ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF THE BOARD OF DIRECTORS FOR UTILITIES OF THE DEPARTMENT OF PUBLIC UTILITIES OF THE CITY OF INDIANAPOLIS, AS TRUSTEE OF A PUBLIC CHARITABLE TRUST FOR THE WATER SYSTEM, D/B/A CITIZENS WATER FOR (1) AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR WATER UTILITY SERVICE AND APPROVAL OF A NEW SCHEDULE OF RATES AND CHARGES APPLICABLE THERETO, AND (2) APPROVAL OF CERTAIN CHANGES TO ITS GENERAL TERMS AND CONDITIONS FOR WATER SERVICE	**CAUSE NO. 44306**	
	APPROVED:	**MAR 19 2014**

ORDER OF THE COMMISSION

Presiding Officers:
Carolene Mays, Commissioner
Aaron A. Schmoll, Senior Administrative Law Judge

On February 21, 2013, the Board of Directors for Utilities of the Department of Public Utilities of the City of Indianapolis, as Trustee of a Public Charitable Trust for the Water System, d/b/a Citizens Water ("Petitioner" or "Citizens") filed its Verified Petition ("Petition") with the Indiana Utility Regulatory Commission ("Commission") initiating this Cause.

On February 22, 2013, Petitioner filed the direct testimony and exhibits of its witnesses. On March 13, 2013, the Citizens Water Industrial Group ("Industrial Group") filed its Petition to Intervene in this Cause. On March 22, 2013, the Indianapolis Water Service Advisory Board ("SAB") filed a Petition to Intervene. The Presiding Officers granted the Industrial Group's and SAB's respective Petitions to Intervene by docket entries dated March 26, 2013 and April 5, 2013, respectively.

In accordance with 170 IAC 1-1.1-15 and pursuant to proper notice given as provided by law, a Prehearing Conference and Preliminary Hearing was commenced on March 26, 2013, at 1:00 p.m., in Room 222, PNC Center, 101 West Washington Street, Indianapolis, Indiana. Proof of publication of notice of the Prehearing Conference was incorporated into the record and placed in the official files of the Commission. Counsel for Petitioner, the Indiana Office of Utility Consumer Counselor ("OUCC"), the Industrial Group and the SAB appeared and participated in the Prehearing Conference. The Town of Pittsboro, Indiana ("Pittsboro") and Brown County Water Utility, Inc. ("Brown County") also appeared. On April 10, 2013, the Commission issued its Prehearing Conference Order setting forth certain determinations with respect to the conduct of this Cause based upon the stipulations of the parties at the Prehearing Conference.

Pittsboro and Brown County filed separate Petitions to Intervene on April 24, 2013 and May 2, 2013, respectively, which the Presiding Officers granted by Docket Entries dated May 9, 2013.

On May 16, 2013, at 6:00 p.m., the Commission held a public field hearing in Room 222, PNC Center, 101 West Washington Street, Indianapolis, Indiana for the purpose of receiving testimony from the general public. Seven members of the general public appeared to offer testimony at the field hearing and the OUCC offered into evidence certain written comments the OUCC had received from the public.

On May 23, 2013, the Town of Whitestown, Indiana ("Whitestown") filed its Petition to Intervene in this proceeding, which the Presiding Officers granted by docket entry dated June 18, 2013. On June 19, 2013, the Industrial Group filed a Motion for Administrative Notice requesting the Commission take administrative notice, pursuant to 170 IAC 1-1.1-21(f)-(k) of the Commission's Final Order in Cause No. 43645; the Verified Direct Testimony of Daniel C. Moran filed on behalf of Citizens Water in Cause No. 44240; and the Compliance Filing Regarding Capacity Factor Analysis filed by Citizens Energy Group in Cause No. 43936. The Presiding Officers granted the Industrial Group's Motion for Administrative Notice on July 29, 2013. Also on June 19, 2013, the OUCC and Intervenors filed their respective cases-in-chief.

On July 10, 2013, Petitioner filed its rebuttal case. Also on July 10, 2013, Brown County and Pittsboro jointly filed its cross-answering testimony, and the Industrial Group and OUCC filed their respective cross-answering testimony.

Pursuant to proper notice given as provided by law, an evidentiary hearing was commenced on July 29, 2013 at 9:30 a.m. in Room 222 of the PNC Center, 101 West Washington Street, Indianapolis, Indiana. Petitioner, the OUCC, the Industrial Group, Brown County, Pittsboro, Whitestown and the SAB participated in the hearing. Petitioner's direct and rebuttal testimony and exhibits, aside from the testimony and exhibits of Michael C. Borchers, were admitted into evidence without objection. The testimony and exhibits filed by the OUCC, aside from the testimony and exhibits of Jerry D. Mierzwa, also were admitted into evidence without objection, along with the testimony and exhibits of the SAB.

At the conclusion of the evidentiary hearing on August 2, 2013, this matter was continued until August 13, 2013 for the presentation of the parties' respective testimony and exhibits relating to the issues of cost-of-service and rate design. On August 12, 2013, Petitioner notified the presiding Administrative Law Judge by a conference call with attorneys for all parties that settlement discussions were underway with respect to the cost-of-service and rate design issues, which would affect the hearings scheduled to reconvene on August 13, 2013. On the same day, Citizens filed a Motion for Continuance requesting that the Commission continue the August 13, 2013 evidentiary hearing. On August 13, 2013, the Commission issued a Docket Entry continuing the hearing to an attorneys' conference to be conducted on August 15, 2013.

During the attorneys' conference, the parties represented that settlement negotiations were ongoing and agreed to file a settlement agreement on some or all of the issues, along with supporting testimony on or before August 29, 2013. Accordingly, the Commission continued the

evidentiary hearing to September 16, 2013.

On August 29, 2013, the Parties filed a "Stipulation and Settlement Agreement Resolving Cost-of-Service Issues" (the Agreement) with the Commission. A copy of the Agreement is attached hereto. Also on August 29, 2013, Citizens filed the supplemental testimony and exhibits of Michael C. Borchers and LaTona S. Prentice in support of the Agreement.

Pursuant to proper notice given as provided by law, a hearing was commenced on September 16, 2013, at 9:30 a.m., in Room 224 of the PNC Center, 101 West Washington Street, Indianapolis, Indiana 46204. Petitioner, the OUCC, the Industrial Group, Brown County, Pittsboro and Whitestown participated in the hearing. No members of the general public appeared. The direct and rebuttal testimony of Citizens' witness Michael C. Borchers, the testimony and exhibits of OUCC witness Jerry D. Mierzwa, the testimony and exhibits of Industrial Group witness Michael Gorman, and testimony and exhibits of Brown County/Pittsboro witness Patrick Callahan were all offered and admitted into the record without objection. Joint Exhibit 1, the Agreement, and supporting exhibits attached thereto, along with the testimony and exhibits of Citizens' witnesses Borchers and Prentice in support of the Agreement were also offered and admitted into the record.

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

1. **Legal Notice and Commission Jurisdiction.** Due, legal and timely notice of the filing of the Petition in this Cause was published by Petitioner, as required by law. Petitioner also gave proper and timely notice to its customers, which summarized the nature and extent of the proposed changes in Petitioner's rates and charges for water service in accordance with the Commission's Rules. Due, legal and timely notice of the public hearings conducted in this Cause was caused to be published by the Commission.

Petitioner is a municipally-owned water utility as defined in Ind. Code § 8-1-2-1(h). Petitioner is subject to the jurisdiction of the Commission in the manner and to the extent provided by the laws of the State of Indiana, including certain provisions of the Public Service Commission Act, as amended. Citizens' rates and charges, and its terms and conditions for water service, are subject to the approval of this Commission by virtue of the provisions of Ind. Code § 8-1-11.1-3(c)(9). Indiana Code § 8-1-11.1-3(c)(9) provides that rates and rules for utility service "shall be in effect only after the rules and rates have been filed with and approved by the commission and such approval shall be granted by the commission only after notice of hearing and hearing as provided by IC 8-1-1 and IC 8-1-2 . . . and only after determining compliance of the rules of service with IC 8-1-1 and IC 8-1-2, along with the rules and standards of service for municipal utilities of Indiana approved by the commission." Indiana Code § 8-1.5-3-8 provides that municipal utility rates and charges are subject to Commission approval, in accordance with the procedures set forth in Ind. Code ch. 8-1-2. Accordingly, the Commission has jurisdiction over Petitioner and the subject matter of this proceeding.

2. **Petitioner's Organization and Business.** Petitioner is engaged in the business of providing municipal water service to the public as the Board of Directors for Utilities of the

Department of Public Utilities of the City of Indianapolis, as Trustee of a Public Charitable Trust for the Water System, d/b/a Citizens Water. Petitioner owns and operates certain water utility assets acquired from the City of Indianapolis, Indiana ("the City") and the Department of Waterworks ("the DOW") of the City pursuant to an Asset Purchase Agreement approved by the Commission's July 13, 2011 Order in Cause No. 43936. Citizens provides water utility service to the public in Marion, Boone, Brown, Hamilton, Hancock, Hendricks, Johnson, Morgan and Shelby Counties, Indiana. Petitioner's principal office is at 2020 North Meridian Street, Indianapolis, Indiana.

3. Test Year. In accordance with the Prehearing Conference Order, the twelve (12) month period ended September 30, 2012, was the test year used in this Cause to determine Petitioner's actual and *pro forma* operating revenues, expenses and operating income under its present rates and charges and the effect of its proposed rates. We find the September 30, 2012 test year, as adjusted, is sufficiently representative of Petitioner's normal utility operations to provide reliable data for ratemaking purposes.

4. Relief Requested. Pursuant to the Commission's Order in Cause No. 43936, Citizens' existing rates and charges were placed into effect on August 26, 2011, the "Closing" date of Citizens' acquisition of the water utility assets from the City and DOW. The Commission's Order in Cause No. 43936 specifically authorized Citizens to "adopt the schedules of rates and charges applicable to the provision of water utility service by the DOW in effect at Closing. . . ." The DOW's rates and charges applicable to the provision of water utility service in effect at Closing were approved by the Commission's February 2, 2011 Order issued in Cause No. 43645. The test year in Cause No. 43645 used for determining the DOW's actual and *pro forma* operating revenues, expenses and operating income was the twelve month period ending December 31, 2008.

In its case-in-chief, Petitioner sought approval from the Commission to increase its rates and charges to generate additional annual operating revenues of $25,314,657, representing a 14.71% overall increase in its *pro forma* operating revenues. Petitioner also proposed that its requested increase in operating revenues be recovered from customer classes based upon the results of its cost-of-service study prepared by Black & Veatch. Citizens also proposed several miscellaneous revisions to its tariffs and terms and conditions for water service based on its experience operating the water utility over the past year.

In rebuttal and during the evidentiary hearing, Petitioner revised its proposed increase in *pro forma* operating revenues to $23,083,861, representing a 13.26% overall increase in operating revenues. *See* Pet. Proposed Order, pp. 5, 53.

5. Revenues. Petitioner's Exhibit LSP-1 includes several *pro forma* present rate revenue adjustments that yield an overall test year revenue increase of $1,243,980. The OUCC accepted Petitioner's proposed adjustment for Delivery Charges, a test year revenue increase of $5,914,475, Average Service Charge adjustment, a test year revenue decrease of $1,608, an Average Volume Charge adjustment that increased test year revenue by $826,100, and a Correction Factor test year revenue decrease of $16,685. No other party opposed Petitioner's proposed adjustments on these items.

Based on the foregoing, the we find the amounts for delivery charges of $5,914,475, average service charge adjustment of ($1,608), an average volume charge adjustment of $826,100, and a correction factor adjustment of ($16,685) are appropriate. The remaining revenue adjustments are discussed below.

A. *Customer Growth.*

1. *Petitioner's Direct Evidence*. Ms. LaTona Prentice, Petitioner's Vice President of Regulatory Affairs, sponsored Petitioner's proposed adjustments to test year operating revenues. Petitioner did not include in its case-in-chief a test year residential customer growth adjustment. Rather, Petitioner provided a customer growth adjustment that included all classes and was based on the net total billing instances, not customer count. This adjustment included the test year as well as the adjustment period. Ms. Prentice stated that Petitioner's Exhibit LSP-1, page 5 represents a net 9,367 customer/meter (an average 781 customer/meter count per month) increase from the test year number of billing instances to the *pro forma* number of billing instances. She stated the *pro forma* number identifies and annualizes those customers/meters whose service was disconnected or added during the test year. She stated how Petitioner determined the number of customers it added by noting Petitioner "added customers/meters to the extent we know they will be connected during the 12 months following the end of the test year." (*Id.* at 6.) She stated that the number of billing instances (customers/meters) is defined by the number of active meter points. She stated it is possible for some services to be served by more than one meter. She stated that the *pro forma* number of billing instances and their associated usage and the test year revenue is increased by $96,345 to reflect the increased number of customers and the associated service charge revenue. (Pet. Ex. LSP at 6.) Ms. Prentice stated that Petitioner's Exhibit LSP-1, page 5 also reflects a net decrease in the volume of water sold during the test year of 695,850 hundred cubic feet, which results in a *pro forma* decrease in revenue of $1,591,100. (*Id.*) Petitioner designated this adjustment as "Volume Charge Adjustment. (See LSP-1, p. 5 of 13.) Together these total to Petitioner's negative $1,494,755 adjustment.

2. *OUCC's Evidence*. Mr. Charles E. Patrick, Utility Analyst for the OUCC's Water/Wastewater Division, stated that Petitioner did not propose a test year residential customer growth adjustment. He stated that a test year growth adjustment represents the accumulation of customer bills not accounted for by Petitioner in its test year revenues. (Pub. Ex. No. 1 at 15.) Mr. Patrick stated that a test year customer growth adjustment is calculated by taking the number of customers billed by month, subtracting each month from the prior month's total customer bills and multiplying the net changes by an increasing amount (January less December multiplied by one, February less January multiplied by two, etc. for the entire test period). (*Id.*) Mr. Patrick stated that by using this approach to determine the customer growth in revenues for the test year, the sum of the net additional bills is multiplied by the average test year bill. He stated that any large change in bills invoiced during a month would significantly alter the calculation. (*Id.*)

Mr. Patrick stated that monthly customer count information the OUCC received from Petitioner indicated "large swings in monthly customer counts," and these large swings did not

allow the calculation of a valid residential customer growth adjustment. (Pub. Ex. No. 1 at 16.) Mr. Patrick stated the OUCC asked Petitioner to explain the large swings in its customer counts, and Petitioner advised that it routinely experiences variances in customer counts on a month to month basis due to differences in the accounting month and meter reading cycles. While a typical month may have 21 billing cycles, there are times within a year that the accounting month may have more or less than 21 cycles making natural variances even more pronounced. Citizens explained for example that in the month-to-month change from August 2012 to September 2012, August had more than 21 read cycles and September had fewer. Mr. Patrick stated Petitioner did not invoice each billing cycle during each month of the test year and continued this practice into the adjustment period. Mr. Patrick stated that, based on the Commission's established methodology to calculate test year customer growth, the information provided by Petitioner was not useful for calculating a customer growth adjustment. (*Id.* at 16.)

Mr. Patrick stated that other water utilities invoice each customer each month with no more than a day or two difference in bill cycles. He stated that each month these utilities read and invoice every bill cycle. Mr. Patrick stated that Citizens does not adhere to the practice of reading and invoicing every billing cycle each month, as other utilities do. Therefore, he explained Citizens is unable to provide information that can be used to calculate a customer growth adjustment for the test period. Mr. Patrick stated he therefore found it necessary to rely on Petitioner's 2012 IURC Annual Report to calculate an adjustment for net annual residential customer growth. Mr. Patrick stated that the 2012 IURC Annual report indicated a net 4,391 new customers were added in 2012, representing 28,548 additional bills at an average amount of $29.66. (*Id.* at 17.) Mr. Patrick populated the Commission's accepted growth model with a monthly average of 366 additional customers to determine the number of additional bills not accounted for in test year revenues. Where Petitioner had asserted an increase in revenues attributable to net additional customers during the test year of $96,345, Mr. Patrick's analysis indicated an increase of $846,734. (*Id.*)

The OUCC also proposed an adjustment period customer growth adjustment of $626,846. In reaching that amount, the OUCC used Petitioner's stated 781 average monthly meter additions to calculate the adjustment period customer growth adjustment. (*Id.* at 19.) Mr. Patrick stated the OUCC multiplied the additional bills (60,819) by the average service revenue ($10.29) to establish the OUCC's proposed adjustment of $626,846. (*Id.*) (See also OUCC Sch. 5, Adjustment 2.)

Finally, Mr. Patrick addressed Petitioner's proposed negative $1,591,100 Volume Adjustment, which Ms. Prentice mentioned on page 6 of her testimony. (Petitioner's Exhibit LSP, p. 6, lines 17-19.) He stated that Petitioner did not provide any evidence in its case-in-chief to support the reduced volumes shown on its work paper W646/2. (Public's Exhibit 1, p. 21. See Attachment CEP 20.)

3. *Industrial Group's Evidence*. Mr. Gorman, Managing Principal with Brubaker and Associates, testified regarding the Petitioner's adjustments based on changes in customer billing units. He testified that the Petitioner adjusted its test year revenue based on an increase in Rate 1 customer billings which increased revenue by approximately $96,000, and an assumed decrease in CCF sales to customers that reduced revenue by approximately $1.591

million. (*Id.* at 13). Mr. Gorman stated that the resulting $1.49 million decrease was partially offset by an adjustment to the delivery rate that produced a net adjustment of a negative $0.67 million. (*Id.*).

Mr. Gorman stated that Citizens failed to provide an explanation for the assumed decline in sales per customer bill and testified that the customer use adjustment made by Ms. Prentice was unreasonable. (*Id.* at 14). Mr. Gorman stated that he reviewed the Company's Rate 1 sales for the last three years, and found the sales per customer in the test year were reasonable. (*Id.*) In doing so, he noted that the test year average volume per billing instances was roughly equal to the same volumes in 2008 and 2011. On this basis, he stated that adjusting for the increase in customers, but decreasing the per billing instance volume was unreasonable. (*Id.*). Mr. Gorman also examined the impact of the severe dry weather conditions during the test year. He stated that the despite the drought, Citizens took a number of steps that curtailed water usage that kept test year sales comparable to past years rather than being elevated as might otherwise be expected during a drought. (MPG Direct at 14-16).

Mr. Gorman stated that to correct Citizens' adjustments, he applied the same level of CCF per billing instance in the *pro forma* year as the test year, resulting in a total reduction in the Petitioner's revenue requirement of $1.1 million. (MPG Direct at 14).

4. *Petitioner's Rebuttal Evidence.* Ms. Prentice stated Petitioner's proposed customer growth adjustment identifies significant "customer and/or volume additions and losses" that occurred during the test year, and known changes to customers and/or volume that will occur during the twelve months following the test year. (Pet. Ex. LSP-R at 8.) Ms. Prentice stated that the OUCC, on the other hand, "prepared a residential customer growth adjustment by arbitrarily assuming that an equal number of customers were added each month of the calendar year (which also is not the same twelve months as the test year) and multiplying each month's assumed additional customers by the remaining number of months in the year to determine 'the number of additional bills not accounted in test year revenues.'" (*Id.* at 9.) This adds 28,548 billing instances and associated revenue to *pro forma* revenues. (*Id.*)

Ms. Prentice stated that the OUCC inaccurately interprets Petitioner's customer growth numbers as adjustment period growth, which in effect double-counts customer growth when coupled with the OUCC's test year customer growth adjustment. (*Id.* at 8.) Ms. Prentice stated that instead of making separate adjustments for test year customer growth and adjustment period customer growth, Petitioner made one adjustment that combines test year and adjustment period customer growth. (*Id.* at 13.)

Ms. Prentice stated that Mr. Patrick's adjustments assume 4,391 residential customers (or 28,548 billing instances) were added during the test year, and that 9,367 customers (or 60,819 billing instances) are expected to be added during the adjustment period. That would equate to adding more than 14,000 new customers and more than 88,000 new billing instances over a two-year period. (*Id.* at 13-14.) Ms. Prentice stated, however, that the average change in billing instances over the last 4 years is a reduction of 13,363. (*Id.* at 14.) Ms. Prentice stated it would be inconceivable that Citizens would add 88,000 new billing instances in a two-year period,

when the number of billing instances has not increased more than 17,434 in any of the previous four years. (*Id.* at 14.)

Ms. Prentice stated that Petitioner proposed a net reduction in volumes of 695,850 ccf based on an analysis of Petitioner's customers and known or projected changes in their consumption. (*Id.* at 11.) Ms. Prentice stated the asserted level of reduced consumption is largely driven by the loss of a commercial customer, a significant reduction in consumption by a large industrial customer, and a planned phased transition of a wholesale water customer off of the system. (*Id.* at 12.) Ms. Prentice stated that Mr. Patrick's test year residential customer growth adjustment incorrectly assumes net additional customers equate to net additional sales volume. (*Id.*) Ms. Prentice stated that the Commission should reject the OUCC's $846,734 revenue adjustment for the test year residential customer growth as well as the OUCC's $626,846 proposed adjustment period customer growth revenue adjustment, and accept Petitioner's negative $1,494,755 "customer growth revenue adjustment." (*Id.* at 17.)

Ms. Prentice stated that Mr. Gorman similarly proposed to reject Petitioner's adjustment for reduced sales. (*Id.* at 33.) Ms. Prentice stated that Petitioner's Exhibit LSP-4, pages 2 and 3 reflects additional sales volumes of 310,926 ccf (line 32), as well as a loss of sales volumes of 1,006,776 ccf (line 48), which amounts to a net loss of 695,850 ccf from the test year to the *pro forma* period (Petitioner's Exhibit LSP-l, page 5, line 4). Ms. Prentice stated that these are very real, fixed, known and measurable sales reductions that simply cannot be ignored. (*Id.*)

5. *Discussion and Findings.* The parties have made customer growth adjustments involving changes in residential customer numbers during the test year and adjustment period, as well as adjustments due to volume losses of a commercial and sale for resale customer.

Petitioner proposed a downward "Volume Charge Adjustment" of ($1,591,100), "based on a decrease in water sold [from] the test year" in conjunction with a $96,345 Service Charge Adjustment for a net revenue reduction of $1,494,755. (See Petitioner's Exhibit LSP at 6 and LSP-1, page 5 of 13.) On the other hand, the OUCC proposed a residential customer growth adjustment for $846,734 and an adjustment period growth adjustment of $626,846 to reflect the addition of customers to Petitioner's operations. The Industrial Group proposed an adjustment of $1.1 million.

Petitioner calculated a customer growth adjustment of $96,345 compared to the OUCC's test year residential customer growth adjustment of $846,734 and adjustment period growth of $626,846. In reaching its adjustment ($96,345), Petitioner relied on a comparison of billing instances in the test year to "the pro forma number of billing instances and their associated usage." (Pet. Ex. LSP at 6.) Ms. Prentice noted that "the pro forma number identifies and annualizes those customers/meters whose service was disconnected or added during the test year." (Pet. Ex. LSP at 6.) By referring to her Exhibit LSP-1 p.5 of 13, Ms. Prentice indicated the net change in billing instances was 9,367.

The OUCC relied on representations made by Petitioner on its 2012 IURC Annual report as to the number of customers it added in 2012. Mr. Patrick calculated a growth of customers of

4,391 (278,126 Year End Number of Customers less 273,735 Beginning Year Number of Customers). (Pub. Ex. No. 1, p. 17.) This number included nine months of the test year, as well as the three months following September, 2012. In terms of billing instances, the OUCC's methodology would add 28,548 billing instances to *pro forma* revenues during the test year. The OUCC further relied on Ms. Prentice's testimony (Pet. Ex. LSP, at 6) to calculate an adjustment period growth adjustment of 60,819 billing instances during the adjustment period. Petitioner countered with data showing that the billing instances from 2008 through 2012 have actually decreased.

We find that both parties' methodologies with respect to customer growth are problematic. Petitioner's use of billing instances, while showing actual data, does not comport with the data Citizens Water provided in its annual report or how this issue has typically been presented to the Commission. Other than noting that the 2012 Annual Report figure does not fall within the test year, Ms. Prentice offered no explanation why the 2012 calendar year figure (when converted to billing instances) would have exceeded Petitioner's proposed test year figure by such a large margin (28,548-9,367). Meanwhile, the OUCC's extrapolation of this same data to show customer additions through the adjustment period appears to lead to an unrealistic customer count that is not supported by historic data. The OUCC undertook this methodology, in part, because Citizens Water does not track customer count additions by class on a monthly basis, which further complicated its analysis. While it appears likely that Citizens will have a higher customer count than shown in the test year and proposed by Citizens, we believe neither party presented sufficient evidence for the Commission to support an adjustment for customer growth.

With respect to a volume adjustment, Petitioner explained for the first time in its rebuttal case that its adjustment of ($1,591,100) was "largely driven by the loss of a commercial customer, a significant reduction in consumption by a large industrial customer, and a planned phased transition of a wholesale water customer off of the system." LSP-R at 12. To reach this adjustment, Petitioner netted the customer volume loss of 1,006,776 ccf with a smaller volume adjustment of 310,926 ccf, which accounted for increased volumes due to customer growth and demand. As indicated above, however, Citizens customer growth adjustment is suspect and inadequately supported, and the related volume gain is similarly flawed. Further, the only evidence supporting the large customer adjustment was Ms. Prentice's statement in her rebuttal testimony. Citizens did not identify the commercial customer and the associated volumes and timeframe for that loss, did not identify the industrial customer and the process change associated with the unidentified volumes and timeframe for that change, and Ms. Prentice's workpapers shown in LSP-R4 appear to show Brown County Water's consumption in the test year will be the same going forward, which would not have resulted in any adjustment. While volume loss may occur, we cannot determine, based on the evidence presented, what that loss should be. We also note that Citizens chose to use the system average volume charge, which would have overstated the volume loss for the large meter customers. Accordingly, we make no adjustment for volume loss.

In conclusion, we make no adjustments for customer growth. We suggest that in its next rate case, Citizens provide additional support for its customer growth adjustment, and include that support in its case-in-chief in order to provide the parties a better opportunity to respond.

B. *Unbilled Revenues.*

1. *Petitioner's Direct Evidence*. Ms. Prentice adjusted test year operating revenues for unbilled revenues in the amount of $9,802,445 because the *pro forma* revenue reflects a calendar month billed basis, rendering unbilled revenue unnecessary. (Pet. Ex. LSP-1, page 7)

2. *OUCC's Evidence*. Mr. Patrick stated that unbilled revenues are accrued to recognize *unrecorded revenues* at the end of an accounting period. This allows a utility to match revenues with expenses incurred during the same timeframe. Mr. Patrick stated that the matching principle is a basic Generally Accepted Accounting Principle (GAAP) fundamental of accrual accounting. Mr. Patrick stated that the American Water Works Association (AWWA) M-1 Manual, p. 22 provides:

> All water meters are not read and billed at the same time, because most water utilities cycle their billing process throughout the month. Under any cycle-billing system, there are unbilled revenues at the end of each accounting period, representing water sales from the last billing of each customer to the end of the accounting period. Thus, earned revenues do not typically equal the billed revenues for any accounting period. The difference between the unbilled revenues at the end and at the beginning of an accounting period is the accrued amount to be applied to the billed revenues to determine the earned revenues for the accounting period. (Pub. Ex. No. 1 at 23.)

Mr. Patrick proposed two adjustments. First, he adjusted Petitioner's proposal to remove $9,802,445 of unbilled revenues from its *pro forma* operating revenue. Mr. Patrick stated that Petitioner failed to reverse an accrual entry for this revenue category in arriving at its unbilled revenues adjustment. Mr. Patrick stated Petitioner confirmed that the $7,102,910 of accounting adjustment – service charges that he proposed be re-categorized as unbilled revenues is unbilled revenues for the month ending September 30, 2011. Therefore, OUCC Schedule 5, Adjustment 7 of ($2,699,535) reduced unbilled revenue to $0.

Second, Mr. Patrick stated that Petitioner has 21 billing cycles per month or 252 billing cycles per year but invoiced only 250 billing cycles in the test year. Thus, Petitioner did not include two (2) billing cycles in its test year operating revenues. Mr. Patrick netted the $7,102,910 of unbilled revenue that should have been reversed in the unbilled revenues category against the $9,802,445 Petitioner included as unbilled revenue. Mr. Patrick stated that the difference of $2,699,535 was the true unbilled revenue amount. (*Id.* at 24-25.) Therefore, Mr. Patrick accepted the $2,699,535 of unbilled revenues as the amount that represented the two billing cycles excluded from the test year. (*Id.* at 25.)

3. *Industrial Group's Evidence*. Mr. Gorman testified that Petitioner made two adjustments to unbilled revenue that resulted in a $2.8 million reduction to test year revenue. Mr. Gorman testified that this reduction was a result of a $7 million increase in

revenues as a result of an adjustment labeled "Accounting-Adjustment – Service Charge" and a $9.8 million decrease in revenue labeled "Unbilled Revenue."

Mr. Gorman stated that the $9.8 million decrease in revenue was removed by Petitioner because the *pro forma* revenue reflects a calendar month billed basis rendered an unbilled revenue adjustment unnecessary. Mr. Gorman testified that Petitioner failed to provide adequate explanation, support, or justification for the adjustments, and recommended the "Unbilled Revenue" adjustment should be eliminated by netting it against the "Service Charge" adjustment to equal zero.

4. *Petitioner's Rebuttal Evidence.* Ms. Prentice stated that Mr. Patrick testified that Petitioner "failed to reverse an accrual for this revenue category." Ms. Prentice testified that she had made such an adjustment. She stated that she made the same adjustment in Petitioner's Exhibit LSP-R2 as Mr. Patrick's adjustment by reducing line 3 – accounting adj – service charge by $7,102,910 leaving an unbilled adjustment of a negative $2,699,534. She stated that on page 24 of Mr. Patrick's testimony, Mr. Patrick describes an unbilled adjustment as the netting of "the $7,102,910 of unbilled revenue that should have reversed in the unbilled revenues category against the $9,802,445 Petitioner included as unbilled revenue." Ms. Prentice stated that she agreed with Mr. Patrick's treatment of the $7.1 million, which she had included in her adjustments, only it was described in Petitioner's Exhibit LSP-1, page 1, line 3 as a component of Accounting Adjustment – Service Charge. (*Id.* at 3.)

However, Ms. Prentice disagreed with the OUCC's adjustment to add back unbilled revenue in the amount of $2,699,535 to recognize two billing cycles not invoiced during the test year. Ms. Prentice stated that although she agreed with the concept of including an adjustment to recognize these two billing cycles, she did not agree with the arbitrary nature of the amount of the OUCC's proposed adjustment. (Pet Ex. LSP-R at 17-18.) Ms. Prentice stated that the revenue adjustment for the two missing billing cycles be based upon the billed revenues for the month of September 2012. Ms. Prentice stated the adjustment should be based upon 2/19 (2 unbilled cycles/19 billed cycles) of the September 2012 billed revenue of $10,012,501, or $1,053,947. (*Id.* at 19.)

5. *Discussion and Findings.* No party disagreed with the ($2,699,535) adjustment to reverse an accrual that occurred during the test year and that the remaining amount should be adjusted to reflect the two missing billing cycles. During cross-examination, the OUCC offered its cross-examination exhibit CX-19, which was Petitioner's response to OUCC Data Request No. 62-18 issued after Petitioner filed its rebuttal testimony. The data request contained the following:

> Please state the actual number of customers and actual associated revenues by revenue class included in the two billing cycles that Petitioner did not invoice during September 2012 of the test year.

Ms. Prentice acknowledged the answer to that question was 32,317 and further that the total revenue associated with the unrecorded revenues for the two missing billing cycles was $1,972,177. Ms. Prentice agreed with counsel for the OUCC that the number that should be used

for unrecorded revenues is $1,972,177 (Tr. at I-110 - 111). Relying on OUCC CX-19 and Petitioner's acknowledgement that $1,972,177 is the correct amount to adjust for unrecorded revenues associated with the two missing billing cycles, we find this is the appropriate amount of unrecorded revenues.

C. *Accounting Service Charges.*

1. *Evidence.* Ms. Prentice adjusted test year operating revenues for accounting service charges amounting to $7,006,071. (Pet. Ex. LSP-1 at 1.) Ms. Prentice included the $7,006,071 as a component of her brief discussion of removing test year accounting adjustments of $12,920,546. (Id. at 7.)

