FILED
June 22, 2018
INDIANA UTILITY
REGULATORY COMMISSION

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

VERIFIED PETITION OF THE BOARD OF DIRECTORS FOR UTILITIES OF THE DEPARTMENT OF PUBLIC UTILITIES OF THE CITY OF INDIANAPOLIS ("BOARD") IN ITS CAPACITY AS OWNER OF THE GAS UTILITY D/B/A/ CITIZENS GAS; THE BOARD IN ITS CAPACITY AS OWNER OF THE WATER UTILITY D/B/A/ CITIZENS WATER; THE BOARD IN ITS CAPACITY AS OWNER OF THE STEAM UTILITY D/B/A/ CITIZENS THERMAL; WESTFIELD GAS, LLC D/B/A CITIZENS GAS OF WESTFIELD; CITIZENS WASTEWATER OF WESTFIELD, LLC; CITIZENS WATER OF WESTFIELD, LLC; AND CWA AUTHORITY, INC., FOR PRESENTATION AND APPROVAL OF NEW DEPRECIATION ACCRUAL RATES	)	**CAUSE NO. 45039**

OUCC PREFILED TESTIMONY

OF

EDWARD R. KAUFMAN, CRRA - PUBLIC'S EXHIBIT NO. 2

ON BEHALF OF THE

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

June 22, 2018

Respectfully Submitted,

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

Lorraine Hitz-Bradley

Lorraine Hitz-Bradley, Atty. No. 18006-29
Deputy Consumer Counselor

CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing ***Office of Utility Consumer Counselor's Prefiled Testimony of Edward R. Kaufman, CRRA*** has been served upon the following counsel of record in the captioned proceeding by electronic service on June 22, 2018.

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TESTIMONY OF OUCC WITNESS EDWARD R. KAUFMAN, CRRA
CAUSE NO. 45039
CITIZENS ENERGY GROUP

I. INTRODUCTION

Q: Please state your name and business address.

A: My name is Edward R. Kaufman, and my business address is 115 W. Washington St., Suite 1500 South, Indianapolis, IN 46204

Q: By whom are you employed and in what capacity?

A: I am employed by the Indiana Office of Utility Consumer Counselor ("OUCC") as the Water-Wastewater Division's Assistant Director. My qualifications and experience are set forth in Appendix A.

Q: Please describe the review and analysis you conducted to prepare your testimony.

A: I reviewed the Joint Petition initiating this Cause, the testimony, and the exhibits filed by Citizens Energy Group [Citizens Gas, Citizens Water, Citizens Thermal, Westfield Gas, Citizens Wastewater of Westfield, Citizens Water of Westfield, and CWA Authority] ("CEG"). I participated in conducting discovery and reviewed CEG's responses. I reviewed the testimony of OUCC witness Wes Blakley and the Indiana Utility Regulatory Commission's ("Commission") final order in Cause No. 42959, Indiana Michigan Power Co. dated October 19, 2006.[1]

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[1] In Cause No. 42959 Indiana Michigan Power Company sought Commission authority to revise its depreciation rates between rate cases.

Q: What is CEG requesting in this case?

A: CEG is seeking to lower its depreciation rates. However, CEG is seeking to implement the revised depreciation rates upon the issuance of an order in this cause and not concurrent with future rate cases. CEG proposes the following depreciation rates:

<u>Change in Depreciation Rates</u>

Municipal utilities	**Current**	**Proposed**	**Cause No.**
Citizens Gas	2.86% (overall)	1.97%	43975
Steam	3.97% (overall)	3.92%	44781
Citizens Water	2.0% (composite)	1.18%	44644
CWA Authority	2.5% (composite)	1.73%	44685
Investor-owned utilities			
Westfield Gas	3.22% (overall)	2.18%	44731
Westfield Water	2.0% (composite)	1.84%	44273
Westfield Wastewater	2.5% (composite)	2.44%	44273
Shared Services	12.75% (overall)	8.4%	43975

Q: What is the purpose of your testimony?

A: My testimony summarizes the OUCC's position in this Cause. First, OUCC witness David Garrett proposes several adjustments to CEG's proposed depreciation rates. Next, the OUCC disagrees with CEG's proposal to implement the revised depreciation rates immediately upon the issuance of a Commission order. Instead, depreciation rates should be revised with a final order in each of CEG's individual utilities' next rate cases. Because CEG includes multiple utilities and industries, my testimony specifically addresses CEG's water utilities, OUCC witness Edward Rutter provides testimony regarding CEG's gas utilities, and OUCC witness Michael Eckert provides testimony regarding Citizens Thermal.

