

**ORIGINAL**



STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF INDIANA-AMERICAN WATER )  
COMPANY, INC., AN INDIANA CORPORATION, )  
FOR (1) APPROVAL OF ITS 2016-2019 FINANCING )  
PROGRAM WHICH INCLUDES (A) APPROVAL OF )  
THE ISSUANCE OF UP TO \$200,000,000 IN )  
AGGREGATE PRINCIPAL AMOUNT OF SECURED )  
OR UNSECURED LONG-TERM DEBT AND (B) THE )  
ISSUANCE AND SALE OF ADDITIONAL COMMON )  
STOCK TO ITS PARENT COMPANY IN AN )  
AGGREGATE AMOUNT OF UP TO \$82,000,000; (2) )  
AUTHORITY TO USE THE NET PROCEEDS )  
THEREFROM TO REIMBURSE ITS TREASURY, )  
REPAY SHORT AND LONG TERM BORROWINGS )  
AND FINANCE ITS CONSTRUCTION PROGRAM; )  
AND (3) APPROVAL TO ENTER INTO )  
AGREEMENTS IN ORDER TO USE DERIVATIVE )  
INSTRUMENTS TO MANAGE ITS INTEREST RATE )  
RISK AND OTHER FINANCIAL EXPOSURES. )

CAUSE NO. 44682

APPROVED: MAY 11 2016

ORDER OF THE COMMISSION

**Presiding Officers:**  
**James F. Huston, Commissioner**  
**Gregory R. Ellis, Administrative Law Judge**

On September 24, 2015, Indiana-American Water Company, Inc. (“Indiana-American” or “Petitioner”), filed its Petition for approval of its 2016-2019 financing program. Petitioner’s 2016-2019 financing program includes: (1) the issuance of secured or unsecured long-term debt in aggregate principal amount of up to \$200,000,000; (2) obtaining funding from the Drinking Water State Revolving Fund Loan Program (“DWSRF”) and other low-cost or tax-advantaged government programs and participate in tax-exempt financings, provided the amount of such new debt in combination with debt described in (1) above does not exceed \$200,000,000; (3) the issuance and sale of additional common stock to Petitioner’s parent company in an aggregate amount of up to \$82,000,000; and (4) entering into agreements in order to use, at its discretion, derivative instruments such as forward-starting interest rate swaps, treasury locks, or other derivatives to manage its interest rate risk and other financial exposures. Also on September 24, 2015, Petitioner filed the testimony and exhibits of Gary M. VerDouw, Senior Manager of Rates for Indiana-American, constituting its case-in-chief. The Indiana Office of Utility Consumer Counselor (“OUCC”) filed the testimony and exhibits of Edward R. Kaufman, Chief Technical Advisor of the OUCC Water/Wastewater Division, constituting its case-in-chief on December 17, 2015. On January 13, 2016, Petitioner filed the Rebuttal Testimony of Mr. VerDouw. Also on January 13, 2016, Indiana-American requested the Indiana Utility Regulatory Commission

(“Commission”) take administrative notice of testimony and exhibits offered in prior financing cases brought before the Commission by Indiana-American, as well as the Commission’s orders in those cases. The Commission granted Petitioner’s request for administrative notice by a Docket Entry dated January 29, 2016. Indiana-American submitted revisions to the testimony of Mr. VerDouw on February 1, 2016.

The Commission held an evidentiary hearing in this Cause at 9:30 a.m. on February 3, 2016, in Room 222, PNC Center, 101 West Washington Street, Indianapolis, Indiana. Indiana-American and the OUCC were present and participated. The testimony and exhibits of Indiana-American and the OUCC were offered and admitted into the record without objection. No members of the general public appeared or participated at the evidentiary hearing.

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

1. **Notice and Jurisdiction.** Notice of the hearing in this Cause was given and published by the Commission as required by law. Petitioner is a public utility as defined in Ind. Code § 8-1-2-1(a). Petitioner requests authorization and approval for its proposed financing program pursuant to Ind. Code §§ 8-1-2-76 through 8-1-2-81. Therefore, the Commission has jurisdiction over Petitioner and the subject matter of this Cause.