OUCC witness Mr. Patrick transferred $7,102,710[1] of account service charges to unbilled revenues leaving a negative balance of $96,839. Mr. Patrick stated the makeup of accounting service charges was provided in response to an OUCC data request (See Attachment CEP-21). Mr. Patrick also rejected the inclusion of the balance of the accounting adjustment - service charge of $96,839 as an adjustment to revenues, because the amount was for a settlement, "which should be considered non-recurring." (Pub. Ex. No. 1 at 22.)

Mr. Gorman testified that Petitioner made two significant adjustments to other revenues relating to unbilled revenue, which netted to an approximate $2.8 million reduction to test year revenue. (IG Ex. MPG at 12.) The first adjustment labeled Accounting Adjustments – Service Charges increased revenues by approximately $7 million. (*Id.*) The second adjustment labeled Unbilled Revenue decreased revenues by approximately $9.8 million. (*Id.*) Mr. Gorman stated that "Citizens has not provided adequate explanation or justification for these adjustments" and therefore, they should be eliminated to equal zero. (*Id.* at 13.)

In rebuttal, Ms. Prentice stated that she had made the same adjustment as Mr. Patrick by reducing Petitioner's Exhibit LSP-R2, line 3 – accounting adj – service charge by $7,102,910 (leaving an adjustment of ($96,839)) and increasing line 5 – unbilled by the same amount (leaving an adjustment of a negative $2,699,535).

2. *Discussion and Findings.* There is no dispute that the $7,102,910 originally included in accounting service charges has been used to reduce unbilled revenues. Both Citizens and the OUCC agree on this issue. The remaining balance of Petitioner's adjustment is a negative $96,839, which no party disputes was related to a settlement. However, the parties are in dispute as to how the adjustment should be reflected in Petitioner's revenue requirement. The OUCC contended that Petitioner's adjustment of $96,839 should not be accepted because this adjustment is related to a settlement that should be considered non-recurring. In rebuttal, Petitioner stated "[t]he very fact that the settlement is non-recurring, is why the adjustment should be made." (Pet. Ex. LSP-R2 at 19.)

We find that Petitioner's *pro forma* test year revenue decrease of $96,839 should be rejected. Petitioner provided nothing in direct testimony that describes the $7,006,071 *pro forma* test year revenue increase shown on Petitioner's Exhibit LSP-1. The only testimony provided by

[1] Mr. Patrick referenced the incorrect number in his testimony, but his schedules used $7,102,910.

Ms. Prentice was "[o]ther changes reflected in Petitioner's Exhibit LSP-l, page 7 include removing test year accounting adjustments of $12,920,546 ..." There was no testimony explaining that the two adjustments she refers to are an "Accounting Adj – Service Charge to increase test year revenues of $7,006,071 and an additional test year revenue increase of $5,914,475 for an "Accounting Adj – Delivery Charge ($7,006,071 + $5,914,475 = $12,920,546). Nor was there testimony explaining what was included in the adjustment.

In fact, the OUCC through more than one round of discovery questioned Petitioner concerning the $7,006,071 test year *pro forma* revenue increase. Petitioner responded that "this adjustment captures three broad categories of adjustment – unbilled revenue adjustment from a prior period, reclassification of CIAC dollars and a non-recurring adjustment reflecting a settlement with a customer." Petitioner also provided a schedule that contained 56 adjustments that it claimed fit into one of the three categories referred to in their discovery response, including the $96,839 settlement amount in dispute. Petitioner did not explain whether or not all these adjustments were included in Petitioner's test year revenues of $170,856,374. Given Petitioner's proposed adjustment increases test year revenues, one could reasonably assume these adjustments were not included in test year revenues.

The burden is on Petitioner to show a fixed, measurable and known change to test year revenues necessitates an adjustment to test year revenues, and Petitioner has not met its burden on this issue. Accordingly, the Commission finds that Petitioner's remaining adjustment of $96,839 should be disallowed.

In addition, we note that Petitioner's testimony was either non-existent or vague regarding many of their proposed revenue adjustments, which is unacceptable. Petitioner also combined several revenue adjustments together making it difficult for all parties involved to process this case. All adjustments should be fully identified and explained with the filing of Petitioner's direct testimony.

D. *Late Payment Charges (Penalty Revenues).*

1. *Petitioner's Direct Evidence*. Ms. Prentice sponsored w/p # W660/A which summarized the Miscellaneous Revenue Adjustment of a negative $1,876,173. A line item included in this schedule is Late Payment Charges of a negative $103,216. Petitioner proposed to reduce Late Payment Charges using a three year average of $1,156,654.

2. *OUCC's Evidence*. Mr. Patrick stated Petitioner adjusted late payment charges downward by $103,216 ($1,259,870 test year late payment charges less a three year average of $1,156,654). (*Id.* at 19.) Mr. Patrick stated this adjustment was improper, because in determining a decrease in late payment charges, Petitioner relied on information from the utility's prior owner, the Department of Water, whose operations were run by Veolia. Mr. Patrick stated that Citizens has been running the water utility for less than two years. Therefore, Citizens' proposed three year average was based on another entity's procedures, policies, and practices. Mr. Patrick stated that as a new owner, Citizens Water should rely on its own operations to establish how much revenue it will acquire through late payment charges. Mr.

Patrick stated Citizens Water should not use a three year average until it has been operating for three years. (*Id.* at 20.)

3. *Petitioner's Rebuttal Evidence*. Ms. Prentice stated Petitioner used a three-year average to determine *pro forma* miscellaneous revenues attributable to the Late Pay Charge, Damaged Meter Replacement Charge, Miscellaneous Service Revenue - Other Revenue, Contract Specific Customer Revenue, Collection Charge and Tampering Penalty Fees. (Pet. Ex. LSP-R7 at 21.) Ms. Prentice stated that a three-year average was used to recognize that these miscellaneous revenue accounts vary from year-to-year, and simply relying upon the test year amounts may not be representative of an ongoing level of revenue. *(Id.* at 22.) Ms. Prentice noted that Mr. Patrick does not take issue with the concept of using an average as a basis for the amount of *pro forma* miscellaneous revenue, but he does take issue with the adjustments because "Citizens Water has been in business for less than two (2) years" and should not rely on another company's operating history. *(Id.)*

Ms. Prentice disagreed with Mr. Patrick's assessment that as a new company, Citizens should not rely on another operator's history with respect to miscellaneous revenues. (*Id.* at 22.) As an example, Ms. Prentice stated that late pay charges are automatically included in a customer bill pursuant to a Commission prescribed formula. (*Id.*) The application of the late pay charge is completely dependent on the payment timeliness of customers, and it bears no relationship to the ownership of the utility. Using a three-year average normalizes the fluctuation in revenue that occurs from year-to-year with respect to late pay charges. (*Id.*)

4. *Discussion and Findings*. Petitioner proposed using a three-year average to determine a representative level of revenues received from its Late Pay Charge. The OUCC and Industrial Group proposed that the Commission reject the use a three-year average and instead rely on the test year amounts. Petitioner contends that the use of a three-year average "normalizes" Petitioner's penalty revenues that otherwise fluctuate from year-to-year.

While we acknowledge that the level of penalty revenue may fluctuate from year-to-year, absent a rationale that test year revenues are inappropriate as a basis for the revenues going forward, we believe that a multi-year average should not be used to determine future revenues in this case. We find that Citizens has not sufficiently demonstrated that test year penalty revenues are inappropriate. We are further hesitant to apply a prior operator's history to Citizens for purposes of making a determination on going-forward amounts. Accordingly, we find no present rate adjustment should be made to test year late payment charges of $1,259,870.

E. *Non-recurring Charges (Other Revenues – Miscellaneous).*

1. *Petitioner's Direct Evidence*. Ms. Prentice provided workpapers w/p# W660/A, wp# W660/B and w/p #'s W660/1 through W660/18 to assist in understanding Petitioner's position on each miscellaneous revenue category. The purpose of Petitioner's Exhibit LSP-1, page 8, is to show the amount of "other revenues" included in Petitioner's proposed *pro forma* revenue requirement. The adjustment on page 8 of Exhibit LSP-1 amounts to a $1,187,173 reduction in other revenues and includes each miscellaneous charge, such as

reconnection and collection fees, return check charges, late payment charges, smaller miscellaneous items, and items charged to this account in error. (Pet. Ex. LSP at 7.)

2. *OUCC's Evidence*. The OUCC accepted Petitioner's proposed level of non-recurring charges for Reconnection Charges of $160,925, Monthly Read at Customer Request Charges of $0, and Returned Check Charges of $39,550. The OUCC also accepted, Establish Account & Install Meter Charges, Temporary Hydrant Connection Charges, Late Reporting of Temporary Hydrant Meter Usage Charges, Install/Modify Private Fire Protection Charges, Damaged Meter Replacement – Repair Charges and Private Fire Protection Turn On Charges, collectively Other Water Revenues of $276,991. (Public's Ex. 1 at 33-36.)

However, the OUCC rejected Petitioner's proposed *pro forma* adjustments to other non-recurring charges. With respect to the Damaged Meter Replacement Charge, Miscellaneous Service Revenues, Customer Specific Contract Charges and Collection Charges, the OUCC disagreed with Petitioner's proposal to use a three-year average since Citizens has been operating the water utility for less than two years. (Pub. Ex. No. 1 at 28-32.) The OUCC also proposed the Commission disallow Petitioner's adjustment to Tampering Penalty Fees, which is based on a two (2) year average. (*Id.* at 32-33.) Mr. Patrick stated that the policies and procedures employed by Citizens Water are not those that were used by Veolia Water to generate the revenues in 2010 and 2011 on behalf of the City of Indianapolis. Mr. Patrick stated it does not make sense for a new owner to use an average that includes data from its predecessor's operations. (*Id.* at 29-35.) Specifically, the OUCC proposes the *pro forma* amount of $259,800 (1,299 instances in 2012 multiplied by the $200 fee) less the 2012 test year amount of $64,100. Deducting the general ledger amount of $64,100 from the *pro forma* amount of $259,800 creates an adjustment of $195,700.

Mr. Patrick indicated that $81,869 of Other Revenues – Miscellaneous should not be removed from the revenue requirement because Petitioner did not provide sufficient evidence that it should be removed. (*Id.* at 35)

3. *Industrial Group's Evidence*. Mr. Gorman testified regarding the Company's negative $1.187 million adjustment to its operating revenue for Miscellaneous revenues. Mr. Gorman testified that the adjustments made by the Petitioner were largely based on using either two or three year averages of various Miscellaneous Revenue accounts, or were simply eliminated as erroneous entries. (IG Ex. MPG at 16). Mr. Gorman stated his disagreement with using multi-year averages as for the most part the data reflected an upward or downward trend. In those cases, Mr. Gorman stated that actual test year data should be used to determine the level of miscellaneous revenue. (*Id.* at 16-17). With respect to the revenue that Citizens simply eliminated, Mr. Gorman testified that in the absence of justification for the elimination, the test year amounts should be included as operating revenue. (*Id.* at 17). Based on his own adjustments, Mr. Gorman stated that Citizens' *pro forma* operating revenue should be increased by $1.21 million in Miscellaneous Revenues. (*Id.* at 5).

4. *Petitioner's Rebuttal Evidence*. Ms. Prentice stated that Petitioner made *pro forma* adjustments to the following miscellaneous revenue accounts by using a three-year average of each of the accounts: late pay charge, damaged meter replacement-replacement

charge, miscellaneous service revenue-other revenue, contract specific customer revenue, collection charge and tampering penalty fee. Ms. Prentice further stated that these adjustments were made to recognize that these miscellaneous revenue accounts vary from year to year, and simply relying upon the test year amounts may not be representative of an ongoing level of revenue. Ms. Prentice stated Mr. Patrick does not seem to take issue with the concept of using this three-year average as a basis for determining the amount of *pro forma* miscellaneous revenue, but he does take issue with the adjustments because "Citizens Water has been in business for less than two (2) years" and should not rely on another company's operating history. (Pet. Ex. LSP-R at 21-22.)

Ms. Prentice stated that damaged meter replacements are not likely to change as a result of a change in ownership. She stated that meters are damaged and in need of replacement based on a multitude of reasons that have nothing to do with ownership of the company. With respect to Miscellaneous Service Charge – Other Revenue, she noted that such revenue is received by Petitioner for meter reading services provided to other utilities. She stated this is a service provided to those utilities every year. She stated it is not likely to change as a result of a change in ownership but would be more likely to change as a result of a number of customers served by those other utilities. She stated that contract specific customer revenue is derived from customers for services provided not related to the production and distribution of water. She stated this activity fluctuates according to the number of customers who request these services, and is not likely to change as a result of a change in ownership. She stated that collection charges may be influenced by a change in ownership but asserted they are also impacted by a multitude of other factors, including changes in the economy and individual customer circumstances. She stated that revenues from tampering fees are not likely to be influenced by the change in ownership since this activity fluctuates according to the number of customers who attempt to alter their meters in some way. (*Id.* at 23-24)

Ms. Prentice states that the OUCC's proposed adjustment to include $81,869 of Other Revenues – Miscellaneous should be rejected because each of the transactions making up that amount is non-recurring in nature. (*Id.* at 25) Other Revenues – Miscellaneous consists of 1) System – Related Corrections, 2) Service Recoveries, 3) Payment Corrections, and 4) Guaranteed Revenue Offsets. (*Id.* at 24) Many of these transactions were corrections resulting from or generated by Petitioner's legacy billing system (*Id.*)

5. *Discussion and Findings*. We find Petitioner's proposed levels of non-recurring charges for Reconnection Charges of $160,925, Monthly Read at Customer Request Charges of $0, and Returned Check Charges of $39,550 are approved. We also find Petitioner's *pro forma* adjustments for Establish Account & Install Meter Charges, Temporary Hydrant Connection Charges, Late Reporting of Temporary Hydrant Meter Usage Charges, Install/Modify Private Fire Protection Charges, Damaged Meter Replacement – Repair Charges and Private Fire Protection Turn On Charges, collectively Other Water Revenues of $276,991 are approved.

Petitioner proposed using a three-year average to determine a representative level of revenues received from its Late Pay Charge, Damaged Meter Replacement - Replacement Charge, Miscellaneous Service Revenue-Other Revenue, Contract Specific Customer Revenue,

Collection Charge, and a two-year average for Tampering Penalty Fee. The OUCC and Industrial Group proposed that the Commission reject the use a three-year average and instead rely on the test year amounts. Petitioner contends that the use of a three-year average "normalizes" Petitioner's revenues associated with these charges that otherwise fluctuates from year-to-year.

As noted above in our discussion of late payment charges, we believe that a multi-year average should not be used in this case absent evidence that test year revenues are not reflective of going-forward amounts. Accordingly, we find Operating Revenues Associated with Damaged Meter Replacement Charge, Miscellaneous Service Revenues, Customer Specific Contract Charges, and Collection Charges shall be based on Citizen's test year revenues.

Regarding Petitioner's tampering penalty fee revenue, Petitioner's w/p# W660/5A reflected *pro forma* tampering penalty fees for 2012 of $259,800. Deducting test year tampering penalty fee revenue of $64,100, the amount recorded on Petitioner's general ledger, from Petitioner's *pro forma* amount, yields a *pro forma* test year revenue increase of $195,700. Thus, the Commission accepts the OUCC's *pro forma* amount.

For Other Revenues–Miscellaneous, Petitioner explained how System-Related Corrections and Guaranteed Revenue Offsets can be related to Petitioner's legacy billing system. But Service Recoveries and Payment Corrections will remain with any billing system. Petitioner provided a list of 150 transactions that made up the four categories (see CEP-34). But on questioning from the Presiding Officers, Ms. Prentice could not classify which of the transactions could be placed in the categories. Tr. at I-137. Without a breakdown by classification, the Commission accepts the OUCC's position and includes $81,869 in the revenue requirement.

6. Revenue Requirement Offsets and Other Income. Petitioner's Exhibit LSP-1, page 2 reflected proposed revenue requirement offsets of $4,952,159 associated with System Development Charges and $950,000 related to the Carmel note. Petitioner's schedule also reflected another revenue requirement offset of Other Income, net of $2,858,322, which is comprised of $2,616,452 in interest income and $241,870 in other income. The OUCC accepted Petitioner's offsets for interest income and system development charges, but were in disagreement with the amount of Other Income and the Carmel note. In addition, the OUCC proposed revenue requirement offsets for an Atrazine settlement in the amount of $942,715, for a Brown County note of $100,197, and for an increase to the revenue requirement of $12,753 associated with interest expense on customer deposits.

Based on the foregoing, the parties agree to the amounts for interest income of $2,616,452, and system development charges of $4,952,159 and we so find. The remaining adjustments are discussed below.

A. *Atrazine Settlement.*

The OUCC proposed that Petitioner amortize its settlement of $2,828,146 received from the manufacturers of Atrazine in January 2013 over a three-year period to offset its revenue

requirement. (Pub. Ex. No. 1 at 12.) The settlement of the Atrazine lawsuit was to recover "costs incurred by water utilities associated with monitoring and treatment to remove Atrazine from water supplies." (Pet. Ex. LSP-R, p. 26.) Petitioner stated that "this is a one-time, non-recurring event." (*Id.*)

We have held that settlements are non-recurring in nature and should not be considered in determining a utility's rates and charges. See *New Whiteland Water Utility*, Cause No. 39052-U, 1991 WL 11811765, at *1 (IURC April 17, 1991). We agree that Petitioner, by not including the Atrazine settlement in revenues, has addressed this issue appropriately because this is a non-recurring event, and we decline to amortize the settlement as recommended by the OUCC.

B. *Brown County and Carmel Notes.*

Shown on Petitioner's Exhibit LSP-1, column E, Petitioner offset its proposed revenue requirement by $950,000. The OUCC does not accept the amount of Petitioner's offset. In response to OUCC DR 7-21, Petitioner provided the amortization schedule for the Carmel accounts receivable note (Pub. Ex. No. 1 at 10). To calculate his adjustment, Mr. Patrick used the amount of principal payments received, during the adjustment period, of $950,300 ($469,423 in December 2012 and $480,877 in June 2013) based on the Carmel note amortization schedule, which resulted in a slightly higher adjustment ($300). (*Id.* at 10-11) On rebuttal, Petitioner agreed to the OUCC's recommendation, which can be seen at Ex. LSP-R2, page 2, line 43. (Pet. Ex. LSP-R at 3). We find that $950,300 is the appropriate revenue offset for the Carmel note.

Regarding the Brown County note, the OUCC proposed to reduce the total revenue requirement by the Brown County note receivable principal amount due in the twelve months following the test year of $100,197 (Pub. Ex. No. 1 at 11). This note was acquired by the City of Indianapolis Department of Water from Eastern Morgan County Rural Water Company and subsequently by Citizens Water. (*Id.*)

In rebuttal, Petitioner did not recognize receipt of the principal amount from Brown County as a cash receipt. Likewise, Petitioner did not reduce its revenue requirement by Brown County's annual principal payment. Petitioner stated that the interest that is received is captured as interest income and therefore, is an offset to revenues. Petitioner's witness Prentice stated that the principal from this note should be used to retire the outstanding note receivable, thus it should not be used to reduce the total revenue requirement. Ms. Prentice stated:

> In Cause No. 43645, it is explicitly stated that the proceeds from the Carmel note are to be used to offset revenue-funded capital expenditures and annual debt service. And, as such, the principal from this note has been and continues to be treated as a revenue offset. However, there is no mention of the Brown County note in Cause No. 43645.

(Pet. Ex. LSP-R, p. 25.)

As the holder of the Brown County note, payments received from Brown County are recorded to reduce the note receivable balances on Citizens' books. However, the actual cash

received is not placed in a restricted account, but instead is deposited into Citizens cash account. Therefore, we agree with the treatment proposed by Mr. Patrick and find that the $100,197 principal received from this note annually should be used as an offset to Petitioner's revenue requirement.

C. *Other Income.*

In his direct testimony Mr. Patrick increased Other Income by $56,265, due to a "negative contribution" from CSS that should be identified as an expense and not other income. Mr. Patrick proposed that the Other Income decrease to Petitioner's revenue requirement should be $298,135. In her rebuttal testimony and exhibit SEK-R7C, Ms. Karner explicitly stated that "no charitable contributions remained in *pro forma* operating expenses, regardless of where they had been charged." SEK-R at 24. We find that $298,135 shall be the Other Income reduction from the revenue requirement.

D. *Advertising Billing Insert Revenue.*

During cross examination with Mr. Lykins, the OUCC discussed Citizens' practice of including advertising through inserts in Citizens' customers' combined gas, water and wastewater bills. During cross-examination of Citizens' witness Sabine Karner, Ms. Karner confirmed that revenues from advertising should be included as a water utility revenue requirement offset. Ms. Karner testified that advertising commissions of $47,600 were recorded to the gas division during the test year. Accordingly, Ms. Karner testified that approximately $15,000 should be allocated to the water utility. (Tr. at I-10 - 11.) We find that $15,000 shall be offset from the revenue requirement.

E. *Interest Expense – Customer Deposits.*

Mr. Patrick proposed to eliminate from the debt service revenue requirement the $12,753 annual interest expense associated with customer deposits and to include this amount as a direct increase in the revenue requirement. (Pub. Ex. No. 1 at 13.) Citizens did not address this revenue requirement reclassification in its rebuttal testimony. The Commission finds that this issue is a matter of presentation. We reject Mr. Patrick's method of presentation because the Commission has included Customer Deposits in the calculation of debt service in Section 7(B)(2)(d).

7. Petitioner's Revenue Requirements.

A. *Capital Program.*

1. *Evidence.* Lindsay C. Lindgren, Vice Present of Water Operations for Citizens Energy Group, described the water utility system. (Pet. Ex. LCL at 4-5.) Mr. Lindgren stated that Petitioner had made various facility-related improvements and operational improvements to the water system since acquiring it. (*Id.* at 5-8.) Mr. Lindgren stated how the need and timing for additions to the water system are determined, described the most recent capital planning that has been performed for the water system, and discussed how Petitioner

implements the capital projects identified as necessary by its planning process. (*Id.* at 12-13.)

Mr. Lindgren sponsored Petitioner's Exhibit LCL-1, which is a Capital Expenditure Summary Chart for the water system. (*Id.* at 14.) Mr. Lindgren stated that the major categories of the utility's annual capital improvement program are Boosters and Control Valves, Distribution System, Fleet and Facilities, Source and Supply, Tanks, Technology and Support Services, Treatment Plants, CSS Capital, and SFS Capital. (*Id.* at 14-15.) Mr. Lindgren stated he believes that the costs shown on that exhibit for projects to be undertaken in fiscal years 2013 through 2015 are reasonable projections and are representative of the costs that actually will be incurred. (*Id.* at 21.) Petitioner's Exhibit LCL-1 reveals a three-year average of $58,888,333 for total water capital expenditures.

Mr. Larry W. McIntosh, Utility Analyst for the OUCC's Water/Wastewater Division, stated that Petitioner plans to spend an average of $56,889,000 on capital expenditures for FY2014 and FY2015. (Pub. Ex. No. 6 at 11.) He stated that $56,889,000 per year should be used for Petitioner's proposed capital improvement projects based on an average of fiscal years 2014 and 2015. (*Id.* at 12.) Mr. McIntosh stated that he excluded FY2013 because Petitioner's fiscal year ends September 30, and most, if not all of Petitioner's fiscal year 2013 capital projects should be completed prior to an order being issued in this Cause. (*Id.*)

Mr. Edward R. Kaufman, Chief Technical Advisor with the OUCC's Water-Wastewater Division, stated that Mr. Lindgren's testimony shows that Petitioner's proposed capital expenditures are $57,986,000 in fiscal 2014 and $55,793,000 in fiscal 2015 (for an average of $56,889,500). (Pub. Ex. No. 2 at 14.) Mr. Kaufman stated the amount of capital expenditures that Petitioner is seeking to have cash funded.

In rebuttal, Mr. Lindgren stated that, although Petitioner expects all of its estimated 2013 spending of $62,886,000 to be actually spent during 2013, additional projects have been identified over the next three years that further support the use of a 3-year average as representative of water system needs going forward. (Pet. Ex. LCL-R at 3-4.) According to Mr. Lindgren, Mr. McIntosh's elimination of the entire 2013 estimated spending from his averaging and using a shorter 2-year time frame inappropriately reduces Petitioner's *pro forma* capital expense and ignores the normal variation in year-to-year amounts due to system needs, environmental conditions, and customer needs in the longer term. (*Id.* at 4.) Mr. Lindgren stated that, by eliminating all of Petitioner's 2013 capital spending, it is less likely that Mr. McIntosh's *pro forma* capital expense reflects a representative level of future spending for capital purposes. (*Id.*) Mr. Lindgren stated that use of a 3-year average (2013 through 2015) better reflects the on-going level of capital spending Petitioner will experience. (*Id.*)

2. *Discussion and Findings.* In considering the appropriate amount of capital expenditures to include to approve, we are confronted with essentially two proposals. Citizens requested that $58.9 million (rounded) be approved based on a three-year average of expected capital expenditures during FY 2013 through FY 2015. The OUCC recommended approval of $56.9 million (rounded) based on a two-year average of projected capital expenditures during FY 2014 and FY 2015. The Industrial Group adopted a similar recommendation.

There is general agreement among all parties that the utility must increase the level of capital expenditures over the amounts invested by the previous owner and operator of the utility. Indeed, the two proposals described above represent levels of capital expenditures roughly $14.5 million to $16.5 million above that in FY 2012. We also note that the OUCC recommended, after extensive efforts to verify and evaluate the plan, that the Commission approve Citizens' capital improvement plan.

We disagree with Citizens' premise that establishing the E&R revenue requirement is entirely divorced from consideration of the capital projects it is meant to support. Our approval of any regulated utility's expense is conditioned on our determination that expense is reasonable, necessary and prudent. *See, e.g., L.S. Ayers v. Indianapolis Power and Light Co.*, 169 Ind. App. 652, 657, 351 N.E.2d 814, 819 (Ind. Ct. App. 1976) ("While the utility may incur any amount of operating expense it chooses, the Commission is invested with broad discretion to disallow for rate-making purposes any excessive or imprudent expenditures"); *City of Evansville v. S. Ind. Gas and Elec. Co.*, 167 Ind. App. 472, 479, 339 N.E.2d 562, 569 (Ind. Ct. App. 1975). We cannot fulfill our regulatory obligation if we cannot review both the proposed level of expense and the proposed program itself. To adopt any other position would only promote the simplistic presentation of evidence that forces the OUCC and other parties to undertake the sort of investigation described by Mr. McIntosh in his testimony and threaten our ability to review the appropriateness of the proposed capital program and corresponding budget as part of our function as regulators. Moreover, it would fly in the face of established precedent requiring that our findings be supported by substantial evidence. *City of Muncie v. Pub. Serv. Comm'n.*, 177 Ind.App. 155, 158, 378 N.E.2d 896, 898 (Ind. Ct. App. 1978); *City of Evansville*, 167 Ind. App. at 485, 339 N.E.2d at 572.

In this instance, we are presented with broad statements regarding the need to increase spending on E&R and provided with broad categories of expenses. (See LCL-1). To be sure, Citizens has provided some detail as to representative projects within those categories, and the OUCC has recommended approval of Citizens capital plan for at least FY 2014 and FY 2015 following its own investigation. But we have not been presented anything resembling a capital plan for FY 2016. In fact, Citizens' own discovery responses and testimony at the hearing indicate that it does not have a project listing or expected capital expenditures for FY 2016. Tr. at H-78, H-95. Nevertheless, Mr. Lindgren stated on rebuttal that Citizens has identified "additional projects over the next three years" that support the $58.9 million in revenue the Company requests. (Pet. Ex. LCL at 4)

We are not persuaded by this testimony. What Mr. Lindgren, in effect, means is that Citizens has identified roughly $62.9 million (rounded) in additional capital expenditures to be expended in FY 2016 (or at least spread out among FY 2014, FY 2015 and FY 2016). This $62.9 million is the same amount Citizens planned to expend in FY 2013. Our concern with this assertion is heightened by the testimony of Mr. Harrison which indicates that the budgets developed by Citizens may include a wide range of cost estimates. (Pet. Ex. JAH at 8-9). Under such circumstances, we cannot rely on the claim that the capital budget will include an additional $62.9 million (rounded) for the purpose of setting the amount of capital expenditures to be included in Citizens revenue requirement or in assessing the reasonableness of the proposed

budgets.

The remaining question, then, is whether we should include FY 2013 in the average. Having reviewed the evidence, we find that FY 2013 is not representative of a going-forward amount. As the OUCC noted, and as Citizens conceded, much of those funds will have been expended prior to the time the rates established in this case go into effect. While we may look to past investment in capital expenditures as reflective of expected future expenses, we will also adjust past expenses when they are out of alignment with future expenses. In this case, the capital expenditure budget for FY 2013 is between $5-8 million above the budgets for FY 2014 and FY 2015. During the hearing, Mr. Lindgren stated that this was due to the fact that projects originally planned for 2012 were delayed to 2013. We do not consider that disparity to be reflective of the ongoing needs of Citizens while the rates established in this proceeding are likely to be in effect. This is especially true in light of Citizens' failure to provide the Commission with substantial evidence identifying projects and related costs supporting its FY 2016 capital budget.

We therefore accept the OUCC's recommendation to approve Citizens capital plan for FY 2014 and FY 2015 and conclude that $56.9 million (rounded) is a reasonable amount given the evidence supporting those two years' capital budgets and Citizens' proposal to issue debt to fund a portion of that amount.

B. *Debt Service Revenue Requirement.*

1. *Rate-Funded E&R (i.e., Cash-Funded or Revenue-Funded E&R).*

a. *Petitioner's Direct Evidence*. Mr. John R. Brehm, Citizens Energy Group's Chief Financial Officer, stated that Petitioner's *pro forma* amount of E&R is $58,888,333 per year based on the average of the 2013-2015 capital spending requirements. (Pet. Ex. JRB at 17.) Mr. Brehm stated the municipal ratemaking statute (I.C. 8-1.5-3-8(5)) lists E&R as a component of revenue requirements. (*Id.*) He stated that in the DOW's last rate case, Cause No. 43645, the DOW testified that revenue funding 50 percent of its annual amount of E&R was a step in the right direction toward the ultimate goal of getting the funding of extensions and replacements "off the credit cards" of relying on debt funding for a portion of this element of revenue requirements. (*Id.* at 17-18.) Mr. Brehm stated that in that case, the Commission expressed concern about "the highly-leveraged nature of [the DOW's] capital structure" and issued an Order providing for 50 percent of *pro forma* extensions and replacements to be revenue funded. (*Id.* at 18.)

Mr. Brehm stated additional progress toward the goal of revenue funding E&R should be made in this case and, consequently, Petitioner volunteers for this rate case to include $44,000,000 of its total *pro forma* annual amount of E&R in revenue requirements. (*Id.*) This means approximately 75% of the water system's annual average amount of E&R will be "revenue funded," and the remainder will be funded with new issuances of debt. (*Id.*) Mr. Brehm clarified that if the total $58.9 million amount of *pro forma* E&R is reduced for any reason, the amount of revenue funded E&R Petitioner is volunteering should not likewise be reduced. (*Id.* at 19.) He stated that this is because even with the implementation of the proposed

rates, Petitioner's total annual spending far exceeds its total revenue by over $31 million cumulatively in 2014 and 2015. (*Id.*)

Mr. Brehm stated Petitioner's bond covenants beginning in 2014 require Petitioner to maintain a minimum debt service coverage ratio of 1.2 times first lien debt service and 1.1 times first lien and second lien debt service. (*Id.* at 20.) If Petitioner does not maintain such minimum coverage ratios, it is required to seek a rate increase under the "rate covenant" in its bond indenture. (*Id.*) Also, if Petitioner does not maintain a minimum coverage ratio of 1.1 times debt service, taking into consideration debt service on any new debt it must issue to meet its obligations to provide service to customers, its bond indenture prevents Petitioner from issuing new bonds irrespective of how much the proceeds from new bonds may be needed in order to fulfill its obligations to provide service to customers (this is commonly known as the "additional bonds test"). (*Id.* at 20-21.)

Mr. Brehm stated that the rates proposed in this case, which include "revenue funded" extensions and replacements of $44 million as a component of revenue requirements, will improve the water system's total debt service coverage ratio for fiscal years 2014 and 2015 to a more appropriate and financially prudent level of 1.54 times and 1.62 times, respectively. (*Id.* at 21.)

Mr. Brehm testified that a reduction in credit rating would be onerous for Petitioner and its customers, and could place the water system in a situation that cuts Petitioner off from accessing important sources of funding. (*Id.* at 24.) For example, falling to a BBB+ rating would force Petitioner to agree to more restrictive covenants with respect to periodic renewals of its bank facilities. (*Id.*) Mr. Brehm stated that, in the current market, if Petitioner had a BBB+ credit rating, the interest rate it would pay on new debt would be approximately 50 basis points higher. (*Id.* at 24-25.)

