed SIP and Performance Plan at a Technical Conference. For Petitioner to present the SIP for 2018-2022 and Performance Plan and receive initial feedback, Petitioner shall meet with Commission, OUCC staff, and LOFS in a technical conference within approximately 90 days of the effective date of this Order. To coordinate the scheduling of the technical conference, Petitioner, OUCC staff, and LOFS shall propose possible dates for a technical conference to the Presiding Officers in this Cause. As a compliance filing under this Cause, Petitioner shall file the agenda, proposed SIP, and proposed Performance Plan at least five days prior to the technical conference. Additionally, Petitioner shall file minutes from the technical conference within five days after the technical conference.

4. Incorporate Commission's Comments into Petitioner's SIP and Performance Plan. The Commission will provide written recommendations regarding Petitioner's proposed SIP and Performance Plan within ten days following the technical conference. Petitioner shall take into consideration the Commission's recommendations and file a revised SIP and Performance Plan in Petitioner's next Quarterly Status Report, as defined in Paragraph 5 below. Thereafter, Petitioner shall implement the SIP and Performance Plan and report performance in the Quarterly Status Report.

5. File Quarterly Status Reports with Commission. To communicate Petitioner's progress and to maintain accountability, Petitioner shall file a Quarterly Status Report with the Commission. This Quarterly Status Report replaces the previous semiannual reporting requirements ordered in Cause Nos. 43957 and 44388. The Quarterly Status Report shall include: (a) status of implementation of the SIP and updates to SIP, (b) quarterly and annual actual and

target performance of Performance Plan, (c) quarterly and annual televised line-inspection information, (d) a report on complaints elevated to the Director of Customer Care and resolutions, and (e) detailed wastewater lateral and manhole repair tracking forms with customer name and address, description of incident and root cause, a copy of any report to IDEM, and an explanation of the final resolution with the customer. Petitioner is directed to file its next Quarterly Status Report under this Cause, on or before April 30, 2018. A Quarterly Status Report filing shall be due on January 31, April 30, July 31, and October 31, of each year. Petitioner shall also simultaneously serve copies of the report on the OUCC and LOFS. The requirement to file a Quarterly Status Report shall end on December 31, 2022, unless Commission staff determine that Petitioner is not adequately implementing the SIP.

6. Present a Quarterly Update at a Technical Conference with Commission, OUCC staff, and a Representative from LOFS. To maintain accountability and communication, Petitioner shall meet quarterly (or another frequency as agreed to by the parties) with the Commission, OUCC staff, and a representative from LOFS in a technical conference. To coordinate the scheduling of each technical conference, Petitioner, OUCC staff, and LOFS shall propose possible dates for the technical conference to the Presiding Officers in this Cause. As a compliance filing under this Cause, Petitioner shall file the agenda for the technical conference at least five days prior to the conference. The agenda shall include Petitioner's updates regarding the status of Petitioner's SIP, Performance Plan, and any other significant activity occurring in the field. As a compliance filing under this Cause, Petitioner shall file the minutes of the technical conference within five days after the conference. The requirement to present quarterly updates at technical conferences shall end on December 31, 2020, unless Commission staff determine that Petitioner is not adequately implementing the SIP.

7. Meet Quarterly with LOFS to Discuss Plans and to Collaborate. Petitioner shall comply with the requirements in Cause No. 44646 regarding quarterly meetings with LOFS. As required in that Cause, Petitioner shall discuss issues with Petitioner's water or wastewater systems and provide LOFS with filings made to IDEM related to its collection system. Additionally, meetings shall include communication regarding Petitioner's plans to implement the SIP and collaborative actions LOFS and residents can take to help improve service quality. The requirement to conduct quarterly meetings with LOFS shall end on December 31, 2020, unless Commission staff determine that Petitioner is not adequately communicating and collaborating with LOFS.