2. **Indiana-American’s Characteristics.** Indiana-American is a public utility incorporated under the laws of the State of Indiana, with its principal office located in Greenwood, Indiana. Indiana-American is a wholly owned subsidiary of American Water Works Company, Inc. (“American Water”). It provides residential, commercial, industrial, and municipal water utility service to approximately 296,000 customers in and around the State of Indiana. It also provides sewer utility service in Wabash and Delaware Counties. Indiana-American owns, operates, manages and controls plant, property, equipment and facilities within and adjacent to such communities, which are used and useful for the collection, purification, pumping, distribution and furnishing of water to the public in such areas and for providing sewer utility service.

3. **Petitioner’s Existing Capitalization.** As of August 31, 2015, Petitioner’s capitalization amounted to \$776,372,690, and consisted of long-term debt in the principal amount of \$418,186,886 (including current maturities in the amount of \$40,836,111 and debt discount of \$1,040,831); and common equity in the amount of \$358,185,804. As of August 31, 2015, Petitioner’s long-term debt included one series of First Mortgage Bonds, five series of General Mortgage Bonds; six series of loans from the Indiana Finance Authority, and nine senior unsecured notes from American Water Capital Corp. (“AWCC”). As of August 31, 2015, Petitioner had no short term bank borrowings. At such date, Petitioner had issued and outstanding 411,565 shares of common stock and no preferred stock outstanding. One hundred percent of Petitioner’s common stock is held by American Water. All of the outstanding bonds and common stock have been duly authorized by Orders of this Commission.

4. **Relief Requested.** Petitioner seeks Commission approval of a financing program for the period ending December 31, 2019 that would permit Petitioner from time to time, during this period, to:

(a) issue additional long-term debt in an aggregate principal amount not to exceed \$200,000,000;

(b) obtain funding from the DWSRF and other low-cost or tax-advantaged government programs and participate in tax-exempt financings, provided the amount of such new debt in combination with debt described in (a) above does not exceed \$200,000,000;

(c) issue and sell additional common stock for cash to American Water in an aggregate amount not to exceed \$82,000,000; and

(d) enter into agreements in order to use, at its discretion, derivative instruments such as forward-starting interest rate swaps, treasury locks, or other derivatives to manage its interest rate risk and other financial exposures.

The \$200,000,000 long-term debt proposed to be issued includes: (a) potential refinancing of \$25,770,000 in tax-exempt issuance to take advantage of more favorable terms and (b) proposed refinancing of \$27,000,000 senior unsecured promissory note to AWCC which matures in 2018. Finally, \$3,459,996 of debt securities issued through the DWSRF will be retired through sinking fund payments in 2016-2019.

## **5. Evidence of the Parties.**

**A. Indiana-American's Case-in-Chief.** Indiana-American's witness Mr. VerDouw stated that Petitioner has entered into a Financial Services Agreement with AWCC which allows Petitioner to participate in a financial services program (the "AWCC Program") with American and other subsidiaries of American (collectively, the "Participants"). Under the AWCC Program, AWCC provides Petitioner and the other Participants with access to short-term and long-term debt. The Financial Services Agreement with AWCC does not prohibit or restrict Petitioner from borrowing from other parties or obtaining financial services from other parties whenever and on whatever terms Petitioner deems appropriate. Mr. VerDouw testified that the long-term debt to be issued pursuant to the financing program will be for maturities ranging from 5 to 50 years at market interest rates. The long-term debt may be in the form of promissory notes or other unsecured evidences of indebtedness or secured debt issued pursuant to Petitioner's Indenture of Mortgage dated as of May 1, 1968, as supplemented and amended (the "General Mortgage"). Debt issued pursuant to the General Mortgage will be in the form of General Mortgage Bonds issued in accordance with one or more Supplemental Indentures to the General Mortgage creating a new series of General Mortgage Bonds and specifying the terms thereof. The long-term debt, including the tax-exempt financing options, may be issued in whole or in part to AWCC.