Mr. Steven M. Fetter, President of Regulation UnFettered, testified regarding the importance of strong credit ratings for a public water entity, as well as the relationship of credit ratings to the rates and charges for water service proposed by Petitioner. (Pet. Ex. SMF at 4.) Mr. Fetter stated that a utility's credit ratings have a significant impact on whether that utility will be able to raise capital on a timely basis and upon reasonable terms. (*Id.* at 5.) He stated that a utility with strong credit ratings is able to access the capital markets on a timely basis at reasonable rates and also shares the benefit of such attractive interest rates with ratepayers. (*Id.* at 6.)

According to Mr. Fetter, the rating agencies view Petitioner positively. (*Id.* at 9.) S&P rates Petitioner's first lien bonds at 'A+', and second lien bonds at 'A', both with Stable outlooks. (*Id.*) Moody's maintains ratings at a comparable level on Petitioner's bonds at 'A1' on the first lien bonds and 'A2' on the second lien bonds, both having Stable outlooks. (*Id.*) Fitch's ratings are lower at 'A' and 'A-', also with Stable outlooks. (*Id.*)

Mr. Fetter testified that all three rating agencies do not view the regulatory climate for Petitioner the same way. (*Id.* at 10.) He stated that most municipal utilities across the U.S. are self-regulated, while in Indiana the Commission holds rate-setting responsibility, unless a

municipal utility has taken the legal steps to opt out. (*Id.*) Mr. Fetter stated that Indiana's less familiar regulatory framework for municipal utilities has caused Moody's and Fitch "greater pause" than it has S&P. (*Id.*) He stated that the hesitation on the part of Moody's and Fitch appears to be specifically focused on the regulation of municipal utilities under the jurisdiction of the Commission, driven both by the adequacy of the rates that are ultimately approved in a rate case and the length of time that the rate case process might take. (*Id.* at 11.)

Mr. Fetter, referencing a Fitch Ratings report, indicated that the ratios for First Lien debt service coverage would be viewed as "Midrange," and stated that Petitioner's forecasted credit metrics easily meet the 1.2x bond covenants that will be required beginning with fiscal year 2014, and are wholly consistent for first lien debt holding an 'A+' credit rating. (*Id.* at 13.) With respect to Second Lien debt service coverage, Mr. Fetter stated that Fitch describes these ratios as "Midrange," easily meeting the 1.1x bond covenants and wholly consistent for second lien debt rated at the 'A' level. (*Id.*) He stated that computing debt service coverage out for the next 3 years at present rate levels shows a much weaker credit rating profile. (*Id.*) Mr. Fetter stated that coverage ratios are not considered to be sufficient by the rating agencies unless they are sustained at a comfortable margin above minimum bond covenant levels. (*Id.*) He stated that operating continuously at or near minimum coverage levels would create ongoing risk of a downgrade, which negative action brings diminished access to capital and higher financing costs. (*Id.*)

b. *OUCC's Evidence*. Mr. Kaufman testified that Petitioner's proposed cash funded E&R of $44 million is not based on a calculation or a percentage of its projected capital needs; it is simply a figure that Petitioner "volunteers" as reasonable. (Pub. Ex. No. 2 at 13.) He stated that Petitioner's current rates were approved in Cause No. 43645. In that Cause the City of Indianapolis's approved rates included approximately $27.9 million per year for cash funded E&R and that, accordingly, Petitioner is seeking to increase its cash funded E&R by approximately $16.1 million in this case over currently authorized rates. (*Id.*) Mr. Kaufman stated that almost 64% ($16.1M / $25.3M) of Petitioner's proposed rate increase is driven solely by Petitioner's proposal to increase its cash funded E&R. (*Id.*)

Mr. Kaufman stated Petitioner is not seeking to fund a specified ratio of capital improvements through cash funded E&R. (*Id.* at 14.) He stated Petitioner seeks to include $44 million in rates for E&R irrespective of its capital needs. (*Id.*) Mr. Kaufman stated Petitioner's proposal results in funding its proposed E&R approximately 75% through rates and 25% through other sources (mostly debt). Mr. Kaufman testified that Petitioner's proposed cash funded E&R of $44.0 million is not a specific ratio of capital improvements and is arbitrary. (*Id.*)

Mr. Kaufman stated that at this time it is reasonable for Petitioner to fund a greater proportion of planned capital expenditures through cash versus debt compared to its current authorized rates, but that any movement towards a greater reliance on cash funded E&R should also be tempered by how that movement affects rates. (*Id.* at 15.) Observing that almost 64% of Petitioner's proposed rate increase is driven by its proposal to fund a greater proportion of capital expenditures through cash E&R instead of through debt, Mr. Kaufman stated that a more balanced approach is appropriate at this time. (*Id.*) Mr. Kaufman stated that if Petitioner funds approximately 2/3 of its proposed capital expenditures through rates and 1/3 through debt, it can

still reduce its reliance on debt, while also reducing its proposed rate increase by almost 32%. (*Id.*)

Mr. Kaufman stated that any movement towards a greater reliance on cash funded E&R should also be tempered by how that movement affects rates. Mr. Kaufman testified that a ratio of 66.7% cash E&R and 33.3% debt funded capital improvements is a reasonable compromise between what was authorized in Cause No. 43645 and the 75% cash funded E&R and 25% debt funded capital projects that results from Petitioner's proposal. (*Id.* at 16.)

Mr. Kaufman referred to Mr. Lindgren's testimony and stated that for fiscal years 2014 and 2015, Petitioner's proposed capital expenditures total $113,779,000. (*Id.* at 16.) Pointing to Mr. Brehm's testimony and observing that Petitioner expects to earn $6,500,000 from the sale of the Waterway property in 2015, and that these proceeds will be available to fund Petitioner's future capital requirements, Mr. Kaufman acknowledged that Petitioner's two year (FY2014 and FY2015) capital plan requires a total of $107,279,000. (*Id.*) Mr. Kaufman then calculated that Petitioner's two year proposed capital plan requires an average of $53,639,500. Mr. Kaufman stated that if Petitioner's rates reflect a plan to fund 66.7% of its average annual capital expenditures of $53,639,500 through cash, it would have an annual cash funded E&R requirement of $35,777,547 (rounded to $35,778,000). (*Id.*) The OUCC's proposed cash E&R is $8,222,000 ($44,000,000 minus $35,778,000) less than proposed by Petitioner. (*Id.*)

Mr. Kaufman stated that, holding all other factors constant, his proposal will still lead to an improved total debt service coverage ratio compared to the test year credit metrics. (*Id.* at 17.) He stated that his proposal will lead to somewhat lower coverage ratio than provided by Mr. Brehm's proposal, but that Petitioner's desire to obtain a specified coverage ratio should not drive the Commission's determination of reasonable rates in this Cause. (*Id.* at 17-18.)

Mr. Kaufman stated that an effect of Petitioner's proposal to keep its cash funded E&R amount fixed is that the proposed rate increase remains relatively fixed and immune to changes in the capital improvement plan. (*Id.* at 18.) Mr. Kaufman explained that if five million in the capital improvement plan was found unnecessary, Citizens' cash funded E&R would remain static and the debt issuances would be reduced by five million. This would only reduce the proposed debt service by about $317,900. (*Id.* at 19.) A material reduction in capital spending will only have a minimal influence on the rate increase. Mr. Kaufman stated that Petitioner's proposal to keep its cash funded E&R at a fixed level irrespective to changes in its capital plan should be rejected by the Commission. (*Id.* .) Mr. Kaufman stated that Petitioner does not need Commission authority to issue long term debt, and that even if Petitioner is granted its proposal to include $44 million in rates to fund its projected capital improvements, Petitioner could still borrow funds for E&R, without Commission approval, and include the annual debt service in rates in its next rate case. (*Id.*)

c. *Industrial Group's Evidence*. Mr. Gorman testified against adopting Citizens' proposal to rate revenue fund $44 million of its E&R program. He stated that it was a misleading analogy to compare increasing the rate revenue funding of E&R to getting "off the credit cards" as funding a capital program through long-term debt is not akin to using short-term consumer debt to fund ordinary household expenses. (IG Ex. MPG at 6). Mr. Gorman

testified that funding E&R programs involves investment in major utility infrastructure with long service lives. (*Id.*) Mr. Gorman testified that matching the funding of long-lived assets with a source of capital similar to the life of the asset is a well-recognized, conservative, and reasonable policy spreading the cost of the assets over the generations of customers that will benefit from the assets. (*Id.*) He stated that Citizens' E&R funding should be structured to minimize the cost to customers and maintain a strong credit standing just as the capital program should be managed to minimize cost while maintaining system integrity. (*Id.* at 6-7.)

Mr. Gorman testified that Citizens' proposed rate revenue funding of its E&R program is unreasonable. He stated that while Citizens provided detail regarding the Company's plan, there was no detail or support to show how Citizens considered managing the company's rate structure or the cost to customers while the plan is implemented. (*Id.* at 7.) Mr. Gorman testified that the level of rate revenue funding proposed by the Company provides for an unreasonable increase of $44 million to the Company's revenue requirement without explanation as to why the method of funding should change materially from the utility's last rate case. To put the requested revenue increase in perspective, Mr. Gorman noted that the $44 million in proposed revenue funded E&R actually exceeded the utility's entire capital expenditures in 2012. (*Id.*) Mr. Gorman further contrasted the Company's proposal in this case with what was established in the utility's last general rate case, by noting the Commission previously approved a 50/50 rate revenue/debt funded E&R plan while the Company is now proposing what amounts to a 75/25 split. (*Id.* at 8.)

Mr. Gorman stated that the Company's proposal imposes a higher cost on current customers to fund long-term improvements rather than spreading the cost over the generations that will receive service from the improvements. (*Id.* at 7.) Mr. Gorman stated that this was an unreasonable approach when alternatives exist to balance rate impacts and the Company's financial integrity. (*Id.*) Mr. Gorman stated that Citizens should reduce the level of rate revenue E&R funding to a level that would support a DSC ratio of 1.5x. (*Id.* at 9, IG Ex. MGP-3.) This would reduce the amount of rate revenue funded E&R from $44 million to $3.85 million, increase the amount of debt issued by $8.8 million by 2015, and increase 2015 debt service by $957,000. (*Id.* at 9; IG Ex. MPG-2, -3, & -9.) Mr. Gorman testified this proposal supports a DSC ratio of 1.5x and, using the average of the Company's proposed E&R budgets for 2014 and 2015, revenue funds approximately 64% of the E&R program. (*Id.* at 9.) Mr. Gorman testified that this as a reasonable and balanced plan, which would continue to make a significant contribution to E&R funding after 2015. (*Id.* at 8, 9.)

Mr. Gorman testified that the 1.5x DSC ratio he proposed exceeds the median DSC ratio of 1.4x for large public water and wastewater systems (IG Ex. MPG at 10, IG Ex. MPG 9.2). Mr. Gorman testified that S&P concluded that a DSC ratio with the range of 1.26x to 1.5x would be a "Good Credit" coverage ratio for a public water/wastewater utility. (*Id.*) Mr. Gorman stated that with Citizen's proposed increase in E&R program costs, and the need for a competitive rate structure, S&P's benchmarks show that the 1.5x DSC ratio is reasonable. (*Id.*) Mr. Gorman also testified that comparing Citizens Water to a large public utility system was reasonable because of the unique nature of the Trust, which provides economies of scale through the pooling of resources under the CSS network. (*Id.* at 11.) Mr. Gorman stated that these characteristics support using a 1.4x DSC ratio for public power companies. (*Id.* at 12.) Mr. Gorman stated that a lower DSC ratio benchmark was appropriate to consider because water

utilities typically represent a lower risk to potential investors meaning that the lower median DSC ratios for large public water/wastewater systems indicate that a lower DSC ratio he proposed would still support investment grade bond rating for Citizens Water. (*Id.* .)

Mr. Gorman stated that the 1.5x DSC ratio was higher than the historical DSC ratio earned while the water utility was under the City of Indianapolis' control, when the earned DSC ratio was from 1.2x to 1.3x, and averaged well below the 1.5x he proposes. (*Id.* at 11.) Mr. Gorman explained his proposal to set rates based on the 1.5x DSC ratio provides a stronger coverage under Citizens ownership, and accomplishes Citizens' objectives of rate revenue funding a sizable portion of its E&R program and maintaining a strong investment rating, but does so at a must lower cost to retail customers. (*Id.* at 11.)

d. *SAB Evidence*. SAB witness Roger Goings testified the SAB provided a different perspective than the OUCC with respect to Petitioner's capital project plan. (SAB Testimony of Roger Goings at 4.) Mr. Goings stated that the City of Indianapolis focused its capital plan on the short term view. (*Id.*) He stated that long term planning and long term investment requirements to meet the anticipated population and business growth are essential, as much of the growth will be in the SAB service territory. (*Id.*) The SAB communities support "embedding" a core level of capital costs into the operating plan, to a greater degree than the City did. (*Id.*) Mr. Goings stated that this seems consistent with the Citizens model and rate case approach. (*Id.*) A review of the cross examination of Mr. Goings demonstrates that the SAB's criticism of the OUCC's position was based on a flawed assumption about what was agreed to in DOW's last rate case and not on what the OUCC proposed in this Cause. (Tr. at E 50-61.)

e. *Petitioner's Rebuttal Evidence*. Petitioner's witness Brehm disagreed with the proposals of Mr. Kaufman and Mr. Gorman to use a lower increase in the amount of revenue funded E&R of approximately $35.8 Million compared to the $44 Million amount Petitioner proposed. Mr. Brehm stated that Petitioner could have sought to have the full amount of its E&R included in determining its annual revenue requirements. (Pet. Ex. JRB-R at 3.) He stated that, in accordance with Ind. Code § 8-1.5-3-8, Petitioner's ultimate objective is for the full amount of money needed for making E&R to be funded through revenues to the extent the amount needed for making extensions and replacements is not provided for through annual depreciation expense. (*Id.*) Mr. Brehm noted that Citizens Gas has had all of its E&R included in revenue requirements in each of its last three rate cases. (*Id.*)

Mr. Brehm stated that Petitioner is seeking to make progress toward the goal of fully funding E&R through revenues by having a fixed dollar amount of $44 million included for purposes of establishing the E&R component of its revenue requirement in this case, which is less than its *pro forma* going level amount of annual E&R of $58.8 million. (*Id.* at 4.) He stated this amount increases the percentage of revenue funded E&R from the 50% level established in the DOW's last rate case, to approximately 75%, which is consistent with Petitioner's plan to have all of E&R funded with revenues following its next rate case. (*Id.*) Mr. Brehm stated that Mr. Kaufman and Mr. Gorman seek to substitute their own judgment for that of Petitioner's management and the Citizens Energy Group Board. (*Id.* at 6.)

Mr. Brehm stated that Mr. Kaufman's proposal overstates the revenue funded percentage of E&R of 66.7% because it was not based on a going level computation of the amount of E&R. (*Id.* at 6-7.) Mr. Brehm stated there were multiple conceptual errors Mr. Kaufman made in computing the amount that he asserts to be Petitioner's average annual amount of E&R. (*Id.* at 7-9.) Regarding the sale of the Waterway property, Mr Brehm stated this was a one-time nonrecurring event that should be ignored in determining annual E&R. (*Id.* at 8) Moreover, the OUCC's witness on capital expenditures, Mr. McIntosh, stated the average for 2014 and 2015 is $56,889,000, which implied he did not reduce the amount of capital expenditures by the Waterway property sale. *(Id.* at 8-9)

Petitioner's witness Fetter took issue with the testimony of Mr. Gorman and Mr. Kaufman relating to credit rating issues. Mr. Fetter asserted that the water utility previously had been extremely troubled and received emergency rate relief from the Commission. (*See Id.*) (Pet. Ex. SMF-R at 5) Mr. Fetter indicated the debt service ratios underlying that weak water utility should not be used as the norm in this proceeding. (*See Id.*)

Mr. Fetter stated that a very unusual situation existed, which required special treatment from the Commission. (*Id.* at 7.) He stated that the Commission should decide this case on current norms, especially since its decision in this proceeding is being closely watched by the rating agencies. (*Id.*) Mr. Fetter stated that Mr. Kaufman's suggestion that a regulated utility should not aim for a credit profile that the rating agencies would view as supportive of that entity's current credit rating should be rejected. (*See Id.* at 8.)

f. *Discussion and Findings.* In Cause No. 43645 (final Order page 61 City of Indianapolis Water) we determined it was appropriate for Petitioner to fund 50% of its proposed capital expenditures (from its 2 year proposed capital plan) through cash funded E&R and the remaining 50% through debt. All parties to this Cause agree that at this time Petitioner should fund a greater proportion of its proposed capital expenditures through rates and a smaller proportion through debt. It is clear from the evidence that funding a greater portion of capital expenditures through rates verses debt will improve Petitioner's financial posture and its credit metrics. None of the parties disputed this principle.

The question that this Commission must address, then, is determining an appropriate balance between funding E&R through rates verses debt, as this determination will impact the utility and ratepayers. Thus we need to balance Petitioner's goal to improve its financial posture, while simultaneously authorizing a rate increase that is not unduly burdensome to the ratepayers.

Petitioner's witness Brehm argues that Citizens is entitled under Ind. Code § 8-1.5-3-8 to have the full amount of its annualized E&R included in determining its revenue requirement, and thus, the Commission has no discretion other than to approve its proposal to include less rate-funded E&R and support the remaining E&R with debt. We disagree with this interpretation of the statute and Indiana case law.

With respect to Section 8, the Commission has the duty to first determine the appropriate and prudent level of E&R for a given utility. We have done so above, but with the understanding that not all of the annual E&R expense will be funded through rates. If Mr. Brehm's assertion

were taken to the extreme, the Commission would have no discretion to do anything but rubberstamp *any* level of E&R proposed by a municipal utility. Given that Section 8(b) requires that a municipal utility's rates are "nondiscriminatory, reasonable, and just" and subject to Commission approval under Section 8(f)(2), Section 8 does not support Mr. Brehm's assertion or the position Citizens has taken in its proposed order.

With respect to case law, Citizens cited to *Board of Directors for Utilities of the Dept. of Pub. Utilities of the City of Indianapolis v. Office of Util. Consumer Counselor*, 473 N.E.2d 1043 (Ind. Ct. App. 1985) ("Citizens Gas Appeal"). In that case, the Court of Appeals reversed the Commission's decision in Cause No. 36979 to reduce Citizens Gas's proposed E&R on the basis of Citizens Gas's historical level of debt. However, there are several key aspects that distinguish that case from the present Cause. First, it does not appear that Citizens Gas proposed issuing debt in Cause No. 36979, and the Commission's decision would have forced Citizens Gas to do so to fund E&R at the amount it proposed. Moreover, despite the Commission's decision to require debt issuance, or in the Court's words, "punish the utility," the Commission made no allowance for debt service on the required debt issuance. *See Citizens Gas Appeal* at 1053.[2]

Here, Citizens' E&R proposal includes funding a portion of E&R through debt issuance. In responding to questions from the Presiding Officers, Mr. Lykins stated that there was no question Citizens would take on more debt to fund its proposed E&R program, and that the parties are "just trying to decide what the right balance is for that additional debt." (Tr. at G-142). Mr. Lykins' statement appears to contradict Mr. Brehm and the position outlined in Citizens' proposed order. We agree with Mr. Lykins that it is a matter of balance, and ultimately it is this Commission's duty to make the determination of the "right balance."

The difference between the amount of cash funded E&R Petitioner is seeking and the amount recommended by the OUCC and the IG is approximately $8.2 million ($44,000,000 – $35,800,000). Conversely, the amount of debt that Citizens proposes to issue to support its annual E&R revenue requirement is approximately $14.9 million ($58.9 million – $44.0 million) versus approximately $21.1 million ($56.9 million - $35.8 million) as recommended by the OUCC and IG. The additional debt issuance proposed by the OUCC and IG would result in additional debt service of approximately $683,000 ($2,362,137-$1,679,004). *See* OUCC Proposed Order at 39.

As noted above, we have determined that the Citizens Capital Plan should be based on FY 2014 and FY 2015 budgets rather than the three-year average proposed by Citizens, which reduces the total amount of E&R that needs to be funded by approximately $2 million annually. This reduction also results in a corresponding reduction in debt service, discussed below, as Mr. Brehm based his 2015 *pro forma* debt service on an average of FY 2015 and FY 2016 borrowing. When only FY 2014 and FY 2015 borrowings are considered, Petitioner's total proposed debt service would be reduced by over $800,000.

[2] Citizens also cites to two Commission decisions involving rural electric membership cooperatives ("REMCs") for the proposition that the Commission should not second guess the business decisions of REMCs with respect to funding a portion of E&R through debt. *See, Wabash Valley REMC*, Cause No. 39551 (IURC Mar. 31, 1993); *Jackson Co. REMC*, Cause No. 41092 (IURC July 15, 1998). Again, we disagree that the holdings of those cases apply to Citizens Water. REMCs have a management structure entirely different from that of Citizens Water, in that REMC management ultimately answers to the members of the REMC.

Considering all of these factors in determining the appropriate balance between debt-funding E&R and rate-funding E&R, we recognize that each position presented has merit, along with its associated criticism. Petitioner's proposal to debt-fund 25% of its proposed E&R does reduce the reliance on debt that plagued the prior utility ownership, but at a cost to current ratepayers. Similarly, the OUCC and IG proposal to increase debt-funding to 33% of its calculated E&R budget reduces the impact on ratepayers, but at the expense of paying additional debt service over the long term.

Given the reductions that we have made to the Capital Plan Budget and corresponding debt service, as discussed above, we find that a hybrid approach that closely follows Petitioner's proposal is reasonable and does strike an appropriate balance between the ratepayers and utility. Accordingly, Petitioner shall be allowed to recover $42,001,167 through rates, which represents Citizens' proposed $44 million in rate-funded E&R minus $1,998,833 representing the reduction from Citizens' proposed three-year average to the two-year average of FY 2014 and FY 2015. Citizens debt-funded E&R amount shall remain at approximately $14.9 million ($56.9 million - $42 million). Finally, we note that based on the Commission's approved revenue requirement and level of yearly debt service, the debt service coverage would be 1.60, which was within the range described by Mr. Brehm that would be viewed positively by the rating agencies.

Finally, in testimony and during the hearing, various Citizens' witnesses indicated that the ultimate goal for Citizens would be for E&R to be 100% rate-funded, similar to the gas utility. We caution Citizens on this approach, as the capital intensive nature of the water utility makes the comparison to the gas utility questionable. Our approval in this Cause, while generally consistent with Citizens' proposal, should not be construed as supportive of any future request to increase the rate-funded portion of E&R.

2. *Annual Debt Service.*

a. *Petitioner's Direct Evidence.* Petitioner's witness Brehm testified that the *pro forma* amount of debt service Petitioner is proposing to determine the revenue requirement for Petitioner's proposed rates is the *pro forma* debt service for fiscal year 2015, i.e., $70,993,804[3]. (Pet. Ex. JRB at 6.) Petitioner proposed to use *pro forma* debt service for fiscal year 2015 because its debt service obligations will increase each year as new debt must be issued to finance a portion of the large capital spending requirements of the water system. (*Id.*) Mr. Brehm stated this amount of debt service is representative of the annualized debt service Petitioner will be incurring while the proposed rates are in place, through the end of fiscal year 2015. (*Id.* at 7.)

Mr. Brehm stated that he understands it is accepted practice for the Commission to use projected debt service costs to determine the debt service portion of revenue requirements of municipal utilities under its jurisdiction. (*Id.* at 7.) He stated that use of projected debt service to establish the *pro forma* debt service component of revenue requirements is especially important for Petitioner because it must issue new debt annually to finance a portion of its large capital

[3] To determine the proposed *pro forma* amount of debt service for 2015 Petitioner averages the 2015 and 2016. amounts. See WP-JRB1-4.

spending requirements. (*Id.*) He stated that Petitioner's Exhibit JRB-2 shows that in addition to the $2.2 million of new debt required in fiscal year 2013 (the twelve months following the end of the test year), $21.3 million of new debt is required in fiscal year 2014, and an additional $5.7 million of new debt is required in fiscal year 2015 to finance a portion of the capital spending requirements of Petitioner. (*Id.* at 7-8.) Consequently, if projected debt service is not used to establish the *pro forma* debt service component of revenue requirements under these circumstances, the rates established in this rate case would deliberately be based on a debt service amount that is less than the annualized debt service amount Petitioner would be incurring when the rates are actually in effect. (*Id.* at 8.)

Mr. Brehm also stated that given Petitioner's specific facts and circumstances, reflecting *pro forma* 2015 debt service in the proposed rates is superior to reflecting the average of fiscal year 2014 and 2015 debt service. (*Id.* at 8.) According to Mr. Brehm, since Petitioner's debt service costs are increasing each year, a rate increase reflecting the average of fiscal year 2014 and 2015 debt service would result in rates during 2015 reflecting less ongoing debt service than Petitioner is incurring in that year (and beyond 2015 assuming any delay in implementing new rates in a subsequent rate case). (*Id.*)

Mr. Brehm stated that the total principal amount of the debt outstanding of Petitioner at September 30, 2012 was $983,795,000. (*Id.* at 9.) That amount was made up of long-term debt in the amount of $965,230,000 and current maturities of long-term debt in the amount of $18,565,000. (*Id.* at 10.) The total test year debt service for Petitioner was $69,112,550. (*Id.* at 11.) Mr. Brehm additionally explained the fiscal year 2015 *pro forma* debt outstanding and debt service amounts on Petitioner's Exhibit JRB-1.

b. *OUCC's Evidence*. Mr. Kaufman stated Citizens Water is seeking to include in its proposed rates an annual debt service of $70,993,804. He stated that this figure includes annual debt service for both Petitioner's current debt and debt it proposes to issue in 2013, 2014 and 2015. The calculation can be seen in the last column of Petitioner's exhibit JRB-1 line 15. Petitioner's Exhibit LSP-1, columns B, C and E line 42 also show Petitioner's proposed annual debt service.

Mr. Kaufman stated that Citizens Water plans to have its proposed rates in place through fiscal 2015 (September 30, 2015) and assumes that an order will be issued in this Cause by January 1, 2014. (*Id.* at 20.) Mr. Kaufman stated Petitioner's current debt service can be calculated from Mr. Brehm's workpapers ($68,505,192 WP JRB 1-2, 1-4). Mr. Kaufman then stated that because Petitioner and the OUCC have recommended a different level of new debt for Citizens Water the presentation of Petitioner's annual debt service requirement is more transparent if its current annual debt service and its new debt (and subsequent additional annual debt service) are calculated and discussed separately.

Mr. Kaufman calculated the annual debt service for Petitioner's 2014 and 2015 debt assuming Petitioner's proposed E&R and the OUCC's proposed E&R. Mr. Kaufman noted Petitioner is seeking to include in rates annual debt service for its 2013A bonds with an annual debt service of $140,980, its 2014A bonds with an annual debt service of $1,356,407, its 2015A bonds with an annual debt service of $363,233 and its 2015B bonds (interest only) with an

annual debt service of $1,300,152. Petitioner's annual debt service for its proposed debt issuances is $1,497,387 for fiscal 2014 and $1,860,619 for fiscal 2015. Mr. Kaufman stated while Petitioner includes its 2015 proposed debt issuances to calculate its annual debt service, Citizens proposed 2015 debt issuances will not be issued until September 30, 2014. It is not appropriate to include the full cost of the 2015 debt service prior to Citizens Water incurring a cost for this debt. Mr. Kaufman stated that the Commission should either phase in the increase or average the proposed debt service over two years. (*Id.* at 21.) The average debt service on Petitioner's proposed debt issuances is $1,679,004 ($1,497,386 + 1,860,619). If Citizens Water is authorized its proposed cash E&R then its authorized annual debt service should be $70,184,196 ($68,505,192 + 1,679,004 = $70,184,196). (*Id.* at 20-21)

Next, Mr. Kaufman calculated the annual debt service based on the OUCC's proposed level of cash funded E&R. He explained Citizens Water 2014A debt issuance would increase from $21,335,218 to $27,642,888 and the annual debt service on the 2014 bonds would increase from $1,356,407 to $1,757,423. Its 2015A debt issuance would increase from $5,713,366 to $14,588,352 and the annual debt service on the 2015 bonds would increase from $363,233 to $927,468. The average annual debt service on Petitioner's additional debt would be $2,362,137 ($1,898,403 + $2,825,871 / 2 = $2,362,137). Revised page 3 of Attachment ERK 4 provides amortization schedules for Petitioner's proposed debt issuances, and Attachment ERK 5 provides amortization schedules under the OUCC's proposed debt issuances. (*Id.* at 22)

c. *Petitioner's Rebuttal Evidence*. Mr. Brehm stated that he continues to believe using *pro forma* 2015 debt service for the debt service component of revenue requirements is the best course of action in this case. (Pet. Ex. JRB-R at 10.) Mr. Brehm does not believe that establishing the *pro forma* amount of debt service based on the average of *pro forma* debt service for 2014 and 2015 is appropriate because the resulting debt service amount of the revenue requirements would not reflect the going level amount of debt service. (*Id.*) Mr. Brehm stated that Mr. Gorman also uses *pro forma* 2015 debt service for the debt service component of overall revenue requirements rather than an average of *pro forma* debt service for fiscal years 2014 and 2015. (*Id.*)

Mr. Brehm stated that Petitioner recognizes a two-step rate increase would allow the rates approved in this case to be established based on reflecting an accurate view of the debt service cost it will be experiencing during the period the rates will be in effect. (*Id.*) Mr. Brehm stated if the new rates approved in this case are increased in two steps, the step one rates should be implemented at the time of receipt of the rate order, and step two rates should be implemented on October 1, 2014, consistent with Petitioner's fiscal year and how the *pro forma* debt service amounts have been developed. (*Id.*)

Mr. Brehm stated that Mr. Kaufman's computation of average *pro forma* debt service on existing debt that results in an amount of $68,505,192 is wrong because it is founded on a conceptual error. (*Id.* at 13.) Mr. Brehm stated that Mr. Kaufman's computation used the abnormally low amount of debt service on Petitioner's existing first lien bonds that occurs during fiscal year 2015 of $66,551,547. Mr. Brehm presented a table in his rebuttal testimony to illustrate his opinion that fiscal year 2015 debt service on existing first lien bonds was abnormally low. (*Id.* at 15.) Mr. Brehm testified the table shows the average annual debt service

on existing first lien bonds for fiscal years 2013-2020 is approximately $67,821,781 annually. According to Mr. Brehm the annual debt service amount shown in the table is very consistent each year, except fiscal years 2015 and 2016 are anomalies, with fiscal year 2015 being lower than the 2013-2020 average and fiscal year 2016 being higher than the 2013-2020 average by roughly the same amount. Mr. Brehm testified the rates and charges established in a rate case are ongoing until new rates are approved in a subsequent case. Consequently, the *pro forma* cost and revenue elements that comprise the revenue requirements that support the determination of rates and charges must be established on a going level basis. Mr. Brehm testified a reasonable representation of the going level amount of debt service on existing first lien bonds for fiscal year 2015 is the average of fiscal years 2015 and 2016, which amounts to $67,820,280. (*Id.* at 14-16.) Mr. Brehm stated that a reasonable representation of the going level amount of debt service on existing first lien bonds for fiscal year 2016 would be $67,820,280 as well.

Mr. Brehm testified the properly computed total *pro forma* fiscal year 2015 debt service on existing debt is $69,133,185 which is the sum of the $67,820,280 amount of going level debt service on existing first lien bonds plus *pro forma* debt service on second lien bonds of $1,300,152 plus interest on customer deposits of $12,753. (*Id.* at 17.)

Mr. Brehm stated that there is no disagreement among the parties with respect to *pro forma* debt service on new debt to be issued, with the exception of the proposal of Mr. Kaufman and Mr. Gorman to increase the amount of *pro forma* debt service on new debt issued in fiscal years 2014 and 2015 as a result of their proposal to decrease the amount of revenue funded extensions and replacements. (*Id.* at 17-18.)

d. *Discussion and Findings.* Mr. Brehm proposed to use "2015 pro forma" debt service for both 2014 and 2015. In actuality, however, Mr. Brehm's workpapers show that Petitioner's 2015 *pro forma* debt service is an average of 2015 and 2016 debt service. This is not a trivial matter and should have been clearly explained in direct testimony. In the future, Petitioner should make clear in direct testimony when it is using an average.