16. Temporary Rates and Charges. On December 8, 2017, Petitioner filed its Submission of Temporary Rates and Charges seeking a determination that its filing satisfies the requirements of Ind. Code § 8-1-2-42.7 and authorizing Petitioner to implement temporary rates and charges. In a January 8, 2018 Docket Entry, the Commission through the Presiding Officers, approved the temporary implementation of rates and charges by Petitioner according to the provisions of Ind. Code § 8-1-2-42.7. The temporary rates and charges differ from the permanent rates and charges approved by the Commission in this Order. In compliance with Ind. Code § 8-1-2-42.7(i), Petitioner shall perform a reconciliation and implement a refund, in the form of a credit rider or a surcharge, as applicable, on customer bills rendered on or after the date the Commission approves the credit or surcharge. Accordingly, within 60 days from the effective date of this Order and prior to implementing the credit or surcharge, Petitioner shall file their reconciliation as a compliance filing under this Cause for approval by the Commission's Water/Wastewater Division.

On January 12, 2018, LOFS filed their Objection, Appeal to the Full Commission of January 8, 2018 Docket Entry and Motion to Stay Rate Increase Authorized by Docket Entry. LOFS sought to stay the implementation of the temporary rates and charges that were approved on January 8, 2018, as discussed in the paragraph above. However, this Order establishes permanent rates and charges for Petitioner. Accordingly, the filing by LOFS on January 12, 2018, is now moot.

17. **Confidentiality.** Petitioner filed Motions for Protection and Nondisclosure of Confidential and Proprietary Information on December 15, 2015, and June 27, 2016, which were supported by affidavits showing documents to be submitted to the Commission were trade secret information within the scope of Ind. Code §§ 5-14-3-4(a)(4), (9), and 24-2-3-2. On January 29, 2016, and October 24, 2016, the Presiding Officers issued docket entries finding such information to be preliminarily confidential, after which such information was submitted under seal. No party objected to the confidential and proprietary nature of the information submitted under seal in this proceeding. We find the information is confidential pursuant to Ind. Code § 5-14-3-4 and Ind. Code § 24-2-3-2, is exempt from public access and disclosure by Indiana law, and shall continue to be held confidential and protected from public access and disclosure by the Commission.

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

1. Petitioner should be permitted to increase its water rates and charges to produce additional operating revenue of \$734,268 to produce total annual operating revenues of \$2,725,095 and net operating income of \$635,930.
2. Petitioner should be permitted to increase its wastewater rates and charges to produce additional operating revenue of \$336,266 to produce total annual operating revenues of \$2,610,004 and net operating income of \$657,285.
3. In compliance with Finding Paragraph No. 16 above, Petitioner shall file a reconciliation of temporary rates and charges pursuant to Ind. Code § 8-1-2-42.7(i).
4. LOFS's Objection, Appeal to the Full Commission of January 8, 2018 Docket Entry and Motion to Stay Rate Increase Authorized by Docket Entry is denied as moot.
5. Petitioner is authorized to implement the rate increase as set forth in Ordering Paragraph 6 below and subject to the Rate Base Update Mechanism described herein.
6. Prior to implementing the rates authorized in this Order, Petitioner shall file the tariff and applicable rate schedules under this Cause for approval by the Commission's Water/Wastewater Division. Such rates shall be effective on or after the Order date subject to Division review and agreement with the amounts reflected.
7. Petitioner shall file its Rate Base Update Mechanism as described above.
8. Petitioner shall continue to utilize the Commission-approved composite-depreciation rates.

9. Petitioner shall revise its Capitalized Time Guidelines in compliance with Finding Paragraph Nos. 7E and 14B and avoid the inappropriate capitalization of employee time.

10. Petitioner is directed to file, under this Cause, all documents required by this Order.


11. The Confidential Information filed under seal in this Cause shall continue to be held by the Commission as confidential and not subject to public disclosure.

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

**HUSTON, FREEMAN, WEBER, AND ZIEGNER CONCUR:**

**APPROVED:**      **JAN 24 2018**

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

  
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**Mary Becerra**  
**Secretary of the Commission**