Mr. VerDouw testified that although Indiana-American requests authority to receive up to \$82,000,000 in additional common equity through the sale and issuance of additional common stock, Petitioner expects to obtain some or all of the common equity through contributions of additional paid-in capital in order to maintain an appropriate debt-to-equity ratio. To the extent

common stock is issued and sold, all of the additional common stock will be sold to American Water, Petitioner's parent company.

Mr. VerDouw set forth Indiana-American's planned timing for the new debt and equity:

Year	Long-Term Debt Refinance (\$)			Long-Term Debt New (\$)	Total Long-Term Debt (\$)	Additional Paid-in Capital (\$)
	Scheduled Retirements	Sinking Fund Payments	Optional Redemptions			
2016	-	\$836,111	\$25,770,000	393,889	\$27,000,000	\$20,000,000
2017	-	856,083	-	44,143,917	45,000,000	40,000,000
2018	27,000,000	874,153	-	54,125,847	82,000,000	20,000,000
2019	-	893,649	-	45,106,351	46,000,000	2,000,000
TOTAL	\$27,000,000	\$ 3,459,996	\$25,770,000	\$ 143,770,004	\$200,000,000	\$ 82,000,000

Mr. VerDouw testified that while the timing of the debt issuances will depend on market conditions and other factors, Petitioner currently anticipates that they will occur mid-year.

The proceeds of the financing program will be used to (1) pay or reimburse Petitioner for expenditures made for construction or improvements of, or additions to, its facilities necessary to provide adequate and reliable water and wastewater service to its customers, (2) pay for or refinance short-term debt incurred to temporarily fund construction expenditures expected to be incurred for the construction or improvements of, or additions to, its facilities, (3) pay for potential acquisitions, and (4) for other general corporate purposes, including paying the issuance expenses related to the proposed new debt. Mr. VerDouw testified that during the period of the financing program, Petitioner's projected capital investments total \$497,000,000.

Although Indiana-American expects to issue most of the long-term debt authorized in this proceeding through AWCC, Mr. VerDouw explained it may choose to finance outside of that arrangement in certain cases. For example, Petitioner may be eligible for additional funds from the DWSRF or Wastewater State Revolving Fund programs in the future. As Mr. VerDouw described, opportunities may also arise for Petitioner to participate in tax-exempt financings through the Indiana Finance Authority or other economic development agencies. In addition, there may be opportunities to issue tax-exempt financing through AWCC. Petitioner seeks Commission authority to engage in these types of low cost, tax-exempt and tax-advantaged debt financings during the period of the financing program.

Mr. VerDouw also testified regarding the financial effects of the financing program. He presented Petitioner's *pro forma* balance sheet as of August 31, 2015 and Petitioner's *pro forma* income statement for the twelve months ended August 31, 2015, both adjusted for the financing program. These exhibits showed total assets of approximately \$1.45 billion, utility operating income of approximately \$56.5 million, interest charges of approximately \$23 million and net income of approximately \$32 million.

Mr. VerDouw presented Indiana-American's capital structure as of August 31, 2015 and *pro forma* giving effect to the remainder of 2015 and the proposed financing program. The *pro*

*forma* capital structure consists of approximately 52.60% long-term debt. Mr. VerDouw testified that the capital structure and interest coverage resulting from the proposed financing program are reasonable. He stated that the total capitalization after consummation of the financing program will be less than the fair value of Petitioner's utility property as found by the Commission in the Order in Cause No. 44022, the last time a fair value finding was made.