The Commission believes that rates should match the actual expense incurred over the life of the rates. Petitioner has made it clear that it intends to file its next general rate case in fiscal year 2015 to increase its rates at the beginning of its 2016 fiscal year (October 1, 2015). (See Pet. Ex. JRB at 7.) Thus, the life of the rates for purpose of the calculation of debt service should be for years 2014 and 2015. Further, FY 2016 debt included proposed debt funding of Petitioner's proposed three-year average E&R budget, which we have rejected previously in favor of a two-year average of FY 2014 and FY 2015.

Below is a table using Mr. Brehm's WP-JRB1-4 and JRB1-2 that shows actual debt service for 2014 and 2015:

	2014	2015
2011A	$2,265,638	
2011b	10,893,119	$9,566,306
2011C	4,280,650	6,783,150
2011D	3,696,525	3,696,525
2011E	7,180,384	7,184,588
2011F	35,687,025	35,477,316
2011G	3,842,688	3,843,663
2013A	140,980	140,980
2014A	1,356,407	1,356,407
2015A		363,233
2011B Second	1,287,150	
2015B Second		1,300,152
Customer Deposit	12,753	12,753
Total	$70,643,319	$69,725,073
Avg.	$70,184,196	

Based on the table above, the Commission finds the debt service should be $70,184,196, which is an average of 2014 and 2015. This matches the two-year average the Commission used to determine the amount of capital expenditures. We further reject a proposal for a two phase increase based on the difference in debt service for 2014 and 2015. If the debt service varied greatly we would consider approving a two-phase increase, but here the difference between the debt service in 2014 and 2015 is only 1.30%, not enough to consider a two-phase increase.

3. *True-up of Debt Service.*

a. *Evidence*. Korlon L. Kilpatrick, II, Manager, Rates & Business Applications of Citizens Energy Group, testified regarding Petitioner's proposed true-up process for the actual amount of debt service costs. (Pet. Ex. KLK at 3.) Mr. Kilpatrick stated that Petitioner will make a true-up filing with the Commission within 30 days of closing on the debt financing to reflect the actual principal amount of the bonds, the interest rate of the debt, the financing term, the actual average annual debt service requirements and the actual impact on Petitioner's metered rates. (*Id.* at 7.) Mr. Kilpatrick testified that if the actual impact on Petitioner's metered rates is materially different from the increase approved by the Commission in this Cause, Petitioner will file amended schedules of rates and charges within 15 days of filing the true-up report. (*Id.*)

OUCC witness Kaufman testified that within 30 days of closing on any long term debt issuance, Petitioner should be required to file a report with the Commission (and serve a copy on the OUCC) explaining the terms and purpose of the new loan, including the amount of debt service reserve. (Pub. Ex. No. 2 at 22-23.) Mr. Kaufman stated that, because the precise interest rate and annual debt service will not be known until the debt is issued, Petitioner's rates should

be trued-up to reflect the actual cost of the debt, and that Petitioner's report should include a revised rate schedule and tariff. (*Id.* at 23.) If the OUCC deems the change immaterial, it will file a notice with the Commission within 10 days after it receives the report; otherwise the new tariff should go into effect. (*Id.*)

In rebuttal, Petitioner's witness Kilpatrick testified that Petitioner would file a true-up report within 30 days with the Commission that provides details of the issuance. (Pet. Ex. KLK-R at 2.) Mr. Kilpatrick stated that Petitioner also agrees that the true-up report is necessary to reflect the actual cost of debt, which will not be known until the date of issuance. (*Id.* at 2-3.) Mr. Kilpatrick stated there are two specific parts of the OUCC's proposal with which Petitioner disagrees. (*Id.* at 3.) Specifically, Petitioner disagrees with the OUCC's proposal that: "[i]f the OUCC deems the change immaterial it should file a notice with the Commission within 10 business days after it receives the report, otherwise the new tariff should go into effect." (*Id.*) Mr. Kilpatrick stated that it appears that the OUCC would make the determination of materiality, rather than the Commission. (*Id.*)

Mr. Kilpatrick stated that Petitioner also disagrees that the reporting requirement should apply to all debt issuances; but should apply to only to those contemplated as a part of this proceeding. (*Id.* at 4.) Mr. Kilpatrick stated that in a single-step rate increase with multiple debt issuances, Petitioner foresees filing the true-up report after the final issuance because that would reflect the going-level debt service at that point in time. (*Id.*) In a phased rate increase with multiple debt issuances, Petitioner would file a true-up report after each issuance. (*Id.*) Mr. Kilpatrick stated the reporting requirement should not apply to debt issuances not related to this proceeding, because those issuances would not affect base rates and would be considered as a part of a future rate case. (*Id.*)

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

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

C. *Operations and Maintenance Expenses.*

Petitioner's Exhibit LSP-1 included several *pro forma* present rate expense adjustments that yield an overall test year expense increase of $1,058,861. No party objected to Petitioner's

proposed adjustment for Purchased Power, a test year expense decrease of $262,408, IT Network Support adjustment, a test year expense decrease of $31,753, a Customer Bill Expenses adjustment that decreased test year expense by $869,180, a CSS Redistribution adjustment that increased test year expenses by $4,382, and an Out of Period Net Expenses adjustment that decreased test year expenses by $98,176.

Based on the foregoing, we find appropriate the test year expense adjustments for purchased power of ($262,408), IT network support of ($31,753), customer bill expenses of ($869,180), CSS redistribution of $4,382, and Out of period net expenses of ($98,176). The remaining expense adjustment disputes are discussed below.

1. *Labor.*

a. *Petitioner's Direct Evidence.* Petitioner proposed total *pro forma* operation and maintenance expense for payroll of $23,913,940 (Petitioner's Exhibit SEK-2).

Total Base Payroll	$ 21,984,334
Add: Total Overtime	2,312,460
Supplemental Pay	338,373
Short Term Incentive Pay	2,259,243
Executive Incentive Pay	575,982
Total Payroll	27,470,392
Less: Total Capitalized Payroll	3,556,284
Total Expensed Payroll	23,914,108
Less: Amount Charged Below-the-Line	167
Total *Pro forma* O&M Expense	$ 23,913,940

b. *OUCC's Evidence.* The OUCC accepted Petitioner's *pro forma* labor adjustments, but took exception to Petitioner's proposed level of executive and short-term incentive pay. OUCC Utility Analyst Harold H. Riceman proposed a reduction to Petitioner's *pro forma* executive incentive pay by $518,384 and a reduction to Petitioner's *pro forma* short term incentive pay by $903,697. (Public's Ex. No. 3 at 3.) Mr. Riceman explained that Citizens' establishes executive incentive pay for certain executives of Citizens Water through its EIP. Mr. Riceman said the EIP is administered by Citizens Energy Group's Board of Directors. Mr. Riceman noted the EIP's stated purpose is "to provide to key management personnel incentive compensation tied to various performance measures including the provision of gas and steam services at rates lower than similar rates of the competitors of Citizens as well as maintaining and improving customer satisfaction." (*Id.* at 3.) Moreover, the EIP states that the Plan is "intended to (i) link long-term management compensation to Citizens' ongoing objective of achieving low gas and steam rates for Marion County residents; (ii) provide an incentive to attract, motivate and retain the type of key management needed to create, develop and operate profitably all aspects of Citizens' operations including both the regulated and unregulated business units, in a competitive environment; (iv) maintain supplier diversity; and (v) ensure operational reliability." (*Id.* at 4.)

Mr. Riceman stated that Petitioner's EIP looks at performance in four key components: Competitive Rates (25%), Customer Satisfaction (50%), Supplier Diversity (10%) and Operational Measures (15%). (*Id.* at 4.) Mr. Riceman explained that every component except for one is specifically based on performance indicators of Citizens Gas or Citizens Thermal and not Citizens Water. (*Id.* at 4-5.) Mr. Riceman stated that the source of the performance indicator for Supplier Diversity is not described in the Plan. He stated that 80% of the Competitive Rates Component is determined based on a percentage comparison between the rates charged to Citizens Gas residential customers and a twenty city average rate. (*Id.* at 5.) The twenty cities are selected by the Citizen Energy Group's Board of Directors in advance of the comparison. (*Id.*) The remaining 20% of the component is determined based on the ranking of the rates charged to Citizens Thermal's steam customers, compared to the rates of the steam customers for seven (7) Midwest steam suppliers for the weighted average of total annual bill for small, medium, and large customer classes. (*Id.*)

Mr. Riceman stated that 50% of the Customer Satisfaction Component is determined based on the Citizens Gas Residential Customer Satisfaction Index and 35% is based on the Citizens Gas' Commercial/Industrial Customer Index. (*Id.* at 5.) The remaining 15% is based on the Citizens Thermal's Steam Customer Satisfaction Index. (*Id.*) He stated that 100% of the Supplier Diversity Component is based on the "attainment of a certain percentage of minority purchases." (*Id.*) Mr. Riceman added that 67% of the Operational Measures Component is based on Gas System reliability and 33% is based on Steam System reliability. (*Id.* at 6.)

Mr. Riceman expressed concerns with basing pay incentives for Citizen's Water executives on performance indicators of Citizens Gas and Citizens Thermal. (*Id.* at 6.) He testified that, with the exception of the Supplier Diversity Component, all other components of the EIP are based on Citizens Gas or Citizens Thermal Steam indexes. (*Id.*) Mr. Riceman explained that these indexes are not tied to the performance and management of Citizens Water and therefore, costs associated with successful performance under these indexes should not be included as a revenue requirement. (*Id.*) Mr. Riceman recommended that Petitioner be authorized to recover the Supplier Diversity component of the EIP, approximately 10% of the total plan cost. (*Id.* at 6.) Petitioner's *pro forma* EIP expense is $575,982. Mr. Riceman recommended the removal of 90% of the total *pro forma* EIP expense or $518,384 from Petitioner's revenue requirement, leaving $57,598. (*Id.*)

Next, Mr. Riceman addressed his proposed reduction to Petitioner's STIP. Mr. Riceman explained that Petitioner's STIP Plan includes all regular Corporate Support Services, Gas, Oil, Thermal, and Water employees. (*Id.* at 7.) He noted the STIP Plan looks at performance in three key areas: Customer Satisfaction (40%), Quality (25%) and Safety (35%). (*Id.*) Achievement Scales include Threshold (50% pay out), Target (100% payout) and Outstanding (150% payout). (*Id.*) Mr. Riceman added that regardless of performance achievements, in order for a payout to occur, the Trust must earn $200,000,000 or more before interest, taxes, depreciation, and amortization. (*Id.*) Mr. Riceman stated that Petitioner updated its STIP Plan in 2013. (*Id.*) However, the only changes to the 2013 STIP Plan are adjustments to the number of DART incidents and vehicle accidents permissible under the Safety component. (*Id.*)

Mr. Riceman advised that the Customer Satisfaction component, which represents 40% of the STIP, is explicitly based on two indexes of Overall Gas Customer Satisfaction: MSI and J.D. Power. (*Id.*) He stated it is not clear how the other two measures are derived or whether these measurements bear a sufficient relationship to water operations. (*Id.* at 7-8.) Mr. Riceman testified that the water utility should not be permitted to recover STIP expenses relating exclusively to its gas operations and recommended 40% of the total *pro forma* STIP Plan expense of $2,259,243 or $903,697 be removed from Petitioner's revenue requirement. (*Id.* at 8.) Mr. Riceman also recommended that, as part of its case-in-chief in its next rate case, Petitioner should establish with greater clarity and specificity how the Safety and Quality measurements incorporate or relate to its water operations. (*Id.*) Mr. Riceman stated that reducing Petitioner's *pro forma* EIP expense and *pro forma* STIP expense results in a decrease to test year labor expense of $1,327,269 compared to Petitioner's proposed increase to test year labor expense of $94,808. (*Id.*) With respect to payroll tax expense, Mr. Riceman stated that decreasing *pro forma* executive incentive pay and *pro forma* short term incentive pay in accordance with his labor adjustment yields a *pro forma* decrease of $79,898 to test year operating expense. (*Id.*)

c. *Petitioner's Rebuttal Evidence*. Mr. Lykins stated that the OUCC did not take issue with the amount of EIP or STIP payouts, but rather has taken the position the measures used to determine EIP and STIP payouts are not sufficiently related to the water utility. (Pet. Ex. CBL-R at 7.) Mr. Lykins stated that the broad-based categories used to determine EIP and STIP payouts, such as customer satisfaction, quality and safety, are clearly designed to create incentives for employees that benefit all Citizens Energy Group utility customers. (*Id.* at 8.) Mr. Lykins further indicated that when Citizens Energy Group hits all objectives of the EIP and STIP at target performance, employees receive compensation that is about the 50th percentile of the market. (*Id.*) Mr. Lykins asserted that the OUCC's proposed reductions would allow the water utility to avoid paying its fair share of the compensation. (*Id.*)

M. Jean Richcreek, Petitioner's Senior Vice President, Chief Administrative Officer explained the purpose of Petitioner's compensation strategy and how the EIP and STIP fit into that strategy. (Pet. Ex. MJR-R at 3.) Ms. Richcreek asserted Petitioner's compensation system is designed to provide its employees an opportunity to earn total compensation at the 50th percentile of the market, meaning that Petitioner's employees are paid less than about half of the people in the market with comparable positions and more than the other half. (*Id.*) Ms. Richcreek stated that the EIP and STIP are important components of the market-based 50th percentile target compensation that Petitioner chooses to put at risk for employees instead of including that compensation as a part of base salary. (*Id.*)

Ms. Richcreek observed that EIP and STIP compensation is allocated across all utilities and unregulated affiliates on the same basis as base pay compensation. (*Id.* at 3.) She advised that base salary, EIP and STIP compensation all are part of a total compensation package that is paid to employees providing services to water utility customers. (*Id.*) Ms. Richcreek said that if Mr. Riceman's proposal is accepted by the Commission, the water utility will not be paying its fair share of the compensation of those employees, which will result in it being unfairly subsidized by the other businesses Citizens Energy Group owns and operates. (*Id.* at 4.)

Ms. Richcreek disputed Mr. Riceman's claim that components of the EIP are not related to water operations. (*Id.* at 4.) With respect to the competitive rates component, Ms. Richcreek asserted the rate comparisons for Gas and Thermal are representative of Citizens Energy Group's commitment to balancing the need for revenues that support the long-term reliability of each system with reasonable customer rates. (*Id.*) She argued that as such, competitive gas rates achieved through the efficiencies of the integrated Citizens Energy Group utilities serve as an indicator that the water utility is benefiting from the efficiencies of the integrated utilities. (*Id.*)

With respect to Customer Satisfaction, Ms. Richcreek testified that, in the integrated structure, Gas, Water, Wastewater and Thermal customers are served by one Customer Contact Center, on Shared Field Services ("SFS") group, and one Corporate Shared Services ("CSS") group. (*Id.* at 5.) Ms. Richcreek argued that the majority of measures in the MSI annual random survey and J.D. Power survey are not utility specific and measure the customer's perception of his or her experience with Citizens Energy Group, focusing on topics such as ease of use, contact center quality and effectiveness, perception of Citizens Energy Group in the community, billing accuracy and customer communications effectiveness. (*Id.* at 5, 6.) Ms. Richcreek noted that, with regard to Operational Measures, the current plan (2013-2014) includes a water reliability measure. (*Id.* at 6.)

Ms. Richcreek disagreed that in Petitioner's next rate case it is necessary for Petitioner to establish with greater clarity and specificity how the safety and quality measurements relate to its water operations. (*Id.* at 7.) With respect to quality, Ms. Richcreek noted that the measure is based on performance against the "Malcolm Baldrige Criteria for Performance Excellence," a national standard for quality in all aspects of a business. (*Id.*) Beginning in 2012, the Water and Wastewater utilities were included in the measurement. (*Id.*) With respect to safety, Ms. Richcreek stated that each division is measured on the safety performance of that division, including the Water and Wastewater utilities. (*Id.*) That portion of STIP is paid based on the divisional results. (*Id.*)

d. *Discussion and Findings*. CEG compensation is comprised of base salary and two incentive compensation plans, STIP and EIP. As set forth in testimony, STIP represents a compensation incentive available to all CEG employees for achieving metrics related to customer satisfaction, quality, and safety, while EIP represents a compensation incentive only available to CEG executives for achieving metrics related to rates, customer satisfaction, supplier diversity, and operational measures. Citizens proposed to recover a *pro forma* amount of labor expense, including base compensation of its employees and allocated employees, and incentive payouts to its allocated executives (EIP and STIP) as well as non-executives (STIP only). The OUCC proposed an adjustment to remove most of the EIP and STIP payouts on the basis that the metrics applied mainly to the gas utility, and thus the responsibility for supporting the payouts should not be allocated to the water utility.

Initially, we note that it is the utility that carries the initial burden to demonstrate that a proposed expense is reasonable and necessary for the provision of utility service. In rebuttal, Mr. Lykins noted that the challenge by the OUCC was not based on the amount of the payouts, but the metrics themselves. For our discussion here, we focus exclusively on CEG executive compensation allocated to Citizens Water, and whether Petitioner has demonstrated that the total

executive compensation allocated is reasonable and necessary for municipal water service. In other words, the issue we must address is not the reasonableness of salaries paid by CEG, which we do not regulate, but the pushdown of those costs to Citizens Water, which we do regulate. Ultimately, the allocated executive compensation this Commission approves for Citizens Water is borne by its ratepayers.

In its proposed order, Citizens cites to our Order in Cause No. 42767, and the Commission's prior approval of its STIP and EIP (called Long Term Incentive Plan at that time). *Citizens Gas*, Cause No. 42767 at 26-27 (IURC Oct. 19, 2006). There, we reiterated the two criteria by which the recovery of incentive pay should be judged:

> (1) a plan which also ties compensation levels to better service to the customers rather than a pure profit-sharing plan, which only incent employees to become more profitable and is more appropriate for funding solely by the shareholders; and
>
> (2) a plan which does not cause compensation to exceed levels which are reasonably necessary for the utility to attract its workforce.

Indiana-American Water Co., Inc., Cause No. 42029, slip op. at 45 (IURC Nov. 6, 2002). Ultimately, we agreed that Citizens Gas's incentive plan, as presented in that case, met those criteria.

In this Cause, however, we have been presented evidence that makes us question whether the executive compensation exceeds levels reasonable and necessary for a municipal utility. Petitioner's August 15, 2013 Docket Entry Response to the Commission included a table outlining the base compensation, STIP, and EIP paid[4] to various executives and the amount of total compensation allocated to Citizens Water:

[4] Petitioner's Response reflected fiscal year 2012 compensation, which for Citizens is October 1 to September 30. Mr. Lykins indicated that other figures referred to in media reports, such as his $2.9 million compensation, related to calendar year 2012 compensation.

	Base Pay	STIP	EIP	Total Pay	Water Pay (26.83%)
President & CEO	$614,910	$ 461,183	$614,910	$1,691,003	$ 453,696
Senior VP, Chief Administrative Officer	$296,640	$148,320	$148,320	$593,280	$159,177
Senior VP and CFO	$306,940	$ 153,470	$153,470	$ 613,880	$164,704
Senior VP, Chief Operations Officer	$355,350	$177,675	$177,675	$710,700	$190,681
Senior VP, Customer Relationships and Corporate Affairs	$257,500	$128,750	$128,750	$515,000	$138,175
Senior VP, Engineering & Sustainability	$270,890	$135,445	$ 135,445	$ 541,780	$145,360
VP Corporate Communications and Chief Diversity Officer	$203,940	$71,379	$71,379	$346,698	$93,019
VP Regulatory Affairs	$189,520	$66,332	$66,332	$322,184	$86,442
VP Strategy and Corporate Development	$196,730	$68,856	$ 68,856	$334,441	$89,731
VP Water Operations*	$269,860	$107,944	$107,944	$485,748	$130,326
VP Information Technology	$224,540	$78,589	$78,589	$381,718	$102,415
VP and General Counsel	$267,800	$93,730	$93,730	$455,260	$122,146
VP & Controller	$180,250	$63,088	$63,088	$306,425	$82,214
VP Engineering and Shared Field Services	$180,250	$72,100	$72,100	$324,450	$87,050
VP Major Capital Projects	$80,250	$72,100	$72,100	$324,450	$87,050
VP of Human Resources	$180,250	$63,088	$63,088	$306,425	$82,214
Total	$4,175,620	$1,962,047	$2,115,775	$8,253,442	$2,214,398

The *pro forma* amount of total compensation for 16 executives totaled approximately $8.25 million, with approximately $2.21 million allocated to the water utility.[5]

Ms. Richcreek and Mr. Lykins both provided testimony concerning the level of compensation. They referenced a Mercer salary study as the basis for determining the appropriate salary levels for the CEG executives, and indicated that Mercer conducted a comparison of similarly sized for-profit companies, 75% which were utility-related. Compensation levels for CEG executives were then determined at the 50% level of the comparison group. Based on questioning of Mr. Lykins, it appears that none of the entities in the comparison group were municipalities or municipal utilities. Ms. Richcreek stated that the executive compensation level is appropriate for "the market in which we compete for talent. . . ." Tr. at H-65.

While we can appreciate the need to offer competitive salaries in order to attract and retain talented individuals, we find that the comparison of CEG salaries to for-profit entities is problematic and the allocation of for-profit-based costs inappropriate for a municipal utility. We note that in addition to the water utility, CEG also includes municipal gas, sewer, and thermal utilities, and our decision here may have an impact on the allocation of CEG executive compensation for those utilities as well.[6]

First, one of the bases for determining the comparison group was annual revenues. With the acquisition of the water and sewer utilities, CEG has increased total revenues to $795 Million, based on the 2012 remuneration study identified as Public's CX-11. Mr. Lykins

[5] Two of the 16 executive included in the *pro forma* period will be retiring in FY 2013 and 2014.
[6] CEG's sewer utility, CWA Authority, Inc. currently has a rate case pending under Cause No. 44305, and CEG's thermal utility currently has a rate case pending under Cause No. 44349.

confirmed that the acquisition of the water and sewer utilities increased revenues from "roughly [$]400 million to maybe [$]800 million. . . ." Tr. at A-69 (Lykins Direct). The doubling of annual revenues resulted in Citizens Energy Group moving into a Mercer comparison group that was similarly twice the revenues of previous comparison groups. Although the actual Mercer studies were not provided in evidence, it is reasonable to presume that the commensurate salaries of executives of the $800 million peer group are higher than those in the $400 million peer group. *See also* Tr. at A-70 ("fair" to say that larger companies have an average compensation level higher than smaller companies). While Mr. Lykins indicated that this change in peer groups may have resulted in base pay increases ranging from 2% to 9% for CEG executives, the incentive pay under STIP and EIP also increased executive compensation with the acquisition. On questioning from Chairman Atterholt, Mr. Lykins stated:

> There's another thing I really value the chance to clear up. It seems to me that there have been some sensational soundbites, let me say, around my compensation and others. That's true in OUCC exhibits; it's true in the Indianapolis Star, in particular, and the casual reader is left with the ability to conclude that we're here today to ask you to put $2.9 million compensation for me in water rates. Of course, as you know, that's completely wrong.
>
> Another soundbite out there, I think, is the notion that we acquired water and what happened was my income doubled because of—by virtue of being larger or by virtue of having acquired the water system. My base pay for 2012 was $560,000. As we sit here today, I think it's $597[,000], maybe something like that, which gives you an idea of how much it went up in October of this year. Frankly, that's not particularly—it's a little higher percentage than I've typically had every year but not a lot as I mature in the job. So there probably was some base pay increase that might have been attributable to being in a larger market there; I don't know, but it's nothing like doubling my salary. The [STIP], the [EIP] and the retirement pay that I'm receiving now were all programs in place as they are today before we acquired the water/wastewater system. To quote Babe Ruth, I had a really good year, but it is wrong to conclude that that huge increase reported on my salary is a result of the larger market or the result of having acquired water/wastewater.

Tr. at A-74-76. We do not believe that the acquisition of the water and sewer utilities is an appropriate basis for any increased allocation of executive compensation to the municipal utility.

This is especially true here, as we note that in addition to moving up into the $800 million peer group, CEG authorized payment of an acquisition bonus for the successful completion of the sewer and water integration into CEG and reaching savings targets. Although not part of Citizens' rate request, the acquisition bonuses paid to CEG executives totaled approximately

$1.5 million.[7] *See Joint Petition of Citizens Water of Westfield, LLC et al.*, Cause No. 44273, Responses to Commission's June 19, 2013 Docket Entry. While Mr. Lykins described the bonus as recognition for "an extraordinary achievement" (Tr. at A-73), the acquisition resulted in two types of pay events: the acquisition bonus and the compensation increases associated with the doubling of annual revenues.

Second, and more importantly, CEG's status as a not-for-profit public charitable trust is inconsistent with a for-profit compensation model and the resulting allocation of for-profit-based costs to municipal utility ratepayers. In discussing the benefits of a public charitable trust, Mr. Lykins stated "We are a model that does not build profit into utility rates, which is a savings for customers." Tr. at A-109-110. However, CEG's executive compensation plan results in exactly the opposite dynamic: by allocating for-profit-based executive compensation to Citizens, that profit-based compensation would be built into municipal water rates.

Mr. Lykins attempted to justify the current compensation model by discussing the basis for the charitable trust. "[P]art of our original structure was set up with the express purpose of not having this utility, or now these utilities, under political control subject to the vagaries of politics." Tr. at A-111. Again, the political independence granted by the charitable trust structure bears no relation to the trust's decision to utilize a for-profit salary structure. Commissioner Mays questioned Mr. Lykins on this point:

> Comm. Mays: [D]o you see how it appears that you all want it both ways? You want the benefits on one side, but . . . or actually the benefits on both sides.
>
> Mr. Lykins: Well we do. You know, to an extent, I can interpret your question to mean do you understand that you want the benefits, but then on the other side, you take something that you're really not entitled to, really should not have, and I—maybe it's just rationalization or defensiveness on my part—humans are pretty good at that—but I can't get to this belief that I am taking something that I don't deserve or I shouldn't have, so I think we are trying to have it both ways, indeed; that, you know, we're being very effective in the integration, we're delivering good quality utility service, and I'm being paid like I'm delivering good quality utility service to the people of central Indiana.

Tr. at A-114.

As we noted initially in this discussion, our role is not to determine the appropriate executive compensation for CEG executives. That is ultimately a decision for CEG's Board of Directors, and the probate court, among others. *See Citizens Gas*, Cause No. 36979, 1983 Ind.

[7] Mr. Lykins clarified that the acquisition bonuses were paid by all units of CEG, and not Citizens Resources, which is the for-profit arm of CEG. While we agree that the bonuses were not included in Citizens' request for a rate increase, ratepayers did fund the allocated portion of the bonuses through current rates paid to the respective utilities.

PUC Lexis 410, at *51-*52. Our role, however, is to determine an appropriate amount of compensation that should be allocated to Citizens' ratepayers, under our authority to determine municipal utility rates and charges. Citizens' proposal to allocate levels of for-profit-based compensation to a municipal utility is not well-received. While CEG executives may in fact be able to have it both ways, municipal utility ratepayers are only obligated to pay for municipal-based expenses when they take municipal utility service.

In reviewing the various elements of CEG's executive compensation, we note that EIP is isolated to CEG executives, while STIP is paid company wide. Chairman Atterholt questioned Mr. Lykins on the differences:

> Mr. Lykins: All of the employees at [CEG] are—have an opportunity to earn what we call our [STIP], so all 1,200 of us chase the same performance objectives in that sense. . . .It's an incentive plan that establishes goals for the organization relative to quality, safety and customer satisfaction.
>
> Chairman Atterholt: . . . . [I]s the criteria similar for the EIP as to the STIP?
>
> Mr. Lykins: Well, there is a good deal of similarity, especially in spirit. The EIP is designed to give the officers pay at risk working together as a team across all of our business enterprises to ensure ultimate success, and it, too, measures things like customer satisfaction, utility reliability. . . . Our minority purchasing practices are in there. There are other incentives as well.
>
> Chairman Atterholt: [J]ust from an outside observer perspective, it looks as if the officers get two bonuses for a similar set of metrics; is that unfair?
>
> Mr. Lykins: Well, I don't know about unfair; I don't think it's accurate. As I say, the [STIP] applies to everybody at Citizens, which I think is an important fact that we're all in pursuit of the same performance goals, and then the executive plan does provide the opportunity to earn that other pay at risk for executives, and while some of the objectives are similar philosophically, I don't think they're—it's duplicative in any way; it's just an attempt to give people the opportunity to earn at the average of market.

Tr. at A-59, A-61, A-64-65.

We continue to find that Citizens' STIP represents an appropriate incentive-based compensation plan, despite the OUCC's criticism that the STIP metrics are based on gas operations. However, in reviewing the percentage of base salary awarded as STIP during the *pro forma* period, we note the level of STIP incentive pay at the executive level exceeds the company average by a wide margin. CEG executives received an average of 46.99% of base

salary in STIP, while non-executives only earned an average of 8.96% of base salary as STIP. *See* SEK WP 302-S2.

	Pro Forma Base Salary ($)	STIP ($)	%STIP
All Employees	$54,033,866	$6,426,890	11.89%
Executives (16)	$4,175,620	$1,962,047	46.99%
Nonexecutives	$49,858,246	$4,311,116	8.96%

We find that aspect excessive and inappropriate to be allocated under municipal rates.

Instead, we find that executive level STIP compensation should be based on the same percentage as non-executive employees (8.96%). Applying that percentage to base executive compensation of $4,175,620 results in a STIP incentive of $373,927. Accordingly, we find that an adjustment of allocated salary expense in the amount of ($447,562) is appropriate. We suggest that going forward, CEG should eliminate the disparity of STIP percentages between the executive level and non-executives. In addition, with the acquisition of the water and wastewater systems, CEG should consider revising its STIP metrics to account for customer satisfaction with all of its respective utilities.

With respect to the EIP, many of the performance goals of the EIP appear redundant with the performance goals outlined in the STIP. The implication of Mr. Lykins' testimony is that the EIP metrics, which are "similar philosophically" to the STIP metrics, are in fact, different. However, Mr. Lykins then explained that EIP is "an attempt to give [CEG executives] the opportunity to earn at the average of market." It does not appear that the EIP metrics, to the extent they differ from the STIP metrics, improve service to Citizens ratepayers. Instead, we find that EIP, as an additional mechanism to increase executive compensation, results in excessive for-profit-based compensation being allocated to municipal ratepayers.

As an example, Mr. Lykins explained above that as the CEO of CEG, he earned $2.9 million in total compensation in calendar year 2012, comprising of his base pay, EIP, STIP and acquisition bonus. Of that amount, $916,000 was EIP,[8] which, pursuant to the Mercer study, provided for Mr. Lykins' total compensation to reach the 50% of market level. We conclude that as set forth in Mr. Lykins' responses above, the purpose of EIP is not to incent customer service, but to provide for meeting executive level compensation targets that we find inappropriate in municipal ratemaking. Further, such compensation appears to this Commission to be inconsistent with the underlying mission statement of a not-for-profit public charitable trust.

We find the pushdown of EIP to Citizens Water would result in the allocation of excessive executive compensation to the municipal utility. Removing EIP from labor expense creates an adjustment of ($595,326).

In calculating these two adjustments for STIP and EIP, we used Petitioner's August 15,

[8] The *pro forma* EIP amount for Mr. Lykins is $614,910, of which $164,980 was proposed to be allocated to the water utility.

2013 Docket Entry Response to the Commission, in which Citizens calculated all allocation percentages at 26.83%, the allocation for Corporate Shared Services employees. However, the VP of Water Operations is a Water employee and should be allocated at 50% since his time is split evenly between water and sewer operations. In addition, the VP of Engineering and Shared Field Services is a Shared Field Service employee and should be allocated at 30.51%. Correcting the allocation percentages for these two executives resulted in an adjustment of $124,488.

Combining all three adjustments, we find that Petitioner's labor expense adjustment is ($918,401). We further find that in its next base rate case, Citizens shall present an allocation of executive compensation that is consistent with municipal-based expenses, and considers the level of compensation (base and incentive pay) as well as the number of executive salaries allocated to the municipal utility.

Based on the foregoing, we find that Petitioner's *pro forma* labor expense is $22,955,539.

Total *Pro forma* Labor Expense per Petitioner	$ 23,913,940
Less: Short-term and Executive Incentive Pay	918,401
Total *Pro forma* Labor Expense	$ 22,995,539

As noted above, the labor expense adjustment of $918,401 only represents the removal of the allocated expense to Citizens Water. However, the rationale for our decision in this Cause is applicable to not only Citizens Water, but CEG's municipal gas, sewer, and thermal utilities as well.