Mr. VerDouw also testified regarding Petitioner's desire to enter derivative contracts to manage its interest rate risk. Mr. VerDouw stated that Petitioner seeks to use derivative instruments, such as forward starting swaps and treasury locks, in order to hedge the benchmark rate over which the debt's yield will be set in a future debt issuance. Ultimately, interest rate derivatives allow Petitioner to have greater certainty over the effective cost of its future debt issuance, as well as allow Petitioner to diversify its interest rate risk by averaging into the hedge over a period of time. Mr. VerDouw noted that a number of other utility companies have used derivative contracts including Duke Energy, Exelon, AGL, Dominion, American Electric, Southern Company, and Xcel Energy. Additionally, Mr. VerDouw testified that the Commission has granted similar hedging authority to other investor-owned utilities in Indiana including Duke Energy Indiana, Inc. (Cause No. 44539 (IURC 3/25/2015)), Indiana Michigan Power Company (Cause No. 44426 (IURC 3/26/2014)), Indianapolis Power & Light Company (Cause No. 44364 (IURC 12/18/2013)), and Southern Indiana Gas and Electric Company and Indiana Gas Company, Inc. d/b/a Vectren Energy Delivery of Indiana (cause Nos. 44225 and 44226 (IURC 1/16/2013)).

**B. OUCC's Case-in-Chief.** Edward R. Kaufman testified that Petitioner's proposed financing program appears reasonable. Petitioner will continue to maintain a balanced capital structure after issuing its proposed debt and equity, and the interest rate appears reasonable. Mr. Kaufman indicated the OUCC accepts Petitioner's proposed debt issuance, provided that the OUCC does not waive or forego in future rate cases (a) the right to challenge the prudence of any particular transaction made by Petitioner pursuant to the authority granted in this Cause, or (b) the right to challenge the prudence of any rate base additions made by Petitioner from funds authorized pursuant to the authority granted in this Cause. Mr. Kaufman also recommended that, unless Indiana-American seeks and is granted an extension, any unused borrowing authority approved in this Cause should expire on December 31, 2019. Finally, he recommended Petitioner be required to notify the Commission and the OUCC within 30 days of issuing any of the authorized debt.

However, Mr. Kaufman responded to an assertion in Mr. VerDouw's testimony that because Petitioner's equity infusion will be booked to Paid-in Capital, and will not involve the issuance of additional shares of common stock, it does not require Commission approval. He indicated the OUCC disagrees with this assertion and believes that all equity infusions, regardless of how they are booked, require Commission authority. He explained that both transactions increase a utility's equity ratio and have the same effect on Petitioner's weighted cost of capital. Mr. Kaufman stated that the necessity for the Commission to review and prevent potentially abusive capital structures does not dissipate when an equity infusion is booked as Paid-in Capital. Mr. Kaufman further explained that the Commission's statutory authority over utility requests to infuse equity is a tool for the Commission to evaluate if a utility's capital structure is reasonable. He testified that because debt is typically less expensive than equity, a

capital structure that includes an excessive proportion of equity will increase the authorized cost of capital and impose an unnecessary and excessive cost on the utility's ratepayers. He noted that a return on the equity portion of a utility's capital structure will incur federal income taxes that will be paid for by its ratepayers.

Mr. Kaufman asserted that without the ability to review equity infusions booked as Paid-in Capital, the Commission would lose its ability to ensure a company's adherence to a reasonable balance of debt and equity in its capital structure. He testified that a utility should not be able to circumvent Commission authority simply by choosing to book an equity infusion as Paid-in Capital instead of an equity issuance.

Mr. Kaufman cited the Commission's Order in Cause No. 43526 and stated that because of the limitation under Indiana law against hypothetical capital structures, financing cases such as the one before the Commission in this Cause are the Commission's only opportunity to review if a utility's capital structure is viable and appropriate.<sup>1</sup> He explained that if the OUCC is prohibited as a matter of law from challenging a utility's capital structure during a rate hearing, it must be provided with an opportunity to review and potentially challenge a utility's capital structure. Mr. Kaufman also stated that if the Commission does not have the authority to review equity infusions booked as Paid-in Capital as part of a financing case, it would be denied any ability to approve or disapprove a utility's capital structure as a result of those equity infusions. He explained that it would be contradictory to argue both that financing cases are the OUCC's and the Commission's only opportunity to review financing decisions made by an Indiana utility, but that equity infused as additional Paid-in Capital is beyond Commission scrutiny in those same financing cases.

Finally, Mr. Kaufman explained that Mr. VerDouw's testimony presents an issue that is ripe for Commission determination in this proceeding. To the extent utilities proceed as though they do not need Commission authority to issue equity as Paid-in Capital, Mr. Kaufman explained that they will simply infuse the equity and not seek Commission approval. Thus, the OUCC or other interested parties could only challenge an equity infusion after it has been made. He testified that it would be difficult to require a utility to unwind an equity infusion after it has been completed. Mr. Kaufman stated that Petitioner may make an equity infusion as Paid-in Capital during its financing period; therefore, this case is the appropriate opportunity to argue the merits of Petitioner's contention that it does not need Commission approval to do so.

**C. Indiana-American's Rebuttal.** Indiana-American filed Rebuttal Testimony responding to Mr. Kaufman's testimony about the need for Commission approval of equity infusions. Mr. VerDouw explained that Mr. Kaufman is essentially asking the Commission to issue an advisory opinion on a matter not proposed by Indiana-American's case-in-chief because Indiana-American has not sought approval of an equity infusion other than the

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<sup>1</sup> *Petition of N. Indiana Pub. Serv. Co. ("NIPSCO") for (1) Auth. to Modify Its Rates & Charges for Elec. Util. Service; (2) Approval of New Schedules of Rates & Charges Applicable Thereto; (3) Approval of Revised Depreciation Accrual Rates; (4) Inclusion in Its Basic Rates & Charges of the Costs Associated with Certain Previously Approved Qualified Pollution Control Prop. Projects; (5) Auth. to Implement A Rate Adjustment Mechanism*, Cause No. 43526, 284 P.U.R.4th 369 (IURC Aug. 25, 2010) on reconsideration, 2012 WL 252442 (IURC Jan. 18, 2012).

issuance of common stock and that Mr. Kaufman seeks an interpretation of the applicable statute which is inconsistent with the past practice and understanding of the statute. Mr. VerDouw opined that the Commission already has the tools needed to address the potential problems identified by Mr. Kaufman and that those potential problems do not exist in this case.

Mr. VerDouw further explained that if Indiana-American had requested in its Petition or evidence approval of a direct infusion of equity, the Commission would have needed to determine whether the statutes requiring approval to issue securities also require prior approval for direct infusions of equity and then would have needed to determine whether that approval should be granted. He stated that the equity authority that Indiana-American has requested is limited to the authority for it to issue and sell additional common stock of up to \$82,000,000. He noted Indiana-American is requesting the authority to sell additional shares of common stock to American Water, but expects instead that any additional equity needed will come in a direct infusion of capital. He testified that the infusion is noted in his testimony in the interest of full disclosure and for the purpose of demonstrating Indiana-American's adherence to a reasonable balance of debt and equity in its capital structure.

Mr. VerDouw cited to Ind. Code § § 8-1-2-76, 8-1-2-77, 8-1-2-78, 8-1-2-79, and 8-1-2-80. He explained that all of those statutes limit the Commission's approval to the issuances of stock or stock certificates – not direct infusions of equity. He testified that he is unaware of any prior occasion where either the Commission has adopted or any other party has suggested direct infusions of equity require Commission approval. He noted that Mr. Kaufman has not cited a single Commission Order suggesting the interpretation he advocated in this case.

Mr. VerDouw disagreed with Mr. Kaufman's assertion that financing cases such as the one before the Commission in this Cause are the Commission's only opportunity to review if a utility's capital structure is viable and appropriate. He indicated that Indiana-American has agreed to file upon each security issuance or direct equity infusion a written report, which will confirm that Indiana-American's capitalization is within the desired range. Mr. VerDouw also explained that the Commission has extensive investigative powers of almost any matter relating to a public utility and to order, based upon that investigation, changes to be made. Even beyond a Commission-initiated investigation, the OUCG has authority to file a complaint addressing almost any matter related to service. He noted that every year public utilities file annual reports with the Commission that set forth their capital structures. There is no need to wait for the filing of a rate case petition before investigating, and, if necessary, ordering that steps be taken to adjust a public utility's capital structure.

**6. Commission Discussion and Findings.** Based upon the evidence of record, the Commission finds that the proposed financing program outlined herein is advantageous and necessary, in the public interest and in the best interest of Petitioner and its customers.