2. *Employee Benefits.* Petitioner proposed total *pro forma* operation and maintenance expense for employee benefits of $11,283,719 (Petitioner's Exhibit SEK-2, page 3).

Employee Health Insurance	$ 5,301,850
Pension	4,201,953
Other Post Retirement Benefits	1,458,874
Grantor Trust	2,041,565
Executive Supplemental Benefits	158,891
Employee Thrift Plan	542,450
Capitalized Paid Absences	(452,054)
Benefit Loadings	9,949,507
Fringe Benefits Contra Credits	(11,919,251)
Total expensed payroll-related benefits	11,283,785
Less: Amount Charged Below-the-Line	66
Total O&M employee benefits	$ 11,283,719

During the evidentiary hearing, Mr. Kaufman redacted his testimony regarding pensions. Thus, no party disputed Petitioner's proposed employee benefits. Based on the foregoing, we find Petitioner's employee benefits expense is $11,283,719.

3. *Purchased Water Expense.*

a. *Evidence.* Petitioner's witness Sabine E. Karner stated that the *pro forma* adjustment for purchased water is based on the contract with each provider; Westfield, Plainfield, and the City of Indianapolis with respect to Eagle Creek Reservoir. (Pet. Ex. SEK at 41.) Ms. Karner noted that Petitioner's proposed *pro forma* adjustment assumes there will be no drought conditions preventing delivery of purchased water during the period rates are in effect and normalizes the Westfield amount for an annual 3% increase. (*Id.*) Ms. Karner stated Petitioner's *pro forma* increase for purchased water expense amounts to $118,867. (*Id.*)

OUCC witness Richard J. Corey noted that the *pro forma* expense for water purchased from Westfield is based on the assumption that Petitioner will purchase the minimum amount of water of 1,825,000,000 gallons that was contracted to be purchased each year per the water purchase agreement. (Pub. Ex. No. 4 at 5.) Mr. Corey further noted that the Petitioner's test year bills indicated that only 1,336,660,000 gallons were purchased from Westfield during the test year. (*Id.*) Mr. Corey stated that the OUCC inquired as to the reason Petitioner did not purchase the required minimum amount of water from Westfield during the test year, to which Petitioner informed the OUCC that the total volume was not made available by Westfield. (*Id.*) Mr. Corey testified that the OUCC's *pro forma* purchased water adjustment is based on the actual water purchased from Westfield during the test year. Mr. Corey further noted that this is $170,919 less than Petitioner's proposed *pro forma* Westfield purchased water expense of $638,750. (*Id.* at 6.)

Petitioner witness Lindsay C. Lindgren claimed that while Petitioner purchased 1,336,660,000 gallons of water from Westfield, which is less than the 1,825,000,000 minimum contracted for, it was not due to any reduction in Petitioner's demand but rather was due to Westfield's inability to deliver the minimum amount. (Pet. Ex. LCL-R at 2.) Mr. Lindgren argued that the inability of Westfield to provide the minimum amount was due to Westfield's development of additional water supply wells and operational issues related to the drought within its service territory. (*Id.*) Mr. Lindgren further claimed that over the last 9 months Petitioner's purchase of water from Westfield has totaled 4.9 million gallons per day, which equates to 98% of the contract minimum. Based on this information, he expected Petitioner's demand for water from Westfield will meet or exceed the contract minimum of 1,825,000,000 gallons annually. (*Id.* at 2-3.)

b. *Discussion and Findings.* Mr. Lindgren stated that in recent months Petitioner's purchase of water from Westfield has totaled 4.9 million gallons per day, which equates to 98% of the contract minimum. He believed Petitioner's demand for water from Westfield going forward will meet or exceed the contract minimum of 1,825,000,000 gallons annually.

While Petitioner did not incur the full expense of the contract in the test year, Petitioner did not purchase the minimum amount of water it was contractually obligated to buy from the City of Westfield because Westfield could not provide the water due to drought conditions. The OUCC raises concerns about Citizens not making an additional adjustment to remove expenses

incurred with replacing the capacity from Westfield that was not provided. However, due to the drought, it is not clear that Citizens produced additional water to offset the water not provided by Westfield. Further, to the extent that Citizens did produce additional water, we do not agree that the cost incurred by Citizens for its production equates to the cost to purchase water from Westfield.

Accordingly, we accept Citizens *pro forma* expense for water purchased from Westfield, and decline to make any downward adjustment as proposed by the OUCC.

4. *Chemical Expense.*

a. *Evidence*. Petitioner's witness Karner testified that a *pro forma* adjustment for chemical expenses was made to normalize test year quantities for current pricing, resulting in a *pro forma* decrease of $100,584. (Pet. Ex. SEK at 39.) Ms. Karner further maintained that test year levels for all ancillary charges for chemicals expenses, primarily freight and inventory adjustments, are representative of ongoing costs. (*Id.*)

OUCC witness Richard J. Corey correctly noted that Petitioner's response to OUCC data request 16.7 indicated that Petitioner used the incorrect pricing for sodium bisulfate due to miscommunication. The unit price was listed in gallons instead of pounds. (Pub. Ex. No. 4 at 6.) Mr. Corey stated the correct unit price of $0.2705 per pound is reflected in the OUCC's adjustment and results in a *pro forma* chemical expense for sodium bisulfate of $13,045, which is $51,097 less than Petitioner's proposed *pro forma* chemical expense for sodium bisulfate. (*Id.*) Ms. Karner agreed the OUCC properly applied the unit price correction that was elicited from Petitioner during discovery. (Pet. Ex. SEK-R at 4.)

b. *Discussion and Findings.* Based on Petitioner's and the OUCC's agreement, the Commission accepts the OUCC's *pro forma* adjustment to decrease Petitioner's revenue requirement for chemical expenses by $151,681.

5. *Shared Services Costs and the Overall Entity Allocation Factor.*

a. *Petitioner's Direct Evidence*. Petitioner's witness Karner sponsored *pro forma* adjustments to certain operating expenses, as well as the test year allocation of Shared Services costs to Petitioner. Ms. Karner stated that Shared Services is an organizational framework for the consolidation of resources and centralization of costs that provides process or knowledge-based services to the various Citizens Energy Group business units. (Pet. Ex. SEK at 14.) She stated that Shared Services is composed of two distinct branches: Corporate Support Services (CSS) and Shared Field Services (SFS). (*Id.*) Ms. Karner explained how Shared Services costs are assigned to the various business units that are served by and benefit from the activities of Shared Services personnel, identified the types of cost drivers used in allocating costs, and provided an overview of the cost allocation methodology. (*Id.* at 15-19.)

Ms. Karner indicated that the *pro forma* allocation for SFS charges is 30.51% to the Water Utility and that the *pro forma* allocation for CSS charges is the overall total actual test

year percentage of 26.83%. (*Id.* at 22.) Additionally, Ms. Karner made a *pro forma* adjustment for the redistribution of *pro forma* CSS costs to the Wastewater Utility in excess of 10%, utilizing the Water Utility's actual test year redistribution percentage of 3.29%. (*Id.*)

Ms. Karner then stated that she is using the overall total allocation percentage for *pro forma* adjustments instead of the factor in use for a specific department or expense item for two reasons. (*Id.* at 22.) First, she wanted to avoid overly complicating the *pro forma* adjustments with allocation percentages that change depending on the department or expense item that is responsible for the costs. (*Id.* at 23.) Second, the redistribution of CSS charges to CWA Authority in excess of 10% is calculated on the overall total, which renders the use of individual allocation percentages ineffectual. (*Id.*)

Ms. Karner testified that she made a *pro forma* adjustment to remove a total of $465,300 in non-recurring expenses from the test year, most of which were charges directly allocable to Petitioner. (*Id.* at 44.) She also removed $16,552 from the test year as a non-allowable expense. (*Id.* at 46.)

b. *OUCC's Evidence*. Following a detailed discussion of her general ledger and voucher review, Ms. Stull identified several operating expenses as non-allowed, non-recurring, or capital in nature. (Pub. Ex. No. 5 at 9.) In addition to the adjustments made by Petitioner's witness Ms. Karner, Ms. Stull proposed to reduce test year operating expenses by $323,079 to eliminate non-allowed, capital, and non-recurring expenses. (Pub. Ex. No. 5 at 3.) She also stated that she proposed adjustments to *pro forma* operating expenses to annualize certain expenses and to eliminate excessive and unreasonable expenses. (*Id.*)

Ms. Stull identified a number of expenses she deemed to be non-allowed as they are expenses that should be excluded from Petitioner's revenue requirement because the expenses are inappropriate to recover from ratepayers. (*Id.*) Ms. Stull explained that non-allowed expenses include expenses that are not necessary to provide safe, reliable water utility service, provide no material benefit to ratepayers, or are otherwise excluded by statute, such as Indiana Code § 8-1-2-6(c). (*Id.* at 10.) Included in Ms. Stull's adjustment for non-allowed expenses are expenses that were allocated to Petitioner during the test year that are related to other Citizens Energy Group ("CEG") affiliates, not Citizens Water. (*Id.* at 11.) She testified these expenses include Platts subscription costs, expenses for a corporate responsibility report, as well as expenses related to the Energy Solutions Center, the National Fuel Funds Network, and a Citizens Energy Group Trust brochure. (*Id.*) Ms. Stull explained that the National Fuel Funds Network is a non-profit advocacy group for home energy assistance funds that promotes energy efficient natural gas solutions. (*Id.* at 12.) She testified that these expenditures do not have a sufficient nexus to the operation of the water utility. Ms. Stull's non-water adjustment totaled $14,684. (*Id.* at 13.)

Ms. Stull also pointed to several transactions related to marketing activities that should be removed from Petitioner's *pro forma* operating expenses. (*Id.* at 13.) She testified that these transactions include an LNG vehicle market entry plan prepared by Capstone Strategic and market research conducted by Market Strategies, Inc. (*Id.*) Ms. Stull also proposed eliminating all costs allocated to Petitioner from Area 1415 – Thermal Market Development. (*Id.*) Ms. Stull

explained that these marketing costs are not necessary to provide safe, reliable water utility service. (*Id.* at 14.) Further, ratepayers receive no benefit from Petitioner's marketing expenses, and therefore, Citizens should not be allowed to recover these costs in rates. (*Id.*) Ms. Stull's marketing adjustment totaled $90,353. (*Id.*)

Ms. Stull indicated that although Petitioner eliminated most charitable contributions, some expenses seem to have been overlooked and should also be eliminated from Petitioner's *pro forma* operating expenses. (*Id.* at 14-15.) Ms. Stull's charitable contribution adjustment totaled $4,411.98. (*Id.*) Further, Ms. Stull proposed eliminating other non-allowed expenses including employee related expenses such as service awards, a holiday lunch for CEG management and the board, retiree lunches, and quarter century club expenditures. (*Id.* at 15-16.) Ms. Stull explained that the expenses related to employee service awards (including $1,000+ gold rings), retiree lunches, and the quarter century club are incurred in addition to the market based salaries and benefits already provided to Petitioner's employees. (*Id.* at 16.) These additional expenditures are not necessary for the provision of water utility service and provide no material benefit to ratepayers. (*Id.*) If CEG wishes to provide these types of perks to current or former employees, the costs should be paid from some source other than utility rates. (*Id.*) Ms. Stull's other non-allowed expense adjustment totaled $19,727.

Ms. Stull then accepted Petitioner's proposed non-recurring adjustments, but indicated that additional non-recurring expenses should be removed from the revenue requirement. (*Id.* at 17.) The additional test year expenses Ms. Stull identified as non-recurring primarily included costs related to the transition of the water and wastewater utilities, such as consulting fees for "Lessons Learned," transition of customer service, public outreach, gifts for new employees, and a new hire employee survey. (*Id.* at 17-18.) The non-recurring expenses identified by Ms. Stull also included one-time fees paid to Lifeline Data centers and miscellaneous legal matters. (*Id.* at 18.) Ms. Stull explained that non-recurring expenses are expenses that are not reasonably expected to recur in future periods. (*Id.* at 17.) It would be inappropriate for Petitioner to recover costs it would not reasonably expect to incur during the period for which rates are being set. (*Id.*) Ms. Stull's non-recurring expense adjustment totaled $81,748.

Ms. Stull indicated that during her review of CSS and SFS test year general ledger transactions, in conjunction with her voucher review, revealed several transactions expensed during the test year that are of a capital nature and should be capitalized according to Petitioner's capitalization policy. (*Id.* at 19.) The types of capital transactions identified by Ms. Stull included software and software development costs, an atomizer controller board, a wireless transmitter and receiver for White River Gate (North), card readers, right of way surveying costs, computers, and office furniture. (*Id.*) Based on Petitioner's capitalization policy and the supporting documentation Petitioner provided for selected transactions, Ms. Stull determined that these expenses met Petitioner's capitalization requirements and should be removed from Petitioner's operating expenses. (*Id.*) Ms. Stull's capital expense adjustment totaled $71,780.

Ms. Stull also proposed adjustments to annualize certain test year expenses and to eliminate excessive or unreasonable expenses identified during her review. (*Id.* at 27.) Ms. Stull proposed to adjust multi-year agreements, including software maintenance agreements, warranty extensions, and computer lease agreements. (*Id.*) In total, Ms. Stull removed $ 14,451 from

operating expenses associated with these costs. (*Id.* at 29.) Ms. Stull also removed $13,539 in fees paid to the Board of Directors of CEG. (*Id.* at 30.) Ms. Stull's review revealed that, due to timing differences, five quarters of fees were recorded during the test year for certain directors. (*Id.*) Similarly, Ms. Stull removed $8,283 from Petitioner's operating expenses to eliminate excess test year costs related to Capital Cities, an investment fiduciary consultant to CEG. (*Id* at 30-31.)

Ms. Stull identified several invoices for office related furnishings that she deemed to be imprudently incurred. (*Id.* at 31.) She removed $4,105.73 in excessive "design services provided" from Petitioner's operating expenses. (*Id.*) Ms. Stull explained that for several items, including name plates, office identification inserts, bookends, and miscellaneous furniture, the design service fee far exceeded the cost of the items purchased. (*Id.*)

During her review of Petitioner's test year accounting transactions, Ms. Stull encountered two transparency issues: (1) Petitioner's method of charging costs incurred by CSS and SFS, and (2) large number of reclassifications and related adjustments. (*Id.* at 33.) Ms. Stull proposed that Citizens conduct another level of review of CSS and SFS costs prior to these costs being allocated to CEG affiliates. (*Id.* at 35.) Now that water and wastewater utilities have been added to the mix of CEG affiliates, the review process needs to be modified. (*Id.*) Currently, CEG uses a two-step procedure to charge CSS and SFS costs to affiliates; first, identifying those costs directly attributable to a specific affiliate, and then allocating the remaining costs based on various allocation factors. (*Id.* at 33.) Ms. Stull recommends these costs should be charged using a three-step procedure. (*Id.* at 35.) After first identifying costs attributable to a specific affiliate, Ms. Stull proposes that remaining costs should be reviewed and those costs that can be specifically attributed to water only be allocated to water and wastewater affiliates. (*Id.*) Similarly, those costs that can be specifically attributed to energy should only be allocated to energy affiliates. (*Id.*) Only after this two-step review should any remaining costs be allocated to all affiliates in a third and final step. (*Id.*)

c. *Petitioner's Rebuttal Evidence*. Ms. Karner testified that the Commission should reject Ms. Stull's proposal to remove $323,079 in Shared Services costs. (Pet. Ex. SEK-R at 8-9.) Ms. Karner noted initially that Petitioner's use of the overall entity allocation factor for *pro forma* adjustments, which Ms. Stull found acceptable, already provides for a reduction of approximately $414,000 in *pro forma* operating expenses, so that Ms. Stull's proposed adjustments are essentially duplicative. (*Id.* at 9.)

Ms. Karner stated that the use of the overall entity allocation factor in *pro forma* adjustments provides for reduced operating expenses, and she testified that the overall entity allocation factor is simply the sum total of all allocations from Shared Services to Citizens Water divided by the sum total of all expenses in Shared Services. (*Id.* at 10-11.) Ms. Karner stated that she used this factor—which computes to 26.83% for CSS allocations and 30.51% for SFS allocations—rather than the individual departmental allocation factors for two reasons: 1) to reduce the complexity of the *pro forma* adjustments, and 2) because it yielded reduced *pro forma* amounts. (*Id.* at 11.)

In testifying why she knowingly used an allocation factor that produces lower *pro forma*

amounts than would have resulted from use of the actual test year allocation factor, Ms. Karner stated that she determined the use of the overall entity allocation factor, apart from being practical, would also yield savings to the customer that would ultimately more than offset any potentially overlooked minor transactions while still maintaining reasonable and representative operating expenses. (*Id.* at 12.)

Ms. Karner stated that Ms. Stull's use of the overall entity allocation factor in her calculations is incorrect and therefore misstates the amount of actual test year expenses that she proposes to have removed from Petitioner's revenue requirement. (*Id.* at 9.) Instead of establishing the *actual* test year allocation amount first and then applying the overall entity allocation factor to the *pro forma* amount as Ms. Karner had done, Ms. Stull erroneously applied the overall entity allocation factor to the test year amount prior to allocations, thereby establishing incorrect test year allocated amounts. (*Id.* at 13-14.) According to Ms. Karner, all of Ms. Stull's proposed adjustments are incorrect based on the erroneous use of the overall entity allocation factor alone. (*Id.* at 14.)

Ms. Karner also pointed out that the OUCC had misinterpreted a number of Shared Services allocations. Ms. Karner observed that, in addition to proposing to eliminate entire areas worth of expenses despite the fact that those areas are an integral part of the allocation percentage to Citizens Water, Ms. Stull also proposes the elimination of certain expenses within other areas on the basis of being "non-water" in nature. (*Id.* at 17.) Ms. Karner stated, however, that certain expenses, while appearing to be "non-water," are simply the cost of CSS employees doing their job, and that the fact that such expenses occur even though they may not directly pertain to a specific business unit is already considered in the allocation percentage for that employee's area and department. (*Id.* at 18.)

Ms. Karner then responded to the specific adjustments to Shared Services costs proposed by Ms. Stull. Ms. Karner noted with respect to some adjustments that Ms. Stull proposed the removal of amounts that are not included in *pro forma* operating expenses; with respect to other OUCC adjustments, Ms. Karner disagreed with Ms. Stull's classification of $322,008 of particular expenses as ones that should be removed. (*Id.* at 19-34.) Ms. Karner's overall recommendation is to reject all of Ms. Stull's adjustments on the basis that the use of the overall entity allocation factor, which she accepted, already provides for a *pro forma* operating expense reduction of more than $400,000. (*Id.* at 18-19.) Ms. Karner's testimony indicates, however, that if the Commission decides to pursue Ms. Stull's adjustments, the CSS redistribution amount needs to be updated to reflect the impact on CSS costs. (*Id.* at 34.)

d. *Discussion and Findings*. Petitioner applied its overall entity allocation factor resulting in a $414,000 operating expense reduction. The OUCC accepted that reduction, and made additional adjustments in the amount of $229,088 for non-recurring, non-allowed, capital, and other expenses.[9] Ms. Karner stated that she used the overall entity allocation factor to avoid overly complicated *pro forma* adjustments and stated that the effect of using an overall allocation percentage as opposed to individual departmental allocation percentages to be immaterial to the *pro forma* revenue requirement.

[9] The OUCC's proposed order clarified that although it originally proposed $323,079 in additional adjustments, upon further review reduced that amount to $229,088 once the proper allocation factors were used.

Ms. Karner stated that the method she used versus the method the OUCC used are both appropriate, but mutually exclusive. We agree. Ms. Karner proposed the use of an allocation factor to calculate her adjustment, and reach a reasonable approximation of ongoing expenditures without delving into the "minutia." Tr. at I-51. The OUCC undertook a methodology using precise review of all expenses.,

This issue is similar to the OUCC's discussion in its proposed order concerning composite depreciation rates. A composite depreciation rate, by definition, has no relation to the actual depreciation rate of any one item. Instead, when all utility plant is considered in total, the composite rate reflects the depreciation rate of the aggregate plant. Here, Ms. Karner's methodology used a rate calculated by summing the allocated Shared Services expenses and dividing that number by the sum total of all Shared Services. Accordingly, when looking at individual items, the allocation factor will most likely not reflect the actual amount of that individual item that should be allocated to the utility.

We accept Ms. Karner's rationale and methodology, and accordingly find that Petitioner's $414,000 expense reduction is appropriate. We note that in this Cause, the $414,000 expense reduction was not identified until Petitioner's rebuttal case. For future cases, Petitioner should include additional testimony in its case-in-chief explaining its methodology, rather than omitting material that may be beneficial to all interested parties. Further, we accept Petitioner's $465,301 adjustment for non-recurring expenses and its $16,552 adjustment for non-allowed expenses.

6. *Costs to Achieve.*

a. *Evidence.* Industrial Group witness Michael Gorman testified that as a result of acquiring the water and wastewater systems, the water utility will realize savings by operating as a large combined utility with other utilities rather than as independent utilities. (IG Ex. MPG at 17.) Mr. Gorman stated that to achieve these acquisition savings CSS incurred additional capital and O&M costs in the amount of $4,097,000 during the test year. (*Id.*) Mr. Gorman stated that these costs, and the realized savings associated with the costs, were reflected in the test year and allocated across all CSS utility companies, including 30.12% allocated to the water system. (*Id.*) Mr. Gorman stated that these costs were non-recurring and should be removed. (*Id.* at 17-18.) Mr. Gorman recommended a $1,234,000 *pro-forma* decrease to the CSS charges allocated to Petitioner. (*Id.*)

Petitioner's witness Aaron D. Johnson noted that Mr. Gorman derived the $4,097,000 amount of costs to achieve from the "Second Semi-Annual Report Regarding Savings and Other Matters." Mr. Johnson asserted that most of this cost was not incurred during the test year. (Pet. Ex. ADJ-R at 15.) Mr. Johnson also argued that Mr. Gorman's proposed adjustment is a "double dip," because Petitioner removed any costs to achieve that were incurred in the test year from Petitioner's proposed revenue requirement. (*Id.*)

Petitioner's witness Karner stated Mr. Gorman's proposed adjustment should be rejected for several reasons. (Pet. Ex. SEK-R at 35.) First, he incorrectly characterizes the costs to

achieve as having been incurred during the test year. (*Id.*) Ms. Karner stated that the costs to achieve included in the savings report is shown as a life-to-date number and a vast majority of these costs were incurred prior to the test year. (*Id.*) Second, Ms. Karner stated Mr. Gorman also wrongly inferred that all costs to achieve were charged to CSS. Finally, Ms. Karner opined Petitioner had already removed any residual cost to achieve expenses from its proposed revenue requirement. (*Id.*)

b. *Discussion and Findings.* The evidence shows that there were no costs to achieve included in Petitioner's proposed revenue requirement. The Industrial Group did not identify transactions or provide other evidence supporting its proposed $1,234,000 *pro forma* adjustment. The Industrial Group's proposed adjustment is based on Mr. Gorman's assumption that $4,097,000 of life to date costs to achieve reflected in Petitioner's semi-annual savings report are included in Petitioner's O&M expenses. Based on the record evidence, the Commission rejects the Industrial Group's proposed $1,234,000 *pro forma* adjustment.

7. *Rate Case Expense.*

a. *Evidence*. Petitioner proposed an adjustment to increase test year expense by $260,845 for rate case expense. Except for Petitioner's estimated cost of the OUCC's outside cost-of-service consultant, OUCC witness Patrick accepted the components of Petitioner's rate case expense. (Pub. Ex. No. 1 at 43.) Mr. Patrick stated that the OUCC proposes Petitioner's rate case expense adjustment should be $237,521. (*Id.*) Mr. Patrick explained the difference was based on Petitioner estimating a total cost of the OUCC's cost of service consultant to be $105,000, when the OUCC was only going to incur $35,000 for this cost. (*Id.*) During the evidentiary hearing, the OUCC stipulated on the record that the consultant cost to be recovered by the OUCC would not exceed $35,000 and Petitioner agreed to Mr. Patrick's rate case expense. (Tr. at I-29.)

b. *Discussion and Findings*. Based on the parties' agreement, the Commission finds Petitioner's total rate case expense is $712,563. The parties agreed to a three-year amortization period. The Commission, therefore, approves the OUCC's $237,521 adjustment for rate case expense.

8. *Bad Debt Expense.*

a. *Evidence.* Petitioner's witness LaTona Prentice testified that the test year provision for uncollectable expense was increased by $971,647 to reflect the effect of an increase in total write-off commensurate with the proposed revenues in this case. She testified that Citizens proposes to recover through its base rates net write-off at a fixed ratio of 1.74%. (Pet. Ex. LSP at 8.) Ms. Prentice explained that she used the test year net write-off as a percent of five-month lagged total water revenues to reach the 1.74%. She added that multiplying the *pro forma* water sales revenues at present rates of $172,100,352 by 1.74% results in *pro forma* net write-off at present rates of $2,994,546, which is $971,647 more than the test year provision for uncollectable expense of $2,022,899. (*Id.*) Ms. Prentice explained why she used net write off as a percent of five-month lagged total water revenues. She explained that a period of five months must pass before Citizens writes off uncollected revenues. She asserted,

therefore, that taking net write-off as a percentage of the revenue that was billed five months prior to the write-off month "is a more appropriate indicator of the level of net write-off." (*Id.*) Although not addressed in her testimony, Ms. Prentice's testimony included an exhibit showing an additional $440,475 of revenue requirement for bad debt expense flowing from Petitioner's prospective increase in total operating revenues. (Pet. Ex. LSP-1, p. 1 of 13.)

OUCC witness Charles E. Patrick addressed Petitioner's proposed adjustments for bad debt expense. Mr. Patrick began by identifying Petitioner's proposed bad debt expense included a *pro forma* adjustment of $440,475 (based on Petitioner's additional proposed revenue requirement of $25,314,657) in addition to Petitioner's proposed increase of $971,647 in O&M expense for increased bad debts expense during the test year. (Pub. Ex. No. 1 at 40.) Mr. Patrick then declared that the OUCC does not accept Petitioner's bad debt adjustments. Mr. Patrick noted that Petitioner's proposed bad debt percentage of 1.74% is substantially higher than the percentage of bad debt Petitioner incurred during the test year of 1.18% ($2,022,899 divided by $172,100,352). (*Id.* at 41.) Mr. Patrick applied the test year bad debt percentage (1.18%) to *pro forma* test year revenue and made an adjustment of $89,614 in the test year. (*Id.*) Through Mr. Patrick, the OUCC proposed a *pro forma* adjustment of $63,446 based on an additional revenue requirement of $5,376,791. (*Id.* at 42.)

Petitioner's witness Prentice disagreed with the OUCC's proposed bad debt percentage of 1.18%. Ms. Prentice stated that Mr. Patrick's calculation utilizes the test year uncollectible expense accrual. (Pet. Ex. LSP-R at 30.) Ms. Prentice stated that because Petitioner's rates are determined on a cash revenue requirements basis, the appropriate calculation is to divide test year actual net write-offs by the five-month lagged revenue. (*Id.*) Ms. Prentice stated that taking net write-offs as a percent of the revenue that was billed five months prior to the write-off month is an appropriate indicator of the level of net write-offs. (*Id.*) Ms. Prentice indicated Petitioner's cash approach to determining the appropriate bad debt ratio has been utilized by Citizens Gas in prior rate cases. (*Id.* at 31.) Ms. Prentice showed how she calculated a 1.74% of revenues for her bad debt percentage through her Petitioner Exhibit LSP-R11.

b. *Discussion and Findings.* The parties' respective Proposed Orders contain disparate findings regarding the appropriate write off percentage of revenues for bad debt. The parties' respective bad debt ratios are:

Petitioner 1.74%
Industrial Group 1.43%
OUCC 1.32%

Petitioner calculated its proposed bad debt ratio in the same manner as it has been calculated for all of the utilities operated by Citizens Energy Group. That approach is illustrated in Petitioner's Exhibit LSP-R11 and uses all twelve months of the test year. In its Proposed Order, the OUCC adopts Petitioner's methodology for calculating the bad debt ratio (which differs from the method of calculation presented by the OUCC in its case-in-chief), but excludes the month of October 2011 from the calculation. The OUCC excludes October 2011 because the amount of write offs during that month ($855,753) was an outlier. The Industrial Group excluded

both October 2011 ($855,753) and November 2011 write-offs ($26,515) because both months were outliers.

The OUCC's approach of excluding the highest monthly amount of write-offs during the test year, without also eliminating the lowest monthly amount, skews and understates Petitioner's bad debt ratio. As reflected above, the Industrial Group recognizes that excluding only the highest month significantly understates the bad debt ratio and accordingly the Industrial Group proposes to eliminate both the lowest monthly amount and the highest monthly amount. We find the IG approach reasonable, with an average write off percentage of 1.43, as the October 2011 write offs exceed that average by more than 400%, while the December 2011 write offs are more than 700% under the average.

Accordingly, the Commission therefore finds Petitioner's bad debt expense adjustment as $509,243 for the *pro forma* test year and $225,387 for its increased revenue requirement.

9. *Property Taxes.*

a. *Evidence.* Mr. Richard Corey, Analyst for the OUCC, recommended test year property tax expense be decreased by $161,508. (Pub. Ex. No. 4 at 7.) He proposed to modify Petitioner's proposed *pro forma* property tax expense in view of certain perceived typographical errors with respect to the assessed value for real property. (*Id.* at 4.) Petitioner's Witness Ms. Karner stated that what Mr. Corey believed were typographical or input errors were, in fact, changes in assessment by the respective assessors that occurred after the *pro forma* adjustments were prepared.

Ms. Karner further noted that since the preparation of the *pro forma* adjustment, all but four out of 324 actual tax bills have become available. (*Id.*) She believes it is appropriate to simply use the actual pay-2013 tax bills as the new *pro forma* amount for property tax expense, which represents a reduction of $155,564 compared to the test year. (*Id.* at 3-4.)

At the evidentiary hearing, the Commission admitted into the record Petitioner's Exhibit CX-1, which includes the responses to two data requests that Mr. Corey prepared. (Tr. at D-89.) Mr. Corey agreed with Ms. Karner that it is appropriate to use the actual pay-2013 tax bills as the *pro forma* amount for property tax expense and that certain notations in his direct testimony are changes in the assessment as indicated in Ms. Karner's rebuttal testimony. (Pet. Ex. CX-1.)

a. Discussion and Findings. Based on the parties' agreement, the Commission accepts Petitioner's proposal to use the actual pay-2013 tax bills as the *pro forma* amount for property tax expense. Therefore, we find Petitioner's *pro forma* property tax expense is $9,125,975 for distributable property and $1,143,596 for real property, including CSS amounts at the Citizens Water allocation share of 26.83%, for a total of $10,269,571 plus $6,202 for CSS redistribution giving Petitioner $10,275,773.

10. *Payroll Tax.*

Based on our findings regarding labor expense, we have accepted the parties' downward

adjustment of $17,121 and make an additional downward adjustment of $13,317 related to our findings on EIP and STIP.

11. *Amortization of DOW Regulatory Asset.*

a. *Evidence*. OUCC witness Patrick noted there was a $43,538 difference between Petitioner's proposed depreciation and amortization expense and the amount of depreciation and amortization expense that Petitioner offset against its proposed revenue requirement. (Pet. Ex. LSP-1, p. 2 of 13 at lines 33 and 44.) Mr. Patrick noted that Petitioner provided no explanation for this difference. In Petitioner's rebuttal case, Ms. Prentice testified that this difference is attributable to Petitioner's predecessor, the DOW, amortizing regulatory assets. Thus, Petitioner and the OUCC disagreed about amortization expense. Ms. Prentice asserted that Petitioner acquired from DOW deferred rate case expense and regulatory assets under the terms of the Asset Purchase Agreement. (*Id.* at 29.) According to Ms. Prentice, the regulatory assets at issue include "water tank painting and water rights." (Pet. Ex. LSP-R at 29.) Ms. Prentice noted that Section 2.01, Subsection (1) of the Asset Purchase Agreement references "all other miscellaneous assets owned, licensed or leased by Sellers and used, necessary or important in the operation of the System." (Pet. Ex. LSP-R, p. 29.) Ms. Prentice explained that "Petitioner carried forward other regulatory assets from the balance sheet of the DOW. These related to costs that were incurred prior to 2002, but were still being amortized by DOW. They were for water tank painting and water rights." (*Id.*) Ms. Prentice noted that Petitioner carried forward other regulatory assets from the DOW balance sheet, an unamortized aggregate balance at closing of $337,561. (*Id.*) Ms. Prentice said that in her opinion "as these assets were part of the assets acquired by Petitioner, it is appropriate for them to be amortized and recovered as they were intended to be recovered by the DOW and Commission." (*Id.*)

b. *Discussion and Findings*. Pursuant to SFAS 71, the Commission may permit a utility to record an asset for expenditures that would otherwise be expensed by non-regulated entities. The Commission granted the DOW the ability to record these regulatory assets. Citizens Water did not request or receive Commission authority to record this regulatory asset. Further, Petitioner represented that these assets include tank painting and water rights. When Citizens Water purchased the water utility, it purchased the water tanks in their painted condition, received the water rights, and provided value for these assets in the purchase price paid to the City, which was financed with debt. Therefore, recovery of the regulatory assets here would result in ratepayers paying twice for the same assets, once through debt service and a second time through amortization of the regulatory asset. Accordingly, Petitioner's request to include the amortization expense of $43,538 is denied.

D. *Depreciation Expense.*

1. *Evidence*. Petitioner's witness Ms. Sabine Karner explained how she determined her *pro forma* adjustment to depreciation expense. She noted that she established the annual amount of depreciation expense on depreciable utility plant in service as of November 30, 2012. She then calculated the net of annual depreciation expense on an adjusted balance for plant in service after expected asset additions less expected retirement as well as the expected amount of amortization for Contributions in Aid of Construction (CIAC). (Petitioner's Exhibit

SEK at 51-52.) Ms. Karner testified that the net adjustments result in a *pro forma* increase of $749,219 for the Water utility.

OUCC witness Patrick disagreed with Petitioner's calculation of depreciation expense. Mr. Patrick stated that Petitioner's proposed test year depreciation expense depended on depreciation rates not authorized by the Commission. (Pub. Ex. No. 1 at 46.) Mr. Patrick noted that in the final order in Cause No. 43936, Section 5A, p. 10, dated March 17, 2011, the Commission found that Citizens Water and the Authority will use, for ratemaking purposes, 2% and 2.5% depreciation rates, respectively. (*Id.*) Mr. Patrick noted that Petitioner used the 2% depreciation rates for utility plant in service on the books of Citizens Water, but it did not use 2% for utility plant in service that was on the books of CSS and SFS. (*Id.*)

Mr. Patrick explained that "Citizens Energy Group has organized corporate and other support services into two entities, Corporate Support Services (CSS) and Support Field Services (SFS)." Mr. Patrick added that together CSS and SFS "provide various services including accounting, engineering, human resources, treasury, fleet services, meter reading, customer support services (call center), and other similar services that are used by most, if not all, Citizens Energy Group subsidiaries and affiliates." Mr. Patrick further indicated that CSS and SFS are considered to own "the majority of the short-lived utility assets such as computers, vehicles, office furniture, and other similar assets." Mr. Patrick noted that Citizens Energy Group depreciates these assets using much higher depreciation rates as compared to the 2% depreciation rate authorized by the Commission for water assets. He indicated that in contrast, Citizens' regulated utilities are considered to own "all of the longer-lived assets such as treatment plants, transmission and distribution mains, lift stations, and other similar utility plant." (*Id.* at 47.)

Mr. Patrick indicated that Petitioner used group depreciation rates for the assets on the books of CSS and SFS, the rates of which are different than the Commission's composite rates. (*Id.* at 46.) Mr. Patrick noted that these group depreciation rates for CSS and SFS are based on a depreciation study from December 31, 2009 for selected plant in service of Citizens Energy Group. Mr. Patrick recited the following from the study itself. The study relates to gas utility plant within the Gas Operations and Customer Shared Services (CSS) Division, Steam and Chilled water assets within the Thermal Division and the Westfield gas utility property. The report describes the concepts, methods and basic judgments which underlie the recommended annual depreciation accrual rates related to the assets studied. (*Id.* at 48.)

Mr. Patrick stated the depreciation method, which Petitioner used for its CSS and SFS assets, overstates overall depreciation expense when selectively combined with composite rates on the longer lived assets as Petitioner as done. He noted that the Commission's composite rates were calculated based on a study of all utility plant assets, both longer and shorter lived assets. The 2% water rates generated by this study are an average rate for all utility assets. He indicated that if shorter lived assets, such as computers and vehicles, were not included in the Commission composite depreciation study, the average depreciation rate would be lower for longer lived assets, all other factors remaining the same. (*Id.*) Mr. Patrick declared that depreciation expense calculated for all utility assets used to service customers of the water utility should be based on the same methodology -- either depreciation expense should be based on rates determined in a depreciation study *or* depreciation expense should be based on the Commission's composite rate.

(*Id.*)

In Petitioner's rebuttal case, Ms. Karner responded that the depreciation rates used by Petitioner for SFS and CSS assets were approved by the Commission in Cause No. 43975. (Petitioner's Exhibit SEK-R at 5-6.) Ms. Karner said the Commission should reject Mr. Patrick's suggestion that Shared Services depreciation rates, when allocated to the Water Utility, should not exceed the Water Utility's depreciation rates. (*Id.* p. 6.) Ms. Karner asserted there can be no doubt that the 2% depreciation rate approved by the Commission is specific to the water utility assets and does not apply to Shared Services assets. (*Id.* p. 7.) She added that the 2% composite depreciation rate is based on an analysis conducted in 1987. She speculated that most likely that analysis did not take into consideration the computing technology based shorter lived assets that make up close to 90% of the Shared Services depreciation expense and which will not logically have a 50 year lifespan. (*Id.*)

2. *Discussion and Findings*. In this Cause, the amount of revenues Petitioner needs to provide sufficient funds for E&R exceeds its proposed annual depreciation expense. Therefore, the rates approved in this Cause will not reflect Petitioner's depreciation expense. However, consistent with Ind. Code 8-1.5-3-8, we address this issue.

In our final order in Cause No. 43936, we authorized Citizens "to use 2% as its depreciation rate for water utility plant in service until such time as the Commission orders a different depreciation rate for ratemaking purposes. . . ." In Cause No. 43975, we approved a settlement in the Citizens Gas rate case, which included the adoption of new depreciation rates used by Citizens for its SFS and CSS assets.

Accordingly, the Commission finds that Petitioner's *pro forma* depreciation expense is $28,975,969 based on a composite 2% rate for water utility assets and the revised rate approved in Cause No. 43975 for SFS and CSS assets.

E. ***Utility Receipts Tax.*** Based on the Commission's approved *pro forma* revenues, we approve a *pro forma* Utility Receipts Tax adjustment of $155,452. We further find Petitioner's revenue requirement for Utility Receipts Tax should be increased as reflected in Section 7 below as a result of our approved increase its annual operating revenues.

7. Discussion and Findings Regarding Aggregate Annual Revenue Requirements. Based upon the above discussion and findings, the Commission concludes that Petitioner's total aggregate annual cash revenue requirement is $201,497,138 as detailed below:[10]

[10] Petitioner did not request a working capital allowance.

Operating Expenses	$ 76,142,764
Taxes other Than Income	12,726,429
Extensions and Repairs	42,001,167
Debt Service	70,184,196
Total Revenue Requirements	201,054,556
Less: Interest Income	2,616,452
Other Income	298,135
Carmel Note	950,300
Brown County Note	100,197
System Development Charges	4,952,159
Billing Insert Income	15,000
Atrazine Settlement	-
Add: Interest Expense - Customer Deposits	-
Net Revenue Requirements	192,122,313
Less: Revenues at current rates subject to increase	175,361,767
Other revenues at current rates	1,463,802
Net Revenue Increase Required excluding taxes	15,296,744
Divide by: Revenue Conversion Factor	97.19%
Net Revenue Increase Required	$ 15,739,326
Percentage Increase	8.98%

We find that Petitioner's current rates and charges, which produce annual operating revenue of $175,361,797, are insufficient to provide for Petitioner's aggregate annual cash revenue requirement and, therefore, are unjust and unreasonable. Petitioner's rates and charges for water service need to be increased by 8.98% or $15,739,326, which includes $217,195 of revenues associated with increased Indiana Utility Receipts Tax and $225,387 of incremental bad debt, in order to meet its aggregate annual cash revenue requirement.

8. Cost-of-Service.

A. *Petitioner's Evidence.* Michael C. Borchers, a manager in the Black & Veatch Corporation ("Black & Veatch") Management Consulting Division, presented the results of his cost-of-service study and the proposed design of Petitioner's rates and charges. The results of Mr. Borchers' cost-of-service study were set forth in Petitioner's Exhibits MCB-2 (Schedules 1 through 10) and MCB-3 (Schedules 1 through 4). Mr. Borchers indicated he used the base extra capacity methodology in the study and allocated the total cost-of-service to functional cost components recognizing the system characteristics of and the parameters having the most significant influence on the magnitude of each element of cost. (Pet. Ex. MCB at 5-6.)

Mr. Borchers noted the Commission previously had ordered Citizens Water to conduct a capacity factor analysis to determine if the capacity factors used during the last several cost-of-service studies for this water utility were still relevant. (*Id.* at 13.) Mr. Borchers testified that

Black & Veatch conducted a capacity factor analysis according to the methodology outlined in Appendix A of the AWWA Manual M1: Principles of Water Rates, Fees, and Charges. (*Id.*) According to Mr. Borchers, using billing data by customer category and system peak day and hour data, Black & Veatch calculated the max day and max hour capacity factors by customer category, which were further consolidated into the proposed customer classes shown in Petitioner's Exhibit MCB-2, Schedule 6 based on similar peaking factors (Residential, Multi-Family, Commercial, Industrial, Sale for Resale, and Irrigation). Mr. Borchers calculated the diversity ratios by comparing the non-coincidental class demand ratios to the overall system max day and max hour demand ratios that were calculated by Black & Veatch. (*Id.* at 14.) The diversity ratios fell within the AWWA Manual's acceptable range of 1.1 to 1.4, indicating reasonable class capacity factors in Mr. Borchers' opinion. (*Id.*) Based upon Mr. Borchers' capacity factor analysis, Citizens Water determined to treat Multi-Family and Irrigation customers as separate classes because their respective capacity factors varied from the overall capacity factor for the Commercial class. (*Id.* at 14-15.)

On Schedule 10 of Petitioner's Exhibit MCB-2, Mr. Borchers presented his comparison of the cost-of-service for each class to the revenue from that class under existing rates and charges, along with the indicated increase in revenues to bring each class to full cost-of-service, as determined by Mr. Borchers, using Petitioner's total allocated cost-of-service in its case-in-chief. (*Id.* at 18.) The next step in Mr. Borchers' cost-of-service study was to design a schedule of rates and charges to recover the total cost-of-service and meet three primary objectives. (*Id.* at 19.) First, the rate design should reflect rates and charges that recover the respective cost to serve each class. Second, the proposed rate structure should satisfy the request of Citizens Water to have rates and charges for the individual customer classes, in lieu of charging all customers using the same declining block rate structure. Finally, Citizens Water asked Mr. Borchers to design rates and charges that would begin moving toward a more conservation-oriented structure. Mr. Borchers testified that he designed the proposed service charges to recover the costs related to billing and collecting, meters and services, and public fire protection. (*Id.* at 20.) Mr. Borchers indicated the proposed monthly service charge is the same for each customer class. (*Id.*)

Petitioner's proposed volumetric charges reflect uniform rates for Residential and Irrigation customers, declining block structures for Industrial and Sale for Resale customers, and a hybrid structure for Multi-Family and Commercial customers. (*Id.*) Mr. Borchers explained the uniform rate for Residential and Irrigation customers was a first step toward potentially implementing an inclining block rate structure for Citizens Water. (*Id.* at 21.) The proposed hybrid rate structure for Multi-Family and Commercial customers was suggested by Mr. Borchers because moving to a uniform rate for these customers would have resulted in large increases for customers that have a significant amount of usage in the fourth and fifth rate blocks, compared to current rates. Black & Veatch proposed to retain the declining block rate structure for the Industrial class and Sale for Resale class and to reduce the magnitude of the rate increase under the cost-of-service study for the Sale for Resale class to avoid rate shock, with the net cost-of-service to be recovered from the other classes. (*Id.* at 22.)

Mr. Borchers further testified that, in his opinion, the proposed cost-of-service based rates he designed for use in this proceeding move each customer class to cost-of-service based

rates, with the exception of the Sale for Resale class. Finally, Mr. Borchers testified that in his opinion, the proposed rates and charges are fair and equitable and represent reasonable and just rates and charges for water service. (*Id.* at 24.)

B. ***OUCC's Evidence.*** Mr. Jerome D. Mierzwa of Exeter Associates, Inc. reviewed the Black & Veatch cost-of-service study and rate design proposals. Mr. Mierzwa testified that although the cost-of-service study presented by Citizens Water witness Borchers is generally reasonable, his review and analyses found that several modifications to the study were appropriate. (Pub. Ex. No. 7 at 3.) First, Mr. Mierzwa indicated the system-wide maximum day and maximum hour ratios, or factors, utilized to determine maximum day and hour extra capacity costs in the study were based on fiscal 2012 water production data. During the summer of 2012, the worst drought conditions since 1956 were experienced in Citizens Water's service territory, which led to mandatory water use restrictions, including a ban on lawn watering. (*Id.*) In Mr. Mierzwa's opinion, these restrictions and conditions undoubtedly affected water usage during fiscal 2012 and, therefore, the calculation of the maximum day and hour ratios used in Petitioner's cost-of-service study. To reflect more normalized usage of the Citizens Water system, Mr. Mierzwa recommended that the maximum day and hour extra capacity factors used in the Black & Veatch cost-of-service study be based on an average of production data for fiscal years 2010 through 2012. (*Id.*)

Second, Mr. Mierzwa noted Citizens Water's cost-of-service study allocates the costs of mains with diameters sized 12-inches or greater to all customers, and the costs associated with mains sized less than 12-inches to all classes except the industrial and sales-for-resale classes. (*Id.*) Mr. Mierzwa asserted this allocation was unreasonable as a significant percentage of industrial customers are served by mains with diameters sized less than 12-inches. Therefore, Mr. Mierzwa stated that industrial customers should not be excluded from an allocation of mains sized less than 12-inches in diameter. (*Id.*)

Third, Mr. Mierzwa testified contributions-in-aid-of-construction ("CIAC"), which are a reduction to rate base, have been allocated between mains sized 12-inches and greater and mains sized less than 12-inches based on the relative investment of these two size categories. (*Id.* at 3-4.) Mr. Mierzwa's review indicated that Petitioner's CIAC was generally associated with mains sized 16-inches or less. (*Id.* at 4.) Therefore, CIAC should be reflected as a rate base reduction to the investment in mains sized 16-inches or less, in Mr. Mierzwa's opinion. (*Id.*)

Fourth, Mr. Mierzwa noted that Citizens Water's cost-of-service study allocated the costs associated with commercial and industrial service account representatives to all customer classes. In Mr. Mierzwa's view, these costs should be allocated only to commercial and industrial customers. (*Id.*)

Finally, Mr. Mierzwa indicated bad debt expense was assigned entirely to the billing and collection functional cost category. (*Id.*) According to Mr. Mierzwa, bad debt expense relates to the failure to recover all of Citizens Water's functional costs, not just billing and collections costs. Therefore, Mr. Mierzwa testified bad debt expense should be allocated more broadly to all functional cost categories. (*Id.*)

Mr. Mierzwa revised the Black & Veatch cost-of-service study to incorporate his recommendations concerning extra capacity ratios, the allocation of mains investment, the assignment of CIAC, the allocation of account service representative costs, and the assignment of bad debt expense. (*Id.* at 11.) Mr. Mierzwa presented in Table 2 a comparison of Petitioner's filed cost-of-service study and his revised study. (*Id.*) Mr. Mierzwa testified that Citizens Water requested a revenue increase of $25.3 million and the cost-of-service study results presented in column (4) of Attachment JDM-2 - Schedule 4 show the distribution of that increase based on cost-of-service. (*Id.* at 12.) The OUCC recommended an increase in revenue requirements of $4,633,883 and recommended that the revenue increase authorized by the Commission in this proceeding be distributed by proportionately scaling back the indicated cost-of-service increase shown on Attachment JDM-2 - Schedule 4. Table 3 in Mr. Mierzwa's testimony presented a summary of the resulting rate increase for each class based on the increase in revenues recommended by the OUCC. (*Id.*)

C. ***Industrial Group's Evidence.*** Mr. Gorman testified on behalf of the Industrial Group regarding Citizens Water's proposed class cost-of-service study sponsored by Michael Borchers. Mr. Gorman stated that Mr. Borchers relied on a generally accepted base and extra capacity methodology, and that he properly recognized the need to separate distribution mains based on those that are common to serving all customers and distribution mains that are primarily relied on to serve only smaller customers. (Ind. Group Ex. MPG at 18.) Mr. Gorman testified that he generally supported Mr. Borchers' class cost-of-service except for three cost element allocation methodologies that should be corrected. (*Id.*)

First, Mr. Gorman stated Mr. Borchers' estimated base and extra capacity factors for the test year are unreliable and should be disregarded. (*Id.* at 19.) Mr. Gorman explained that Mr. Borchers developed new base and extra capacity factors using the test year data, the 12 months ending September 30, 2012. (Ex. MPG-9.4). Because this test year reflected extreme weather conditions in the Citizens Water system, and several months actually reflected extraordinary drought conditions that triggered Citizens Water and the City of Indianapolis to impose curtailments of water service, Mr. Gorman opined that the voluntary, and later mandatory, water use restrictions caused customers to modify usage during the peak period of the test year, which in turn distorted normal base and extra capacity load profiles. (Ex. MPG at 20.) Mr. Gorman added this curtailment activity particularly impacted lawn watering, which Citizens Water recognized as accounting for "40 percent" of its load immediately prior to the July 12 watering ban, as well as other discretionary water usage. (Exhibit MPG10-2.) Mr. Gorman said the extended curtailments modified customers' normal demands for water and resulted in inaccurate base and extra capacity demands on the system in the test year. (Ex. MPG at 20.)

Mr. Gorman recommended that the base and extra capacity factors should be modified to reflect those capacity factors in the most recent cost-of-service study used to set the current water customers' rates. (*Id.*) He said these base and extra capacity factors should be updated in Citizens Water's next water rate case once reliable data becomes available. (*Id.*)

Second, Mr. Gorman testified that allocating pumping equipment on a factor reflecting only base and max day components, as Mr. Borchers did, is inappropriate because as a matter of system design pumping capacity must be sized to support both max day and max hour demands

on the system. (*Id.* at 19.) Mr. Gorman explained pumping equipment for the water treatment plant and the distribution plant has to be adequate to move enough water to meet base, max day, and max hour customers' demands so this pumping equipment must be sized and costs incurred to meet these customer demands. (*Id.* at 22.) As a result, he said the cost of this pumping equipment and the operation and maintenance of this equipment should be allocated between customers in proportion to the load characteristics for which it was designed to serve. (*Id.*) He said modifying the allocation of the pumping equipment from Mr. Borchers' Factor 2 to Factor 3 would more accurately allocate pumping equipment across customers in relationship to the load profile for which it was designed. (*Id.*)

Finally, Mr. Gorman recommended modification of Mr. Borchers' proposed percentage allocation of power expense of 90% of power expense on base and 10% on max day demand to be more consistent with the breakdown of demand and energy charges in Citizens Water's actual electric bills. (*Id.* at 19.) Mr. Gorman attached Exhibit MPG-6, which showed approximately 30% of Citizens Water's total power bill is related to the demand component and the remaining 70% of its total power bill is related to flow. (*Id.* at 22.) Mr. Gorman testified the demand charge is tied to the highest demand in the month, or 60% of the highest billing demand over the last year. (*Id.*) He said these demand charges reflect Citizens Water's max day demand conditions; therefore, allocating a more accurate portion of these costs on max day is consistent with the load demands placed on the system by Citizens Water's customers. (*Id.*)

Consequently, Mr. Gorman recommended adjusting the portion of the costs allocated on max day from 10%, as proposed by Citizens Water, up to 30% consistent with its actual electric power bills. (*Id.*) Mr. Gorman added this adjustment is conservative based on the reduced peak water usage in the test year resulting from the watering ban in place during the test year. (*Id.* at 22-23.)

Mr. Gorman also proposed adjustments to Petitioner's proposed industrial rate design. As shown in his attached Exhibit MPG-8, page 1, Mr. Gorman proposed an industrial rate which will recover the industrial rate class' cost-of-service and reflects a minimal, more modest increase to industrial customers and all other customers on the system, compared to Citizens Water's proposed revenue allocation in this proceeding. (*Id.* at 24.) Mr. Gorman's proposed rate design starts with Citizens Water's current charges to industrial customers, and increases each charge by 19.79%, the percent difference reflected on his cost-of-service study between Citizens Water's industrial class cost-of-service and revenue at current rates. (*Id.*) Mr. Gorman noted that for purposes of his corrected cost-of-service study he used Citizens Water's revenues and expenses for the allocations rather than the adjusted revenues and expenses he proposed. Mr. Gorman said the use of Citizens Water's proposed data for the cost study does not imply his agreement with or acceptance of Citizens Water's data. (*Id.*)

D. *Brown County/Pittsboro's Evidence.* Patrick Callahan of Callahan CPA Group, P.C. testified on behalf of Brown County and Pittsboro. Mr. Callahan responded to the testimony of Mr. Borchers and his proposed cost-of-service study ("COSS"). Mr. Callahan testified that the COSS prepared by Mr. Borchers for Petitioner should be rejected by this Commission. Mr. Callahan stated the Commission should direct Petitioner to recover any increase in revenue requirements on an "across-the-board" method. (Brown County/Pittsboro Ex.

PC at 11.) As an alternative to the "across-the-board" method, Mr. Callahan recommended the Commission require Petitioner to maintain the class capacity factors used in Cause No. 43645 until a valid class capacity factor analysis is presented and/or a proper class demand study can be conducted. (*Id.*)

E. ***OUCC's Cross Answering Evidence.*** Mr. Mierzwa responded to the cost-of-service study testimony presented by Mr. Callahan on behalf of Brown County and Pittsboro and the cost-of-service testimony presented by Mr. Gorman on behalf of the Industrial Group. Mr. Mierzwa noted purchased power expense was allocated 90 percent to the base functional cost category and 10 percent to the maximum day functional cost category, which is the same allocation approved in the prior base rate proceeding for the water utility in Cause No. 43645. (Pub. Ex. No. 8 at 2.)

In this case, Mr. Mierzwa said Mr. Gorman proposes to allocate 70 percent of purchased power expense to the base functional category and 30 percent to maximum day, based on his view that 30 percent of Citizens Water's purchased power expenses are demand-related. (*Id.*) In Cause No. 43645, Mr. Mierzwa testified Mr. Gorman proposed to allocate 50 percent of purchased power costs to the base and 50 percent to the extra capacity functional cost categories, which the Commission did not accept. (*Id.*) In Mr. Mierzwa's opinion, since Mr. Gorman has presented no new evidence in this proceeding to justify a change in allocation of the purchase power expense in this Cause, his proposed allocation of purchased power expense should be rejected as it was in Cause No. 43645. (*Id.* at 3.)

Mr. Mierzwa also responded to Mr. Gorman's claims that because pumping equipment needs to be adequate to move enough water to meet base, maximum day and maximum hour demands, pumping costs should be allocated to the base, maximum day and maximum hour functional cost categories. Mr. Mierzwa testified Mr. Gorman presented no analysis of the functions performed by Citizens Water's pumping equipment and, therefore, his proposed allocation should be rejected. (*Id.* at 4.)

In the Citizens Water cost-of-service study, Mr. Mierzwa said that costs were initially assigned to the base, maximum day and maximum hour functional costs categories based on overall system demands and then allocated to individual customer classes based on the demands of each class. (*Id.*) The overall and class base and extra capacity demand factors reflected in the cost-of-service study were developed using data from the 12-month period ended September 30, 2012, during which extreme drought conditions existed, which led to voluntary and mandatory water-use restrictions. (*Id.*) Mr. Mierzwa said that because these restrictions affected water usage, Mr. Gorman and Mr. Callahan claim that the base and extra capacity demand factors developed by Citizens Water are unreasonable and should be rejected. (*Id.*) Mr. Mierzwa testified he sought information through a data request to Citizens Water to develop class demand factors based on a 3-year average customer demands by class, and Citizens Water responded that the necessary information was not available.

After reviewing the testimony of Mr. Gorman and Mr. Callahan, OUCC witness Mierzwa compared the minimum maximum daily factors for FY 2012, which Citizens Water used to develop class demand factors, with those from sales data available for FY 2011 and FY 2010.

(*Id.* at 6.) The result of that comparison is reflected in Table 1 of Mr. Mierzwa's cross-answering testimony. Mr. Mierzwa concluded from his comparison Table 1 that while it would have been preferable to develop class demand factors based on three years of data to reflect more normalized usage, the detailed data necessary to do so was not available, and the factors Citizens Water used to develop class demand factors appear comparable to those from previous years. (*Id.* at 7.) Mr. Mierzwa noted that it was largely the Residential class which curtailed and interrupted their usage during the summer of 2012. In his view, these curtailments enabled Citizens Water's system to continue to function. As a result, in Mr. Mierzwa's opinion, it is not unusual in a cost-of-service study to allocate a reduced level of costs to customers who curtail or interrupt usage during peak periods. (*Id.*) Mr. Mierzwa testified there are concerns with using class demand factors from 1990, which were used in the Cause No. 43645 and there are concerns with using the Citizens Water's FY 2012 class demand factors. Mr. Mierzwa concluded by recommending that Citizens Water's class demand factors should be used in the cost-of-service study. (*Id.* at 8.)

F. ***Industrial Group's Cross Answering Evidence.*** Mr. Gorman testified in response to the OUCC witness Mr. Mierzwa and recommended that his proposed rate structure be rejected.

G. ***Brown County/Town of Pittsboro's Cross Answering Evidence.*** In cross answering testimony, Mr. Callahan responded to the OUCC's COSS testimony that the system maximum day and maximum hour extra capacity ratios used in Petitioner's COSS be based on a three-year average, in order to reflect usage patterns under more normal weather conditions. Mr. Callahan explained that if a three-year average for system capacity ratio is used, then a three-year average of class capacity factors also should be used, but because the class three-year average was not available, the three-year system capacity ratios should be not be used. (*Id.* at 3-4.) Because the class capacity factors employed in the OUCC's COSS are unsupported, Mr. Callahan believes it would not be reasonable to rely on the OUCC's COSS results to determine class increase in this Cause. (*Id.*)

H. ***Petitioner's Rebuttal Evidence.*** Mr. Borchers offered rebuttal testimony, and disagreed with the criticisms raised by the Consumer Parties' experts. Mr. Borchers reaffirmed his support for the COSS proposed by Black & Veatch.

I. ***Settlement Agreement and Evidence in Support of Settlement Agreement.*** On August 29, 2013, the Parties filed a Stipulation and Settlement Agreement Resolving Cost-of-Service Issues ("Agreement"), Exhibit A to the Agreement and supplemental testimony of Michael C. Borchers and LaTona S. Prentice in support of the Commission's approval of the Agreement. Mr. Borchers testified that the Agreement resolves all of the issues between the parties related to cost-of-service and rate design and was the product of settlement negotiations between and among the settling parties that followed the first week of hearings in this Cause and prior to the resumption of hearings on August 13, 2013. (Pet. Ex. MCB-S at 2.)

As noted in our summary of the evidence above, there was a great deal of cost-of-service evidence and each party presenting cost-of-service testimony and exhibits believed strongly in its position. However, in his supplemental testimony in support of the Commission's approval of

the Agreement, Mr. Borchers testified those differences were put aside and a resolution was reached in settlement that avoids litigation and falls within the range of possible outcomes, if the cost-of-service issues had been litigated. (*Id.* at 3.) In the interest of avoiding further litigation and resolving contested issues that directly affect each customer class, Mr. Borchers said that the settling parties agreed to an allocation of costs to the customer classes that is shown on Exhibit A to the Agreement, which was attached to the supplemental testimony of LaTona S. Prentice. (*Id.* at 2-3.) Mr. Borchers indicated that rate design would be accomplished by apportioning each class' revenue requirement to their respective base and volumetric charges in accordance with Citizens Waters' case-in-chief. He concluded his supplemental testimony by stating that the Agreement was in the public interest, and should be approved by the Commission. (*Id.* at 3-4.)

LaTona S. Prentice provided supplemental testimony sponsoring Exhibit A to the Agreement. Ms. Prentice testified the purpose of Exhibit A is to show how the revenue requirement approved by the Commission will be allocated on a proportionate basis among the customer classes. (Pet. Ex. LSP-S at 2.)

Ms. Prentice stated that when the Commission determines the amount of the final revenue requirement for Citizens Water, the revenue increase approved by the Commission would be allocated to each class in accordance with Column (6) of Exhibit A. (*Id.*) Ms. Prentice explained that each customer class' proportion of the total approved revenue increase would remain in accordance with the percentages set forth in Column (5) of Exhibit A. (*Id.* at 2-3.) The resulting percentage increases to each customer class would be reflected in Column (8) of Exhibit A. Ms. Prentice testified that the Agreement represents a reasonable resolution of the issues regarding cost-of-service allocations and recommended Commission approval. (*Id.* at 3.)

J. ***Discussion and Findings.*** We have previously discussed our policy with respect to the approval of settlements:

> Indiana law strongly favors settlement as a means of resolving contested proceedings. *See, e.g., Manns v. State Department of Highways*, (1989), Ind., 541 N.E.2d 929, 932; *Klebes v. Forest Lake Corp.*, (1993), Ind. App. 607 N.E.2d 978, 982; *Harding v. State*, (1992), Ind. App., 603 N.E.2d 176, 179. A settlement agreement "may be adopted as a resolution on the merits if [the Commission] makes an independent finding, supported by substantial evidence on the record as a whole, that the proposal will establish 'just and reasonable' rates." *Mobil Oil Corp. v. FPC*, (1974), 417 U.S. 283, 314 (emphasis in original).

See, e.g., Indianapolis Power & Light Co., Cause No. 39936, p. 7 (IURC9/24/95); *see also Commission Investigation of Northern Ind. Pub. Serv. Co.*, Cause No. 41746, p. 23 (IURC 9/23/02). This policy is consistent with expressions to the same effect by the Supreme Court of Indiana. *See. e.g., Mendenhall v. Skinner & Broadbent Co.*, 728 N.E.2d 140, 145 (Ind. 2000) ("The policy of the law generally is to discourage litigation and encourage negotiation and settlement of disputes"); *In re Assignment of Courtrooms, Judge's Offices and Other Facilities of St. Joseph Superior Court*, 715 N.E.2d 372, 376 (Ind. 1999) ("Without question, state judicial policy strongly favors settlement of disputes over litigation.") (citations omitted).

Nevertheless, pursuant to the Commission's procedural rules, and prior determinations by this Commission, a settlement agreement will not be approved by the Commission unless it is supported by probative evidence. 170 IAC 1-1.1-17. Settlements presented to the Commission are not ordinary contracts between private parties. *United States Gypsum, Inc. v. Indiana Gas Co.*, 735 N.E.2d 790, 803 (Ind. 2000). Any settlement agreement approved by the Commission "loses its status as a strictly private contract and takes on a public interest gloss." *Id.* (quoting *Citizens Action Coalition v. PSI Energy, Inc.*, 664 N.E.2d 401, 406 (Ind. Ct. App. 1996)). Thus, the Commission "may not accept a settlement merely because the private parties are satisfied; rather [the Commission] must consider whether the public interest will be served by accepting the settlement." *Citizens Action Coalition*, 664 N.E.2d at 406. Furthermore, any Commission decision, ruling or order - including the approval of a settlement - must be supported by specific findings of fact and sufficient evidence. *United States Gypsum*, 735 N.E.2d 790 at 795 (citing *Citizens Action Coalition v. Public Service Co.*, 582 N.E.2d 330, 331 (Ind. 1991)). Therefore, before the Commission can approve the Agreement, we must determine whether the evidence in this Cause sufficiently supports the conclusion that the Agreement is reasonable, just, and consistent with the purpose of determining reasonable and just rates and charges under Ind. Code § 8-1.5-3-8, and that such Agreement serves the public interest.

We find that the Agreement is a reasonable resolution of contested cost-of-service issues raised by the Parties, supported by the probative evidence of record, and results in an allocation of the cost-of-service among the customer classes that is within the parameters of the cost-of-service recommendations in this Cause. The appropriate allocation of costs among the various rate classes varied significantly in this case as reflected in the testimony of the parties' witnesses on cost allocation. The settlement agreement on cost-of-service allocation resolves the significant disputed issues on that issue in an efficient manner and represents a just and reasonable compromise of those issues. Therefore, we find that such Agreement is in the public interest and should be approved.