The long-term debt which Petitioner will have outstanding pursuant to the financing program will bear a reasonable proportion to Petitioner's total capitalization and will be reasonable in the aggregate amount, with due consideration given to the nature of Petitioner's business, Petitioner's credit, future prospects and earnings and the effect that the issuance of such securities may have on the management and efficient operations of Petitioner. Petitioner's total

outstanding capitalization, when adjusted for the financing program, and the application of the proceeds therefrom, will be reasonable in relation to the total value of Petitioner's property and will not be in excess of the fair value of Petitioner's property used and useful for the convenience of the public.

The issuance of long-term debt and the issuance and sale of common stock pursuant to the financing program is reasonably necessary for the purposes for which such securities may be authorized by the Commission and is in accordance with the provisions of the laws of the State of Indiana relating to the issuance of securities by public utilities. The interest rate derivatives, when utilized as proposed by Petitioner to hedge and manage interest rate risk, are utility financing tools we have approved in other cases. Therefore, the Commission finds that Petitioner's proposed financing program should be approved and authorized by the Commission, and a Certificate of Authority should be issued to Petitioner authorizing the financing program.

We note that the evidence in this Cause demonstrates that Indiana-American intends to make a future equity infusion without issuing any securities or evidence of indebtedness and that such action did not require Commission approval. The OUCC responded by noting that whether capital is infused through the issuance of securities or a simple equity infusion, the effect on the utility's capital structure is the same. We find the equity infusion identified in the evidence of Indiana-American and the OUCC is not a sale or issuance of stock, common stock, or certificates of stock as described in Ind. Code § 8-1-2-76 *et seq.* Accordingly, Commission approval is not required for Indiana-American to make equity infusions relating to the requested financing authority in this Cause. We also remind the parties that the Commission has extensive investigative powers over matters related to a public utility, including the ability to initiate an investigation and order steps be taken to adjust a public utility's capital structure if necessary.

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

1. Petitioner shall be, and hereby is, authorized to carry out and consummate the financing program described in the Petition filed in this cause and by the testimony, exhibits and evidence introduced at the hearing in this cause. In particular, Petitioner is authorized over the period ending December 31, 2019, to:

(a) issue additional long-term debt in an aggregate principal amount not to exceed \$200,000,000;

(b) to the extent long-term debt issued pursuant to this authority is secured, execute and deliver Supplemental Indentures supplementing and amending the General Mortgage in order to create new series of General Mortgage Bonds and to specify the characteristics thereof in accordance with the terms and provisions of the General Mortgage;

(c) obtain funding from the DWSRF and other low-cost or tax-advantaged government programs and participate in tax-exempt financings, provided the amount of

such new debt in combination with debt described in (a) above does not exceed \$200,000,000;

(d) execute such other transaction documents and evidences of indebtedness as are necessary and appropriate to effectuate the issuance of such long-term debt;

(e) issue and sell additional common stock to American in an aggregate amount not to exceed \$82,000,000;

(f) use and apply the cash proceeds arising from the issuance of such long-term debt and additional common stock for the purposes set forth in Petitioner's case-in-chief; and

(g) enter into agreements in order to use, at Petitioner's discretion, derivative instruments such as forward-starting interest rate swaps, treasury locks, or other derivatives to manage its interest rate risk and other financial exposures.

2. There shall be, and hereby is issued to Petitioner, a Certificate of Authority for the issuance of securities, upon the terms and conditions, of the character, for the consideration, in the manner, and for the purposes, set forth in this Order.

3. Within 30 days after each financing, Petitioner shall submit a report to the Commission with a copy to the OUCC describing the terms of each such financing, including any common stock issuances or equity infusions from American Water in the form of Paid-in Capital additions.

4. The authority granted in this Order shall expire on the earlier of December 31, 2019, or the effective date of the order in Petitioner's next financing case, to the extent it has not been utilized by that date.

5. This order shall be effective on and after the date of its approval.

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

**APPROVED:**

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

  
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Mary M. Becerra  
Secretary of the Commission