With regard to future citation of the Agreement, we find the Agreement and our approval of it should be treated in a manner consistent with our finding in *Richmond Power & Light,* Cause No. 40434 (approved March 19, 1997) and the terms of the Agreement regarding its non-precedential effect.

9. Acquisition Savings.

A. *Petitioner's Case-in-Chief.* Petitioner's witness Carey B. Lykins testified that at the time Citizens Energy Group was seeking Commission approval of the acquisition, it was estimated that an integration of the water and wastewater utilities with Citizens Energy Group's gas, steam, and chilled water operations would result in $60 million of ongoing annual savings after three years of combined operations. (Pet. Ex. CBL at 11-12.) Mr. Lykins stated that Citizens Energy Group currently is two years ahead of schedule and estimated the integration of the water and wastewater utilities with Citizens Energy Group's pre-existing operations has resulted in approximately $112 million in savings. (*Id.*)

Petitioner's witness Aaron D. Johnson testified that in Cause No. 43936, Citizens Energy Group, with the assistance of Booz & Company, conducted an analysis to identify the synergies

and associated cost savings that could be realized by transferring the operations of the water and wastewater utilities to combine the water, wastewater, gas, and steam utilities serving Indianapolis, and such analysis resulted in an estimated $60 million of annual savings. (Pet. Ex. ADJ at 4-5.) Mr. Johnson stated that Citizens Energy Group has tracked the savings achieved and reported such findings in its "First Semi-Annual Report Regarding Savings and Other Matters," which projected that savings generated through September 30, 2012 for operations and maintenance ("O&M") expenses alone were estimated at $26 million; and, in the "Second Semi-Annual Report Regarding Savings and Other Matters," which reflects an approximate net savings of $111.9 million for the first full fiscal year of operations. (*Id.* at 5-6.)

Mr. Johnson further explained the methodology used to determine the amount of O&M savings. (*Id.* at 6-8.) Mr. Johnson also described the methodology used to determine capital expenditure ("Capex") savings. (*Id.* at 8-10.)

Mr. Johnson summarized the drivers behind the savings achieved by Citizens Energy Group. Mr. Johnson explained that attrition or the reduction in the total full time equivalent employee count by 191 as of September 30, 2012, resulted from individuals who were actively employed by one of the Companies not being offered employment and naturally occurring attrition that is typical of any large scale reorganization. (*Id.* at 11-12.) In addition, O&M savings resulted from the elimination of duplicative general and administrative costs, such as back office functions, redundant positions, consolidation of telephone systems, information technology networks and data centers, and corporate shared services. (*Id.* at 12-13.) Mr. Johnson noted that savings of approximately $46.2 million of retiree health care expenses and $3.4 million pension expenses resulted after most active employees retained by Citizens Energy Group were offered a benefit structure similar to that offered by Citizens Energy Group prior to the acquisition. (*Id.* at 13.)

Mr. Johnson noted that these savings have lowered the revenue requirement that would otherwise be necessary, and that certain savings, such as the $49.6 million in savings from the alignment of pension and health care benefits, are specifically attributable to the water utility; as well as, capital project savings that can be attributed to specific lines of business. (*Id.* at 14.) Mr. Johnson noted that many of the O&M expense savings cannot be attributed to specific lines of business since a functional operating model is used, but these savings are manifested in the form of reduced cost allocations from the common expense areas such as Corporate Support Services. (*Id.*)

Jeffrey A. Harrison, Senior Vice President of Engineering and Sustainability for Citizens Energy Group, described the Capital Programs and Engineering ("CP&E") Group and how it benefits Citizens Energy Group's efforts to plan, design, and construct efficient capital improvement projects that have the potential to produce savings for the ultimate benefit of Petitioner's customers. (Pet. Ex. JAH 3-8.) Mr. Harrison stated that the CP&E Department works to identify economies of scale and better forecast "what and when to buy" materials, equipment and services. (*Id.* at 5.) Mr. Harrison also described the manner in which Petitioner uses value engineering to achieve savings in the completion of capital projects. (*Id.* at 7.)

B. ***OUCC's Evidence.*** OUCC witness Edward R. Kaufman testified that anticipated savings were an essential component of the proposal to acquire the water utility.

(Pub. Ex. No. 2 at 24.) Mr. Kaufman noted that Citizens Energy Group reports that it has achieved approximately $111.9 million in net synergies, which exceeds the anticipated $24.6 million of net savings, in the first year of operations as a result of the acquisition. (*Id.*) Mr. Kaufman stated that Citizens Water is required to discuss the savings achieved and how it affects the proposed rate increase during all rate cases for all regulated utilities. (*Id.* at 25.)

Mr. Kaufman stated that Petitioner's testimony and responses to the OUCC's discovery requests were not helpful in evaluating how the proposed savings provided measureable rate relief. Mr. Kaufman stated that Citizens Energy Group committed substantial time and resources to evaluate, estimate, and promote the savings that would be achieved by the acquisition, which became an essential basis for completing the proposed acquisition of the water system, yet is unable to calculate or estimate a rate impact during the request to increase its rates. (*Id.* at 27.)

Mr. Kaufman testified that he was concerned about the savings Petitioner estimated it would achieve as a result of its acquisition of the water system. Mr. Kaufman noted that Citizens Water would achieve $5.7 to $6.1 million in annual savings by terminating the Veolia contract and eliminating the 12% margin on capital projects would cause capital costs to be reduced. This should have resulted in Citizens' capital plan being approximately $6.0 million less than what the DOW incurred. (*Id.* at 28-29.)

Mr. Kaufman noted that Petitioner's witness Brehm in Cause No. 43936 provided Exhibit JRB-5, entitled Water System Financial Summary, which projected the financial performance of the water system and showed the projected rate increases for the water utility through 2025. Exhibit JRB-5 showed a 7.0% projected rate increase for the water utility in 2014. Mr. Kaufman stated the current request of 14.7% is more than twice the projected rate increase. (*Id.* at 29-30.)

Mr. Kaufman acknowledged that Mr. Brehm described JRB-5 as being the only supporting evidence in Cause No. 43936 for detailing the estimated net cash flow of the water system for twelve months following the closing of the transaction beginning in 2011 and continuing through 2025. (*Id.* at 30-31.) Mr. Kaufman further stated that based on the descriptions of JRB-5, it is reasonable to review the projections in JRB-5 and compare those projections to the proposed rate increase in this Cause. (*Id.* at 31.) Mr. Kaufman stated that Citizens' failure to document how its achieved savings directly influence its proposed rate increase, makes it difficult to evaluate whether Citizens will be able to achieve its initial projection of lower rates arising from its acquisitions. (*Id.* 32.)

C. ***Petitioner's Rebuttal Evidence.*** Petitioner's witness Carey Lykins disagreed with Mr. Kaufman's statement that Citizens did not follow through in its agreement to be transparent and collaborative regarding the methodology used to measure the acquisition savings. Mr. Lykins noted that Mr. Johnson and other members of the Citizens Energy Group team met with the OUCC, members of the Commission's staff and representatives of the Industrial Group to discuss the methodology for measuring and tracking acquisition savings, as well as a template of the semi-annual savings reports. (Pet. Ex. CBL-R at 10-11.)

Petitioner's witness Aaron Johnson testified that the cumulative savings from years one and two of $149.8 million have reduced the amount of the rate increase requested in this

proceeding. (Pet. Ex. ADJ-R at 2-3.) Mr. Johnson stated that capital expenditure synergies include savings that resulted from value engineering process and supply chain management. Mr. Johnson testified that absent the achievement of these savings, the capital costs incurred by all of Citizens Energy Group utilities would be higher and would translate to a higher revenue requirement for extensions and replacements or debt service, depending on the funding source of the particular project. (*Id.* at 4.)

Mr. Johnson noted that representatives of Citizens Energy Group, the Commission's Staff, the OUCC, and the Industrial Group attended a series of technical conferences that were agreed to pursuant to the Settlement Agreement in Cause No. 43936. During the technical conferences, Citizens' semi-annual savings reporting format and methodology were explained. Mr. Johnson further noted that to his knowledge no criticism or questions of the three savings reports filed to date have been voiced by a party to this Cause. (*Id.* at 5-6.)

Mr. Johnson stated that in Cause No. 43936 Joint Petitioners "project[ed] the proposed acquisitions will result in rates approximately 25 percent lower than they otherwise would have been *for the combined water and wastewater utilities by the year 2025.*" Mr. Johnson stated that Citizens Energy Group did not calculate or project any year-to-year rate impacts for each of the particular utilities under Citizens Energy Group's management. (*Id.* at 6.) Mr. Johnson stated that in preparing its savings reports, Citizens Energy Group attempted to categorize savings in the same manner as in Cause No. 43936, by relating savings to either: O&M, which included CSS, Customer Services/Billing, SFS and Capital Programs and Engineering; or, Capex; which included Supply Chain Management, Value Engineering, Project Rationalization and the Deep Rock Tunnel. (*Id.* at 7-8.) Mr. Johnson stated that Citizens Energy Group wanted to be transparent in its reporting of savings so that others could gauge where the savings are in comparison to the projections made in Cause No. 43936. (*Id.* at 8.)

Mr. Johnson stated it is not possible to state with precision how much the savings have impacted the revenue requirement. Mr. Johnson noted the impact on the revenue requirement for debt funded projects would be dependent in large part on the amortization period and the amount of interest that would be attributed and each. O&M expense would potentially present different difficulties with respect to determining the rate impact of those savings. (*Id.* at 8-9.)

Mr. Johnson addressed Mr. Kaufman's concern regarding the amount of savings estimated to be achieved from terminating the Veolia Agreement, and stated that the original savings category of "Veolia Margin Savings" is no longer specifically attributed to the Veolia Agreement, however, a portion of the cumulative $93.1 million of Capex savings achieved to date is attributable to the Veolia margin savings. (*Id.* at 11-12.)

Petitioner's witness John Brehm testified that the financial model contained in JRB-5 in Cause No. 43936 was used "to evaluate the proposed acquisition of the Water System by CEG." (Pet. Ex. JRB-R at 31.) The projection was prepared before Citizens had any actual hands-on operating experience with the water system. Mr. Brehm stated that given these realities, "it is illogical to suggest the projection could be used today to form any conclusions beyond its purpose of providing supporting evidence in Cause No. 43936 that the Board had the financial capability to acquire and operate the water system." (*Id.*)

D. ***Discussion and Findings.*** The Settlement Agreement in Cause No. 43936 provides: "[f]or a period of four (4) years from the date of Closing, Citizens will document the savings it generates as a result of the acquisitions and provide reports to the Commission, the OUCC and other Settling Parties showing the savings that are directly attributable to the acquisitions." (Section 8-a.) With respect to the metrics used to document savings generated as a result of the acquisition, the Settlement Agreement provides: "[w]ithin sixty (60) days from the date of Closing the proposed acquisitions, Citizens shall submit a report to the Commission and the OUCC that specifies the metrics that Citizens proposes to use to track savings realized from the consolidation of the gas, steam, water and wastewater utilities." (Section 8-a-i.) Thereafter, Citizens and the Authority agreed to "participate in a series of technical conferences with the Commission, the OUCC and any other Settling Parties to determine whether Citizens' proposed metrics and proposed reporting on the status of implementation are appropriate." (Section 8-b.)

Section 8-c of the Settlement Agreement provides:

> In the first two (2) rate cases filed subsequent to the Closing by the Authority and each of Citizens' regulated utilities, the Authority or Citizens, as applicable, will present testimony describing the savings achieved from the proposed transactions and how such savings have affected the proposed rate increase. Citizens shall continue to report such savings in future rate cases for all regulated entities until a steady state of annual savings has been achieved.

While the OUCC did not endorse Petitioner's metrics for determining savings associated with the acquisition, the OUCC did not assert that Petitioner did not comply with Sections 8-a and 8-b of the Settlement Agreement.

Citizens Energy Group submitted a report to the Commission and OUCC specifying its proposed metrics on October 25, 2011 in compliance with Section 8-a. (Tr. at G-44.) Thereafter, the OUCC and Petitioner participated in one or more technical conferences or meetings to discuss Petitioner's proposed metrics. (Tr. at G-45.) For the purpose of documenting the savings Petitioner considers it has achieved, Petitioner has filed three semi-annual savings reports using the metrics and reporting format presented at the technical conferences. (*See*, Pet. Exhs. ADJ-1, ADJ-2 and ADJ-R1.)[11]

In this case, Petitioner's witness Johnson stated that "the savings have lowered the revenue requirement that would otherwise be necessary" and that if not for the savings achieved through the acquisitions, there would be a need for a higher rate increase in this proceeding. (Pet. Ex. ADJ at 13-14.) However, Mr. Johnson said he could not "state with precision how much [the] savings would have impacted the revenue requirement." (*Id.* at 15.) The OUCC expressed concern with Petitioner's presentation regarding how the savings have affected the proposed rate increase. OUCC witness Kaufman summarized:

[11] CEG filed a fourth savings report on 12/17/2013 after the record was closed.

> Specifically, we wanted to see how the savings resulted in lower rates. We settled this case [Cause No. 43936] on an expectation of having lower rates. Carey Lykins promised that the combined water/wastewater rates would be 25 percent lower by 2025.
>
> It's important for us to see or for the OUCC to see how the savings specified translate into -- specifically, how they translate into a lower rate increase. These reports do not break savings down by water, wastewater, gas, and the other divisions within Citizens, and so there is no way of taking these reports and showing how they specifically apply to a rate case, and we put provision 8(c) in or we -- you know, this was part of the settlement so that we could see how the savings reported by Petitioner specifically translated into lower rates for the ratepayers. (Tr. at G-48.)

On December 23, 2013, Citizens filed notice that accepted the OUCC's proposed summary and findings with respect to acquisition savings, and noted the OUCC proposal was consistent with the settlement reached with CWA Authority, Inc. in Cause. No. 44305.

Based on testimony presented and the December 23, 2013 Notice, we agree with the OUCC that more specificity in this Case regarding how the savings that have been achieved affected Petitioner's proposed revenue requirement would have been helpful. Consequently, we find that prior to the filing of Petitioner's next rate case or CWA Authority Inc.'s filing its next rate case, whichever comes first, Citizens Energy Group should collaborate with the OUCC, Commission Staff, and any intervenors in this Cause, in a meeting or meetings to discuss the presentation of testimony to be included describing savings achieved from the acquisitions and how such savings have affected the proposed rate increase pursuant to Section 8-c of the Settlement Agreement approved in Cause No. 43936.

10. Miscellaneous Reporting and Rate Case Issues.

A. *Revised Revenue Presentation in Rate Cases.*

1. *Evidence.* OUCC witness Charles Patrick explained that a traditional water revenue section of a utility's *pro forma* net operating income statement shows revenues subject to increase, such as residential, commercial, industrial, public authorities, sale for resale, multiple-family, private and public fire services, interdepartmental sales and penalty revenues. Adjustments to recurring revenues are then shown as relating to specific revenue classes. (Pub. Ex. No. 1 at 13.) Mr. Patrick testified that utilities also show non-recurring charges such as damaged meter replacement, collection charges, tampering penalty fees, reconnection charges, etc., itemized in the revenue section with adjustments to non-recurring revenues shown as relating to specific revenue items. (*Id.* at 13-14.) Mr. Patrick explained that the adjustments Petitioner made to revenues subject to increase that modified the total test year revenues are not typical for water rate cases. He further explained that Petitioner relied on a cost-of-service presentation of service and main sizes to modify recurring revenues rather than customer classification adjustments. (*Id.* at 14.)

Mr. Patrick recommended the Commission require Citizens to file its revenues and any adjustments to test year revenues in future cases in a traditional water format. (*Id.*) Mr. Patrick attached sample revenue presentations used by Indiana-American Water Company, Cause No. 44022; Evansville Municipal Water, Cause No. 44137; and Fort Wayne Municipal Water, Cause No. 44162. (Pub. Ex. No. 1, Attachments CEP – 6, 7 and 8.)

Petitioner's witness LaTona Prentice testified that, in her opinion, the "cost of service presentation" used by Citizens provides the most accurate determination of billing determinants for use in preparing *pro forma* revenues and determining proposed rates and charges. (Pet. Ex. LSP-R at 4.) Ms. Prentice, however, testified that "[h]aving said that, I believe Citizens Water could, in the future, continue to perform the analysis in the manner it was performed in this case, and format it in such a way that it would be consistent with the format Mr. Patrick is used to seeing." (*Id.* at 5.) Ms. Prentice also noted that Citizens Water prepared its water sales revenue analysis broken down only by rate schedules, but that it will be able to break the analysis down by customer class in the future. (*Id.*)

2. *Discussion and Findings*. Based on the testimony of Mr. Patrick and the acknowledgment by Ms. Prentice that Citizens will be able to prepare its water sales revenue analysis broken down by customer class, the Commission finds that in Petitioner's next general rate case, Citizens should include a presentation of its revenues and any adjustments to test year revenues, in a format similar to what is presented in Attachments CEP – 6, 7, and 8 of Public's Exhibit 1 in this Cause.

B. *Semi-Annual Capital Improvement Reports.*

1. *Evidence*. OUCC witness Larry McIntosh stated: "[t]o assist the Commission and OUCC in better understanding Citizens Water's capital needs in the future, I recommend that Citizens Water continue to report semi-annually the Capital Improvement Program Comparison Report that was part of the Order in Cause 43936." (Pub. Ex. No. 6 at 12.) Mr. McIntosh noted that the report should include any prior year's projects until completed or deleted and if deleted there should be an explanation as to why the project was deleted. (*Id.*) Mr. McIntosh stated "[t]his report should be filed with the Commission with a copy served to the OUCC." Mr. McIntosh recommended that this report should continue until an order is issued in the next cause filed by the Petitioner. (*Id.*)

Petitioner's witness Lindsay Lindgren testified that Mr. McIntosh's recommendation to continue to make report filings should be rejected because it would be contrary to Paragraph 34 of the Settlement Agreement in Cause No. 43936, which states that these filings were to be filed until "Citizens' first rate order." Mr. Lindgren stated that the Settlement Agreement reflects that the filings were not intended to be an ongoing obligation. (Pet. Ex. LCL at 4-5.) Mr. Lindgren stated that Petitioner agreed on a temporary basis to continue the DOW's Commission imposed obligation to file the reports after Citizens acquired and assumed the operational responsibilities of the assets and implementation of the Capital Improvement Plan. (*Id.* at 5.) Mr. Lindgren noted that Mr. McIntosh did not claim Citizens has not handled or will not handle properly funds for capital improvement. (*Id.* at 5-6.)

2. *Discussion and Findings.* In the Settlement Agreement entered into in Cause No. 43936, Petitioner agreed:

> Citizens shall make semi-annual compliance filings providing an update on the fulfillment of the water utility's Capital Improvement Program. Such compliance filings shall explain the reasons for any differences between the Capital Improvement Program being pursued by Citizens and the Capital Improvement Plan approved by the Commission in Cause No. 43645. In conjunction with the compliance filings, Citizens shall provide reports detailing the cost of the actual capital improvements implemented during the year which is the subject to the report, separated by project. The duration of this requirement will be until Citizens' first rate order.
> (¶ 34.)

Petitioner has complied with the foregoing provision of the Settlement Agreement. On May 31, 2013, Petitioner filed its Third "Semi-Annual Report Regarding Capital Improvement Program Comparison" in Cause No. 43936. No party filed any comments regarding the three reports filed by Petitioner.

As noted above, the parties were in general agreement concerning the projects included in Petitioner's capital plan. The compliance filings originated in Cause No. 43645, prior to the acquisition of the water and sewer utilities from the City of Indianapolis DOW. Accordingly, we agree with Petitioner that further reporting is unnecessary at this time, and deny the OUCC's request to continue this reporting provision beyond what was contemplated in the 43936 Settlement.

C. *Debt Service Reserve Reporting and Meetings on Future Debt Issuances.*

1. *Evidence.* OUCC Witness Edward Kaufman testified that if Citizens Water spends any of the funds from its debt service reserves for any reason other than to make the last payment on its respective debt issuance; Petitioner should be required to provide a report to the Commission and the OUCC within five (5) business days. Mr. Kaufman explained that the report should state how much Citizens Water spent from its debt service reserve, explain why it spent funds from its debt service reserve, cite to any applicable loan documents that allow it to spend funds from its debt service reserve, describe plans to replenish debt service reserve, and explain any cost-cutting activities implemented to forestall spending funds from its debt service reserve. (Pub. Ex. No. 2 at 23.)

Mr. Kaufman also stated that in paragraph 36 of the Settlement Agreement in Cause No. 43936, Petitioner agreed to meet with the OUCC to develop a process for discussing future debt issuances by Citizens for the water system and to date no such formal meetings have taken place. Therefore, Mr. Kaufman recommended that within 30 days after an order is issued in this Cause, Citizens should schedule a meeting with OUCC staff to discuss future debt issuances. (*Id.*)

Petitioner's witness Brehm argued that Mr. Kaufman's requested reporting appears to be

based on his misunderstanding of the facts of debt service reserve funds. (Pet. Ex. JRB-R at 29.) Mr. Brehm stated the terms of Petitioner's bonds require it to maintain these restricted accounts in the amounts designated as security for the bonds. These funds are actually held in the custody of the first and second lien bond trustees. Mr. Brehm testified that other than for making the final payment on a respective bond issue, the funds can only be used to make debt service payments and then only in the event the net revenues of Petitioner (revenues less operating expenses) are insufficient to make the debt service payments. Mr. Brehm said if the funds are ever utilized because Citizens' financial situation become so precarious that it cannot meet its debt service obligations from net revenues, the terms of its bonds require Petitioner to replenish the reserve funds by any amount so utilized. In addition, the terms of the bonds require Citizens to file a rate case. Consequently, Mr. Brehm stated the Commission and the OUCC would have full details of the situation presented in the Petition and rate case testimony. Because these funds are not available for another use, Mr. Brehm stated that Mr. Kaufman's request for reporting on this matter is unnecessary and redundant and should be rejected. (*Id.* at 30.)

Mr. Kilpatrick testified that the proposal to meet with the OUCC staff to discuss future debt issuances which stemmed from the Settlement Agreement in Cause No. 43936 is unnecessary because contrary to Mr. Kaufman's testimony, the meeting to discuss future debt issuances did occur. (Pet. Ex. KLK-R at 5-6.) Mr. Kilpatrick provided as an exhibit to his rebuttal testimony an agenda for the meeting with the OUCC regarding water bond issuances. (Pet. Ex. KLK-R1.)

2. *Discussion and Findings*. Petitioner's bond terms provide that the debt service reserve fund can only be used to make debt service payments in the event the net revenues of Citizens Water (revenues less operating expenses) are insufficient to make the debt service payments. If that event were to happen, the bond terms also require Citizens to file a rate case. We see no need to have Citizens also file an additional report under this Cause to separately report this issue.

The settlement agreement in Cause No. 43936 states that Citizens Water and the OUCC will meet to discuss future debt issuances, as well as "develop a process for discussing future debt issuance by Citizens for the water system." See Stipulation and Settlement Agreement, para. 36.

Paragraph 36 of the Settlement Agreement creates a two-step process. First, the parties must meet to develop a process for discussing future debt issuances. Following the agreement on the process, for every debt issuance after the process has been developed Petitioner will follow the agreed-upon process. We find that Petitioner and OUCC shall meet to discuss the process and after an agreed-upon procedure is developed, Petitioner will file such process in this Cause.

D. *Call Center Performance.*

1. *Evidence.* OUCC witness Larry McIntosh stated Petitioner's Customer Call Center received 561,961 calls during the test year and 18.3% were abandoned compared to Citizens' goal of 5%. (Pub. Ex. No. 6 at 18) Call center employees answered 39%

of calls within 60 seconds compared to the goal of 80% in less than 30 seconds. (*Id.* at 18-19.) The responses also indicated the average hold time was a little over six and a half minutes. (*Id.* 19.) Mr. McIntosh recommended that within ninety days of the Commission's issuing a final order, Citizens complete a plan for achieving its stated goals and semi-annually file a report detailing its progress on achieving those goals. (*Id.*)

Petitioner's Director of Customer Service, Rhonda L. Harper, testified in rebuttal that the test year statistics Mr. McIntosh cited were based upon a billing system, and a water contact center operating model no longer in use. (Pet. Ex. RLH-R at 3.) Ms. Harper said the water contact center issues were, in part, attributable to the billing system that was acquired with the water system. The water billing system was outdated and antiquated. (*Id.*)

Ms. Harper stated that since combining the contact centers for the Citizens Energy Group utilities in October of 2012, performance has improved. In May 2013, the average hold time was just under two minutes with 59% of 1,280,912 calls answered in thirty seconds or less and an abandoned rate of 6.2%. (*Id.* at 4.) Ms. Harper stated these improvements were achieved by instituting measures to continuously improve contact center performance. Ms. Harper stated that on August 6, 2012, Petitioner met with representatives of the Commission and OUCC to update them on the upcoming move to the combined contact center and single billing system as part of the "One Bill, One Payment, One Call" initiative. Ms. Harper testified that Citizens should not be required to prepare a water contact center improvement plan because a plan to improve customer services through combined contact center has already been implemented and has and will continue to result in improved performance. (*Id.* at 6.)

2. *Discussion and Findings.* As noted by Ms. Harper, Petitioner has made improvements in customer service since moving to a combined contact center, but making improvements is not the same as achieving performance goals. In fact, Ms. Harper does not state what the goals for the combined contact center are or if Petitioner is meeting them, she only states that they are improving. Further, one month of performance data is not indicative of ongoing performance.

It appears that Citizens and the OUCC agree that improvements are being made but questions remain as to whether the call center is meeting expectations. A greater understanding of the call center goals, average hold time, percentage of calls answered within thirty seconds, and the percentage of abandoned calls may be required. However, any additional review, if necessary, will take place outside the context of this docketed proceeding.

E. *Development of an Automated Meter Reading (AMR) Plan.*

1. *Evidence*. Petitioner's witness Curtis H. Popp testified that Petitioner retained SAIC Energy, Environment and Infrastructure, LLC to conduct an Automated Meter Reading (AMR) study. (Pet. Ex. CHP at 14.) Mr. Popp stated the study examined the feasibility of 3 different automated solutions: (i) AMR solutions provide periodic meter reads through a number of mechanisms such as an Electronic Radio Transmitter (ERTs), but require a certain degree of manual work to obtain the read; (ii) AMI solutions differ in that manual intervention is greatly limited and the meter-to-utility communication is bi-directional; and, (iii)

touchpad technology, which allows a meter reader to obtain a meter read via a hardwired connection from the meter to an accessible location and requires a greater degree of manual intervention in order to obtain a meter reading. (*Id.* at 14-15.) Mr. Popp stated that regardless of the technology implemented, the calculated payback period for each was in excess of nineteen (19) years. (*Id.* at 15-16.) Mr. Popp stated that even after taking into account all of the benefits, the study concluded it was not economically viable for Petitioner to pursue a system-wide AMR or AMI deployment at this time. (*Id.* at 16.)

OUCC witness McIntosh testified that the AMR/AMI Study filed by Petitioner explains several benefits to an AMR/AMI meter reading system. Mr. McIntosh agreed that manual meter reading via part-time meter readers is the most economical method to read water meters. (Pub. Ex. No. 6 at 13.) Mr. McIntosh recommended Petitioner develop a plan prior to the next rate case to change out all residential meters over a period of time no longer than fifteen years to an AMR or combination of AMR/touchpad meter system. (*Id.* at 14.) During the next rate case the small meter change out and AMR/touchpad system should be a separate line item on the Petitioner's Capital Plan. (*Id.*)

In rebuttal, Petitioner's witness Popp agreed use of part-time meter readers is the most economical way to manually read water meters and AMR/AMI technologies can have quantifiable benefits. Mr. Popp, however, disagreed with the recommendation that the Commission direct Petitioner to develop a plan prior to its next rate case to replace its residential meters with AMR or a combination of AMR/touchpad system. (Pet. Ex. CHP-R at 3.) Mr. Popp stated it would be premature for the Commission to require Petitioner to invest the financial and other resources that would be needed to develop the plan recommended by Mr. McIntosh. (*Id.* at 4-5.) Mr. Popp noted the study already conducted by Petitioner concluded that Petitioner should re-evaluate use of AMI, AMR, and/or touchpad technologies in a few years after it has operated the water utility longer and has better information on costs associated with its water meter reading function. Mr. Popp stated Petitioner is willing to report to the Commission in its next rate case on the status of its continued evaluation of AMI, AMR and touchpad technologies and any planning or other steps it has taken toward implementing anyone or more of them. (*Id.* at 6.)

2. *Discussion and Findings.* Based on the evidence of record, the Commission declines to require Petitioner to develop a plan prior to the next rate case to change out all residential meters to an AMR or combination of AMR/touchpad meter system and include the cost in its capital plan. We find Petitioner should continue to evaluate AMR options between now and its next rate case. In Petitioner's next rate case, Petitioner should report the status of its continued evaluation of AMI, AMR, and touchpad technologies, as well as any planning or other steps Petitioner has taken toward implementing any one or more of those technologies.

11. Petitioner's Terms and Conditions for Service.

A. *Evidence.* Petitioner's witness Korlon Kilpatrick sponsored Petitioner's Exhibits KLK-1 and KLK-2 setting forth proposed changes to Petitioner's Terms and Conditions for Water Service. He identified the broad categories of proposed changes as: 1) addition of definitions for certain terms to support the creation of new customer classes, 2) removal of the

definitions for unused terms, 3) addition of provision in the Fraudulent Use of Water section to specifically include the unauthorized use of a fire hydrant, 4) addition of a conversion factor between hundred cubic feet and thousand gallons, 5) clarification of the remote meter reading service rule, 6) addition of a provision in the Meter rule that the Petitioner will repair or replace missing or damaged meter pit lids at the customer's expense, and 7) miscellaneous clean-up items. (Pet. Ex. KLK at 3-4.)

With respect to the terms and conditions for service relating to repairing or replacing missing or damaged meter pit lids, Mr. Kilpatrick pointed out that the terms and conditions had provided that "meter pit facilities shall be purchased, owned, installed, removed, and maintained in a safe manner by the Customer." (*Id.* at 4.) He noted, however, that there was some confusion among customers as to whether they were responsible for repairing or replacing the meter pit lid. (*Id.*) The proposed added language clarifies this issue, providing that "[r]epair to or replacement of missing or damaged Meter pit lids shall be made by the Utility, but at the Customer's expense." (*Id.*) Mr. Kilpatrick noted that this added language also ensures the Petitioner will have responsibility for replacing damaged or missing meter pit lids, rather than the customers, who often times neglected to repair the Meter pit lids. (*Id.*)

OUCC Witness Larry McIntosh expressed concern with Petitioner's proposed change to language regarding meter pit lids. He suggested that when a meter lid requires modification for the installation of an AMR, AMI or touchpad meter, the cost should be the responsibility of Petitioner. (Pub. Ex. No. 6 at 15.)

In response to Mr. McIntosh, Mr. Kilpatrick noted that the intent is one of public safety; having damaged meter pit lids go unattended poses a danger to both customers and the Petitioner's meter reading employees. (Pet. Ex. KLK-R at 7.) Mr. Kilpatrick testified that Mr. McIntosh's concern related to when the Petitioner should cover cost versus when the customer should cover cost is well-received. (*Id.* at 7.) He indicated that in instances where the damaged lid poses a public safety concern, it makes sense for costs associated with repair or replacement to be borne by the customer. (*Id.*) He added that if the meter pit lid were to be replaced due to some reason unrelated to public safety concerns, it makes sense that the Petitioner should incur those costs. (*Id.*) Mr. Kilpatrick noted, therefore, that Petitioner proposes to clarify its intent by changing the language to read as follows: "Repair to or replacement of missing or damaged Meter pit lids *for public safety reasons* shall be made by the Utility, but at the Customer's expense." (Emphasis added.)

B. *Discussion and Findings.* The Commission finds that the changes proposed by Petitioner to its Terms and Conditions for Water Service, as modified in rebuttal are reasonable. These changes, among other things, add definitions and provisions that will provide additional clarity regarding specific issues relating to Petitioner's water service. Moreover, Petitioner has acknowledged the OUCC's concern regarding the proposed change to language regarding meter pit lids, by inserting the phrase "for public safety reasons," thus limiting the responsibility of the customer for repair or replacement of meter pit lids to only public safety reasons. For the foregoing reasons, we find the changes proposed by Petitioner to its Terms and Conditions of Water Service, as modified in rebuttal by Mr. Kilpatrick are approved.

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

1. Petitioner is authorized to adjust and increase its rates and charges for water utility service to produce an increase in operating revenues of approximately 8.98% or $15,739,326. Petitioner's rates and charges shall be designed to produce total annual revenue requirement of $201,497,138, which is expected to produce annual net operating income of $67,911,461.

2. The Stipulation and Settlement Agreement Resolving Cost-of-Service Issues is attached to this Order and shall be and hereby is approved. The terms and conditions thereof shall be and hereby are incorporated herein as part of this Order. Petitioner shall file concurrently with the filing of tariffs below a revised Exhibit A to the Stipulation and Settlement Agreement based upon the rate increase authorized in Ordering Paragraph No. 1.

3. Petitioner shall file with the Water/Sewer Division of this Commission, prior to placing into effect the rates and charges and Terms and Conditions for Water Service authorized herein, tariff schedules set out in accordance with the Commission's rules for filing utility tariffs. Said tariffs, when filed by Petitioner, shall cancel all present and prior rates and charges concurrently when said rates and charges herein approved are placed into effect by Petitioner.

4. The proposed changes to Petitioner's Terms and Conditions of Water Service, which were filed in this Cause as Petitioner's Exhibits KLK-1 and KLK-2, are hereby approved, subject to the modification described in Paragraph 11(B) of this Order.

5. Within thirty (30) days of closing on any bonds, Petitioner shall file a true-up report with the Commission and serve a copy on the OUCC. The true-up report shall provide the information specified in Paragraph 7(B)(3)(b) of this Order.

6. In its next general rate case, Petitioner will file its presentation of revenues, and any adjustments to test year revenues, in a format similar to what is presented in Attachments CEP – 6, 7 and 8 of Public's Exhibit 1 in this Cause.

7. In its next rate case, Petitioner will report regarding the status of its continued evaluation of AMI, AMR, and touchpad technologies, as well as any planning or other steps Petitioner has taken toward implementing any one or more of them pursuant to Paragaph 10(E)(2).

8. Prior to the filing of Petitioner's next rate case or CWA Authority Inc.'s filing its next rate case, whichever comes first, Citizens Energy Group should collaborate with the OUCC, Commission Staff, and interested intervenors, in a meeting or meetings to discuss the presentation of testimony to be included describing savings achieved from the acquisitions and how such savings have affected the proposed rate increase pursuant to Section 8-c of the Settlement Agreement approved in Cause No. 43936.

9. Pursuant to Paragraph 10(C)(2), within 60 days from the effective date of this Order, Petitioner and OUCC shall meet to "develop a process for discussing future debt issuance by Citizens for the water system." After an agreed-upon procedure is developed, Petitioner will make a compliance filing under this Cause describing such process.

10. In accordance with Indiana Code § 8-1-2-70, Petitioner shall pay the following charge within twenty (20) days from the effective date of this Order to the Secretary of the Commission, as well as any additional costs that were or may be incurred in connection with this Cause:

Commission charges:	$ 37,234.27
OUCC charges:	$ 168,109.40
Legal Advertising charges:	$ 142.24
Total:	$ 205,485.91

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

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

APPROVED: MAR 19 2014

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

Brenda A. Howe

Brenda A. Howe
Secretary to the Commission

BEFORE THE

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF THE BOARD OF DIRECTORS FOR UTILITIES OF THE DEPARTMENT OF PUBLIC UTILITIES OF THE CITY OF INDIANAPOLIS, AS TRUSTEE OF A PUBLIC CHARITABLE TRUST FOR THE WATER SYSTEM, D/B/A CITIZENS WATER FOR (1) AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR WATER UTILITY SERVICE AND APPROVAL OF A NEW SCHEDULE OF RATES AND CHARGES APPLICABLE THERETO, AND (2) APPROVAL OF CERTAIN CHANGES TO ITS GENERAL TERMS AND CONDITIONS FOR WATER SERVICE	)	**CAUSE NO. 44306**

STIPULATION AND SETTLEMENT AGREEMENT
RESOLVING COST-OF-SERVICE ISSUES

The Board of Directors for Utilities of the Department of Public Utilities of the City of Indianapolis, as Trustee of a Public Charitable Trust for the Water System, d/b/a Citizens Water ("Citizens"), the Indiana Office of Utility Consumer Counselor ("OUCC"), the Citizens Water Industrial Group ("CWIG"), the Indianapolis Water Service Advisory Board ("SAB"), the Town of Pittsboro ("Pittsboro"), Brown County Water Utility, Inc. ("Brown County") and the Whitestown Municipal Water Utility ("Whitestown") (collectively, the "Parties"), solely for the purpose of compromise and settlement and having been duly advised by their respective staff, experts and counsel, stipulate and agree that the following terms and conditions represent a fair, reasonable and just resolution of the issues set forth in this Stipulation and Settlement Agreement Resolving Cost-of-Service Issues ("Agreement"), subject to their incorporation into a non-appealable final order of the Indiana Utility Regulatory Commission ("Commission") without modification or further condition that may be unacceptable to any Party ("Final Order"). If the

Commission does not approve the Agreement in its entirety, the entire Agreement shall be null and void and deemed withdrawn, unless otherwise agreed to in writing by the Parties.

I. Cost-of-Service and Rate Design

1. The Parties acknowledge and agree that rates and charges for water service provided by Citizens to its customers should be designed in order to allocate the Commission-determined final revenue requirement between and among the classes of Citizens' customers in a fair and reasonable manner consistent with general cost-causation principles. The Parties further acknowledge and agree that a variety of methods were utilized by the Parties in their respective testimony and exhibits on cost-of-service issues, including without limitation cost allocation by rate class, and that, absent this Agreement, the respective Parties are prepared to present cost-of-service evidence in this proceeding utilizing different cost-of-service proposals, and that such evidence would support a range of possible outcomes in an ultimate determination on cost-of-service by the Commission in a litigated proceeding.

2. The Parties stipulate that the various cost-of-service proposals that have been filed in this proceeding utilize cost-of-service methodologies and cost allocation proposals that the Commission has previously considered, may properly consider, and can potentially adopt. The Parties agree that the proposed allocated cost of service shown on Exhibit A to this Agreement, based on the amount of the annual requested revenue requirement to be recovered from rates and charges proposed in Citizens' case-in-chief for illustration purposes, is consistent with the range of potential cost-of-service allocation determinations the Commission could make in the event of a contested hearing.

3. The Parties further stipulate that the resulting cost allocations among customer classes set forth on Column (1) of Exhibit A fall within the cost-of-service methodology

allocations advanced by the parties in this proceeding and are just and reasonable.

4. The Parties agree that the Commission's final determination of Citizens' overall revenue requirement increase should be allocated to Citizens' customer classes in proportion to the relative increase reflected in Column (3) of Exhibit A. Column (5) of Exhibit A sets forth each customer class' percentage of the overall revenue increase approved by the Commission. An example of the resulting percentage increase by customer class, using the amount of the proposed revenue increase from Citizens' rebuttal case for illustration purposes, is set forth in Column (6) of Exhibit A. The Commission's ultimate determination of the authorized increase in Citizens' revenue requirement from its determined existing revenues would be the input to Column (6)(a) of Exhibit A in an active Excel spreadsheet to determine the exact allocation of the revenue requirement among the customer classes by completing the formula: (a) * (5), where (a) is the aggregate increase in revenue requirement approved by the Commission in a Final Order and where (5) is the proportion of increase for each customer class under this Agreement as expressed as a percentage and reflected in Column 5 of Exhibit A.

5. Subject to the provisions of this Agreement, the Parties agree that rates and charges should be designed to recover the authorized revenue requirement from Citizens' base and volumetric charges in accordance with the rate design proposed in Petitioner's case-in-chief.

6. No Party, by entering into this Agreement, has acquiesced in or waived any position with respect to the appropriate methodology for determining cost-of-service or rate design in any other proceeding, including future Citizens' rate proceedings. The Parties reserve all rights to present evidence and advocate positions with respect to cost-of-service and rate design issues different from those set forth in this Agreement in all other proceedings, including future Citizens' rate proceedings.

7. No Party, by entering into this Agreement, has acquiesced or waived any argument or position with respect to the Commission's ultimate findings regarding Citizens' revenue requirement, debt service coverage ratios, or any other issue raised by any Party to this proceeding.

II. Agreement -- Scope and Approval

8. Neither the making of this Agreement nor any of its provisions shall constitute in any respect an admission by any Party in this or any other litigation or proceeding. Neither the making of this Agreement, nor the provisions thereof, nor the entry by the Commission of a Final Order approving this Agreement, shall establish any principles or legal precedent applicable to Commission proceedings other than those expressly resolved in this Agreement.

9. This Agreement shall not constitute nor be cited as precedent by any person or deemed an admission by any Party in any other proceeding except as necessary to enforce its terms before the Commission, or any tribunal of competent jurisdiction. This Agreement is solely the result of compromise in the process of negotiating a settlement of cost-of-service issues and, except as expressly provided herein, is without prejudice to and shall not constitute a waiver of any position that any of the Parties may take with respect to any or all of the issues resolved herein in any future regulatory or other proceedings.

10. The undersigned hereby represent and agree that they have been authorized to execute this Agreement on behalf of their designated clients, and their successors and assigns, which will be bound thereby, subject to the agreement of the Parties on the provisions contained herein and in the attached Exhibit A.

11. The communications and discussions during the negotiations and conferences attended only by any or all of the Parties, their attorneys, and their consultants regarding cost-of-

service issues have been conducted based on the explicit understanding that said communications and discussions are or relate to offers of settlement and therefore are inadmissible before any tribunal, including this Commission. All prior drafts of this Agreement, Exhibit A, and any settlement proposals and counterproposals also are or relate to offers of settlement and are privileged.

12. This Agreement is conditioned upon and subject to Commission acceptance and approval of its terms in their entirety, without any change or condition that is unacceptable to any Party.

13. The Parties will request Commission acceptance and approval of this Agreement in its entirety, without any change or condition that is unacceptable to any party to this Agreement.

14. The Parties will work together to prepare agreed upon language regarding the approval of this Agreement for inclusion in any Proposed Orders submitted in this Cause. The Parties will offer supplemental testimony supporting the Commission's approval of this Agreement and will request that the Commission issue a Final Order incorporating the agreed proposed language of the Parties and accepting and approving the same in accordance with its terms.

15. The Parties shall not individually or jointly appeal or seek rehearing, reconsideration or a stay related to the provisions of any Final Order entered by the Commission approving this Agreement in its entirety without changes or condition(s) unacceptable to any Party (or related orders to the extent such orders are specifically implementing the provisions hereof) and any of the Parties may individually or collectively support this Agreement in the event of any appeal or a request for rehearing, reconsideration or a stay by any person not a party

hereto. However, this Agreement does not preclude any of the Parties from appealing, or seeking rehearing, reconsideration or a stay of any terms of the Final Order regarding contested matters in this Cause other than cost-of-service and rate design.

Accepted and Agreed on this 29th day of August, 2013

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

By: Leja D. Courter
Daniel M. LeVay
115 W. Washington Street
Suite 1500 South
Indianapolis, Indiana 46204

THE BOARD OF DIRECTORS FOR UTILITIES OF THE DEPARTMENT OF PUBLIC UTILITIES OF THE CITY OF INDIANAPOLIS, AS TRUSTEE OF A PUBLIC CHARITABLE TRUST FOR THE WATER SYSTEM, D/B/A CITIZENS WATER

By: Michael B. Cracraft
Steven W. Krohne
HACKMAN HULETT & CRACRAFT, LLP
111 Monument Circle, Suite 3500
Indianapolis, IN 46204-2030

Michael E. Allen
Lauren Toppen
2020 N. Meridian Street
Indianapolis, IN 46202

WHITESTOWN MUNICIPAL WATER UTILITY

By: J. Christopher Janak
Stephen C. Unger
Jonathan W. Hughes
BOSE MCKINNEY & EVANS LLP
111 Monument Circle, Suite 2700
Indianapolis, IN 46204

CITIZENS WATER INDUSTRIAL GROUP

Bette J. Dodd
Joseph P. Rompala
LEWIS & KAPPES
One American Square, Suite 2500
Indianapolis, Indiana 46282

THE TOWN OF PITTSBORO, INDIANA

By: James A.L. Buddenbaum
Jeremy L. Fetty
PARR RICHEY OBREMSKEY FRANDSEN& PATTERSON, LLP
201 N. Illinois Street, Suite 300
Indianapolis, IN 46204

INDIANAPOLIS WATER SERVICE ADVISORY BOARD

By: John M. Davis
Samuel R. Robinson
CHURCH, CHURCH, HITTLE& ANTRIM
Two North Ninth Street
Noblesville, IN 46060

BROWN COUNTY WATER UTILITY, INC.

By: Mark W. Cooper
1449 North College Avenue
Indianapolis, IN 46202

Peter Campbell King
CLINE, KING & KING, P.C.
1255 7th Street, Suite B
Columbus, IN 47202-0250

hereto. However, this Agreement does not preclude any of the Parties from appealing, or seeking rehearing, reconsideration or a stay of any terms of the Final Order regarding contested matters in this Cause other than cost-of-service and rate design.

Accepted and Agreed on this 29th day of August, 2013

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

By: Lega D. Courter
Daniel M. LeVay
115 W. Washington Street
Suite 1500 South
Indianapolis, Indiana 46204

THE BOARD OF DIRECTORS FOR UTILITIES OF THE DEPARTMENT OF PUBLIC UTILITIES OF THE CITY OF INDIANAPOLIS, AS TRUSTEE OF A PUBLIC CHARITABLE TRUST FOR THE WATER SYSTEM, D/B/A CITIZENS WATER

By: Michael B. Cracraft
Steven W. Krohne
HACKMAN HULETT & CRACRAFT, LLP
111 Monument Circle, Suite 3500
Indianapolis, IN 46204-2030

Michael E. Allen
Lauren Toppen
2020 N. Meridian Street
Indianapolis, IN 46202

WHITESTOWN MUNICIPAL WATER UTILITY

By: J. Christopher Janak
Stephen C. Unger
Jonathan W. Hughes
BOSE MCKINNEY & EVANS LLP
111 Monument Circle, Suite 2700
Indianapolis, IN 46204

CITIZENS WATER INDUSTRIAL GROUP

Bette J. Dodd
Joseph P. Rompala
LEWIS & KAPPES
One American Square, Suite 2500
Indianapolis, Indiana 46282

THE TOWN OF PITTSBORO, INDIANA

By: James A.L. Buddenbaum
Jeremy L. Fetty
PARR RICHEY OBREMSKEY FRANDSEN& PATTERSON, LLP
201 N. Illinois Street, Suite 300
Indianapolis, IN 46204

INDIANAPOLIS WATER SERVICE ADVISORY BOARD

By: John M. Davis
Samuel R. Robinson
CHURCH, CHURCH, HITTLE& ANTRIM
Two North Ninth Street
Noblesville, IN 46060

BROWN COUNTY WATER UTILITY, INC.

By: Mark W. Cooper
1449 North College Avenue
Indianapolis, IN 46202

Peter Campbell King
CLINE, KING & KING, P.C.
1255 7th Street, Suite B
Columbus, IN 47202-0250

hereto. However, this Agreement does not preclude any of the Parties from appealing, or seeking rehearing, reconsideration or a stay of any terms of the Final Order regarding contested matters in this Cause other than cost-of-service and rate design.

Accepted and Agreed on this 29th day of August, 2013

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

By: Lega D. Courter
Daniel M. LeVay
115 W. Washington Street
Suite 1500 South
Indianapolis, Indiana 46204

THE BOARD OF DIRECTORS FOR UTILITIES OF THE DEPARTMENT OF PUBLIC UTILITIES OF THE CITY OF INDIANAPOLIS, AS TRUSTEE OF A PUBLIC CHARITABLE TRUST FOR THE WATER SYSTEM, D/B/A CITIZENS WATER

By: Michael B. Cracraft
Steven W. Krohne
HACKMAN HULETT & CRACRAFT, LLP
111 Monument Circle, Suite 3500
Indianapolis, IN 46204-2030

Michael E. Allen
Lauren Toppen
2020 N. Meridian Street
Indianapolis, IN 46202

WHITESTOWN MUNICIPAL WATER UTILITY

By: J. Christopher Janak
Stephen C. Unger
Jonathan W. Hughes
BOSE MCKINNEY & EVANS LLP
111 Monument Circle, Suite 2700
Indianapolis, IN 46204

CITIZENS WATER INDUSTRIAL GROUP

Bette J. Dodd
Joseph P. Rompala
LEWIS & KAPPES
One American Square, Suite 2500
Indianapolis, Indiana 46282

THE TOWN OF PITTSBORO, INDIANA

By: James A.L. Buddenbaum
Jeremy L. Fetty
PARR RICHEY OBREMSKEY FRANDSEN& PATTERSON, LLP
201 N. Illinois Street, Suite 300
Indianapolis, IN 46204

INDIANAPOLIS WATER SERVICE ADVISORY BOARD

By: John M. Davis
Samuel R. Robinson
CHURCH, CHURCH, HITTLE& ANTRIM
Two North Ninth Street
Noblesville, IN 46060

BROWN COUNTY WATER UTILITY, INC.

By: Mark W. Cooper
1449 North College Avenue
Indianapolis, IN 46202

Peter Campbell King
CLINE, KING & KING, P.C.
1255 7th Street, Suite B
Columbus, IN 47202-0250

Exhibit A to Stipulation and Settlement

Class Cost of Service and Revenue Allocation

Line No.	Customer Class	(1) Adjusted Cost of Service per Settlement	(2) Revenues Under Existing Rates	(3) Annual Increase (3) = (1) - (2)	(4) Percentage Increase (4) = (3) / (2)	(5) Percent of Revenue Increase	(6) Annual Increase per Order/Settlement (6) = (a) * (5)	(7) Adjusted Cost of Service per Order/Settlement (7) = (2) + (6)	(8) Percentage Increase (8) = (6) / (2)
							$ 24,082,772 (a)		
	Water								
1	RESIDENTIAL	$ 109,668,300	$ 97,657,700	$ 12,010,600	12.30%	47.45%	$ 11,426,200	$ 109,083,900	11.70%
2	MULTI FAMILY	15,904,600	14,823,000	1,081,600	7.30%	4.27%	1,028,973	15,851,973	6.94%
3	COMMERCIAL	52,393,000	43,573,300	8,819,700	20.24%	34.84%	8,390,560	51,963,860	19.26%
4	INDUSTRIAL	8,284,300	6,884,100	1,400,200	20.34%	5.53%	1,332,070	8,216,170	19.35%
5	SALE FOR RESALE	2,155,600	1,785,000	370,600	20.76%	1.46%	352,568	2,137,568	19.75%
6	IRRIGATION	4,462,100	3,034,600	1,427,500	47.04%	5.64%	1,358,042	4,392,642	44.75%
7	Subtotal	$ 192,867,900	$ 167,757,700	$ 25,110,200	14.97%	99.19%	$ 23,888,413	$ 191,646,113	14.24%
	Fire Protection								
8	PUBLIC								
9	PRIVATE	2,128,300	1,924,000	204,300	10.62%	0.81%	194,359	2,118,359	10.10%
10	Total System	$ 194,996,200	$ 169,681,700	$ 25,314,500	14.92%	100.00%	$ 24,082,772	$ 193,764,472	14.19%

Note: Reflects negotiated cost of service settlement between parties using total revenue requirements from Petitioner's case-in-chief. Total revenue increase ultimately approved by Commission will be allocated to classes in proportion to the annual increases shown in Column 3.

(a) Input cell. Would be authorized increase pursuant to Commission Order. Currently represents Citizens Water's rebuttal position.

BEFORE THE

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF THE BOARD OF DIRECTORS FOR UTILITIES OF THE DEPARTMENT OF PUBLIC UTILITIES OF THE CITY OF INDIANAPOLIS, AS TRUSTEE OF A PUBLIC CHARITABLE TRUST FOR THE WATER SYSTEM, D/B/A CITIZENS WATER FOR (1) AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR WATER UTILITY SERVICE AND APPROVAL OF A NEW SCHEDULE OF RATES AND CHARGES APPLICABLE THERETO, AND (2) APPROVAL OF CERTAIN CHANGES TO ITS GENERAL TERMS AND CONDITIONS FOR WATER SERVICE	)	CAUSE NO. 44306

VERIFIED SUPPLEMENTAL TESTIMONY OF LATONA S. PRENTICE IN SUPPORT OF SETTLEMENT

On
Behalf of
Petitioner

Citizens Water

Petitioner's Exhibit LSP-S

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is LaTona S. Prentice. My business address is 2020 North Meridian Street, Indianapolis, Indiana.

Q. DID YOU PREVIOUSLY TESTIFY IN THIS PROCEEDING ON BEHALF OF PETITIONER, CITIZENS WATER ("CITIZENS")?

A. Yes, I did.

Q. ARE YOU SPONSORING ANY EXHIBITS IN THIS PROCEEDING?

A. Yes. I am sponsoring Petitioner's Exhibit LSP-S1, which is Exhibit A to the Stipulation and Settlement Agreement Resolving Cost-of-Service Issues ("Agreement") entered into by and among Citizens, the Indiana Office of Utility Consumer Counselor and the Intervenors, Citizens Water Industrial Group, the Indianapolis Water Service Advisory Board, the Town of Pittsboro, Indiana, Brown County Water Utility, Inc., and the Whitestown Municipal Water Utility.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to explain Exhibit A to the Agreement. My testimony complements the testimony of Michael C. Borchers who is sponsoring the Agreement. I concur with Mr. Borchers' recommendation that the Commission approve the Settling Parties' Agreement and the allocation of cost of service shown on Exhibit A to the Agreement.

Q. PLEASE DESCRIBE EXHIBIT A TO THE AGREEMENT.

A. I prepared Exhibit A after reviewing several similar alternative settlement proposals offered by other Parties in an effort to determine whether the Parties

could agree upon a methodology for allocating the ultimate revenue requirement determined by the Commission in this proceeding. The purpose of Exhibit A is to show how the revenue requirement approved by the Commission will be allocated on a proportionate basis among the customer classes. Column (1) of Exhibit A reflects the negotiated class cost-of-service settlement using the total system cost-of-service of $194,996,200, as taken from Petitioner's case-in-chief. To be clear, the Parties have not agreed to accept $194,996,200 as Citizens' revenue requirement, but they have agreed to the cost-of-service allocations among the customer classes shown on lines 1 through 9 set forth in Column (1). Column (2) of Exhibit A shows the revenues from Petitioner's existing rates, as set forth in Petitioner's case-in-chief, by customer class. Column (3) is Column (1) less Column (2). Column (4) shows the percentage amount of the agreed-upon revenue increase by customer class using the settlement class cost-of-service amounts from Column (3), compared to the revenue by customer class under existing rates in Column (2). Column (5) shows the allocated proportion of the revenue increase by customer class.

When the Commission determines the amount of the final revenue requirement for Citizens, any revenue increase approved by the Commission will be input into cell (a) and allocated to each class in accordance with Column (6) of Exhibit A. Each customer class' proportion of the total approved revenue increase would remain in accordance with percentages set forth in Column (5) of Exhibit A. The resulting percentage increases to each customer class would be

reflected in Column (8).

Conclusion

Q. IN YOUR OPINION, DO THE TERMS OF EXHIBIT A TO THE AGREEMENT REPRESENT A REASONABLE RESOLUTION OF THE ISSUES RAISED REGARDING COST-OF-SERVICE ALLOCATIONS?

A. In my opinion, yes. As with any settlement that resolves contested issues, all parties will receive certain benefits from the bargain in exchange for concessions in the give and take of settlement negotiations. Moreover, the compromises reflected in the Agreement on the part of the Settling Parties are preferable to the uncertainty, expense, and administrative burden of continued costly litigation between and among Citizens, the OUCC, CWIG, Brown County, and Pittsboro.

Q. IN CONCLUSION, WHAT DO YOU RECOMMEND TO THE COMMISSION?

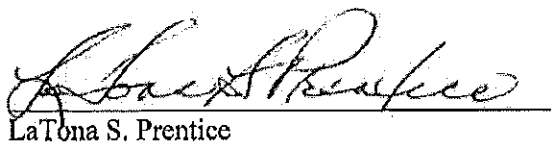
A. I recommend that the Commission approve the Agreement and Exhibit A as consistent with the public interest.

Q. DOES THIS CONCLUDE YOUR SUPPLEMENTAL TESTIMONY?

A. Yes.

VERIFICATION

The undersigned affirms under penalties for perjury that the foregoing is true to the best of her knowledge, information and belief.



LaTona S. Prentice

Exhibit A to Stipulation and Settlement

Class Cost of Service and Revenue Allocation

Line No.	Customer Class	(1) Adjusted Cost of Service per Settlement	(2) Revenues Under Existing Rates	(3) Annual Increase (3) = (1) - (2)	(4) Percentage Increase (4) = (3) / (2)	(5) Percent of Revenue Increase	(6) Annual Increase per Order/Settlement (6) = (a) * (5)	(7) Adjusted Cost of Service per Order/Settlement (7) = (2) + (6)	(8) Percentage Increase (8) = (6) / (2)
							$ 24,082,772 (a)		
	Water								
1	RESIDENTIAL	$ 109,668,300	$ 97,657,700	$ 12,010,600	12.30%	47.45%	$ 11,426,200	$ 109,083,900	11.70%
2	MULTI FAMILY	15,904,600	14,823,000	1,081,600	7.30%	4.27%	1,028,973	15,851,973	6.94%
3	COMMERCIAL	52,393,000	43,573,300	8,819,700	20.24%	34.84%	8,390,560	51,963,860	19.26%
4	INDUSTRIAL	8,284,300	6,884,100	1,400,200	20.34%	5.53%	1,332,070	8,216,170	19.35%
5	SALE FOR RESALE	2,155,600	1,785,000	370,600	20.76%	1.46%	352,568	2,137,568	19.75%
6	IRRIGATION	4,462,100	3,034,600	1,427,500	47.04%	5.64%	1,358,042	4,392,642	44.75%
7	Subtotal	$ 192,867,900	$ 167,757,700	$ 25,110,200	14.97%	99.19%	$ 23,888,413	$ 191,646,113	14.24%
	Fire Protection								
8	PUBLIC								
9	PRIVATE	2,128,300	1,924,000	204,300	10.62%	0.81%	194,359	2,118,359	10.10%
10	Total System	$ 194,996,200	$ 169,681,700	$ 25,314,500	14.92%	100.00%	$ 24,082,772	$ 193,764,472	14.19%

Note: Reflects negotiated cost of service settlement between parties using total revenue requirements from Petitioner's case-in-chief. Total revenue increase ultimately approved by Commission will be allocated to classes in proportion to the annual increases shown in Column 3.

(a) Input cell. Would be authorized increase pursuant to Commission Order. Currently represents Citizens Water's rebuttal position.

Exhibit LSP-S1

BEFORE THE
INDIANA UTILITY REGULATORY COMMISSION

PETITION OF THE BOARD OF DIRECTORS FOR UTILITIES OF THE DEPARTMENT OF PUBLIC UTILITIES OF THE CITY OF INDIANAPOLIS, AS TRUSTEE OF A PUBLIC CHARITABLE TRUST FOR THE WATER SYSTEM, D/B/A CITIZENS WATER FOR (1) AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR WATER UTILITY SERVICE AND APPROVAL OF A NEW SCHEDULE OF RATES AND CHARGES APPLICABLE THERETO, AND (2) APPROVAL OF CERTAIN CHANGES TO ITS GENERAL TERMS AND CONDITIONS FOR WATER SERVICE	)	CAUSE NO. 44306

VERIFIED SUPPLEMENTAL TESTIMONY
IN SUPPORT OF SETTLEMENT
of
MICHAEL C. BORCHERS

On
Behalf of
Petitioner

Citizens Water

Petitioner's Exhibit MCB-S

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Michael C. Borchers. My business address is 5750 Castle Creek Parkway North, Suite 245, Indianapolis, Indiana 46250.

Q. DID YOU PREVIOUSLY PREPARE DIRECT AND REBUTTAL TESTIMONY AND EXHIBITS IN THIS PROCEEDING ON BEHALF OF PETITIONER CITIZENS WATER ("CITIZENS")?

A. Yes, I did.

Q. WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL TESTIMONY?

A. The purpose of this supplemental testimony is to provide the Commission with the background for, and explain the terms of, the Stipulation and Settlement Agreement Resolving Cost-of-Service Issues ("Agreement") that was entered into by and among Citizens, the Indiana Office of Utility Consumer Counselor ("OUCC") and the Intervenors, Citizens Water Industrial Group ("CWIG"), the Indianapolis Water Service Advisory Board, the Town of Pittsboro, Indiana ("Pittsboro"), Brown County Water Utility, Inc. ("Brown County"), and the Whitestown Municipal Water Utility (collectively, the "Settling Parties") and filed with the Indiana Utility Regulatory Commission ("Commission") on August 29, 2013. My testimony concludes by recommending that the Commission approve the Agreement as consistent with the public interest.

Q. PLEASE IDENTIFY WHAT HAS BEEN MARKED AS PETITIONER'S EXHIBIT MCB-S1.

A. Petitioner's Exhibit MCB-S1 is a copy of the Agreement along with Exhibit A attached thereto.

I. Background

Q. PLEASE BRIEFLY DESCRIBE THE HISTORY LEADING UP TO THE EXECUTION OF THE AGREEMENT.

A. The Agreement is the product of settlement negotiations that occurred following the first week of hearings in this Cause and prior to the scheduled resumption of hearings in this proceeding on August 13, 2013.

Q. DOES THE AGREEMENT RESOLVE THE COST-OF-SERVICE ISSUES RAISED BY THE PARTIES IN THEIR RESPECTIVE TESTIMONY AND EXHIBITS?

A. Yes, the Agreement resolves all of the issues that relate to cost-of-service and rate design in this Cause.

II. Settlement of Cost Allocation and Rate Design Issues

Q. WHAT WAS THE IMPETUS BEHIND THE SETTLING PARTIES' AGREEMENT WITH RESPECT TO RESOLUTION OF THE COST-OF-SERVICE ALLOCATION AND RATE DESIGN ISSUES?

A. The Settling Parties' agreement relating to resolution of the cost allocation and rate design issues was structured to reach a mutually acceptable resolution of the cost-of-service issues and avoid the risk, expense, and administrative burden of further litigating that issue.

Columns (1) through (5) of Exhibit A to the Agreement are the result of arms-length bargaining between and among the Settling Parties. While each Party presenting cost-of-service testimony and exhibits believed strongly in its respective position, we were able to put aside those differences and agree upon a resolution of the cost-of-service issues that avoids litigation, generally moves toward the class cost-of-service determined in Petitioner's case-in-chief, and falls within the range of potential outcomes proposed by the Settling Parties, if the case had not been settled.

Q. HOW WOULD RATES BE DESIGNED FOR EACH CLASS?

A. The Supplemental Testimony of Petitioner's witness LaTona S. Prentice and Exhibit A to the Agreement describes how the ultimate revenue requirement determined by the Commission will be apportioned to the rate classes. Rate design would be accomplished by apportioning each class' revenue requirement to their respective base and volumetric charges in accordance with the approach in Petitioner's case-in-chief. This includes moving the Residential and Irrigation classes to a more conservation-oriented uniform volume charge. Sale for Resale and Industrial classes will remain on a declining block structure and a hybrid structure will be used for Multi-Family and Commercial classes.

Q. IN YOUR OPINION, IS COMMISSION APPROVAL OF THE AGREED-UPON CHANGES TO COST ALLOCATION AND RATE DESIGN IN THE PUBLIC INTEREST?

A. Yes, for all of the reasons that I have discussed above.

III. Conclusion

Q. IN YOUR OPINION, DO THE TERMS OF THE AGREEMENT REPRESENT A REASONABLE RESOLUTION OF THE ISSUES RAISED REGARDING COST-OF-SERVICE ALLOCATIONS?

A. In my opinion, yes.

Q. IN CONCLUSION, WHAT DO YOU RECOMMEND TO THE COMMISSION?

A. I recommend that the Commission approve the Agreement and Exhibit A as consistent with the public interest.

Q. DOES THIS CONCLUDE YOUR SUPPLEMENTAL TESTIMONY IN THIS PROCEEDING?

A. Yes.

VERIFICATION

I, Michael C. Borchers, affirm under penalties of perjury that the foregoing testimony is true to the best of my knowledge, information and belief.

Michael C. Borchers
Principal Consultant, Management Consulting Division
Black & Veatch Corporation

Dated: August 29th, 2013