Q: Which divisions of CEG do you address in your testimony?

A: My testimony addresses Westfield Water, Westfield Wastewater, CWA Authority, Citizens Water, and CEG Shared Services.

Q: What is the OUCC’s position in this case?

A: Other than the adjustments proposed by the OUCC witness David Garrett, the OUCC does not oppose the methodologies used in the Depreciation Study sponsored by CEG in this Cause. Further discussion of this position is described in Public’s Exhibit No. 1, the pre-filed testimony of David Garrett, a consultant for the OUCC in this Cause. As described in my testimony and that of the other OUCC witnesses, the OUCC has concerns regarding the implementation of revised depreciation rates outside a base rate case.

II. OUCC’S CONCERNS

Q: What are the OUCC’s concerns about implementing lower depreciation rates between rate cases?

A: CEG’s request to implement lower depreciation rates before a new rate case provides current benefits to CEG without corresponding benefits to ratepayers. In addition, CEG’s request could have a significant, detrimental ratemaking impact on ratepayers at the time of each entity’s next rate case.

Q: How will decreasing depreciation rates immediately impact Indiana ratepayers?

A: Without incorporating the depreciation rate into a new base rate, Indiana ratepayers receive no benefit. In other words, the lower depreciation costs to the utility will not result in lower rates and charges for the customers.

If CEG is allowed to immediately implement reduced depreciation rates, less depreciation will be credited to the accumulated depreciation account. This means rate base will increase – or more accurately, rate base will decrease more slowly than it otherwise would.

Q: How does that negatively impact ratepayers?

A: CEG will continue to collect depreciation in its rates at the higher level approved in the last rate case. This will effectively result in an over-collection of depreciation expense until the new depreciation rate is incorporated into new base rates.

Q: Do you think utilities should be allowed to adjust their depreciation rates between rate cases?

A: In certain circumstances, yes. However, the Commission should be cautious about approving changes to depreciation rates between rate cases. Like many issues, it should be done on a case by case basis. There are practical differences between different types of utilities that could affect the Commission's decision whether to permit depreciation changes between rate cases.

Q: Explain why it is inappropriate to implement CEG's proposed depreciation rates at the time an order is issued in this cause.

A: Revenue requirements include depreciation expense that was determined at the time of the utility's last rate case. Depreciation expense is then deducted from Utility Plant in Service ("UPIS") to determine net utility plant. If a depreciation rate is reduced between rate cases, then the deduction from UPIS is also reduced. Thus, the net utility plant at the time of the utility's next rate case will be higher than it would be absent a change in depreciation rates. Ratepayers will pay higher rates due to the reduction in depreciation rates.

A. <u>Westfield Wastewater</u>

Q: Based on Petitioner's proposed depreciation rate for Westfield Wastewater (2.44% vs. 2.50%), how would CEG's proposal increase Westfield Wastewater's future rate base?

A: Based on Mr. Spanos' analysis, Westfield Wastewater's annual depreciation expense would decrease by $69,388 upon the issuance of an order in this cause. However, if the revised depreciation rate goes into effect upon the issuance of an order, but Westfield Wastewater does not have new revenue requirements go into effect until four years after an order is issued in this cause, its accumulated depreciation would be $277,552 lower than it would be with the current depreciation rates. Thus, its rate base would be $277,552 higher and ratepayers will be denied the benefit of a lower depreciation rate.

Q: Based on the OUCC's proposed depreciation rate for Westfield Wastewater (2.17% vs. 2.50%) how would the OUCC's proposal increase Westfield Wastewater's future rate base?

A: Based on Mr. Garrett's analysis, Westfield Wastewater's annual depreciation expense would decrease by $358,762. Thus, if Westfield Wastewater does not have new rates go into effect until four years after an order is issued in this cause, its accumulated depreciation would be $1,435,048 lower than it would be with the current depreciation rates. Thus, its rate base would be $1,435,048 higher.

B. <u>Westfield Water</u>

Q: Based on CEG's proposed depreciation rate (1.84% vs. 2.00%) for Westfield Water, how would CEG's proposal increase Westfield Water's future rate base?

A: Based on Mr. Spanos' analysis, Westfield Water's annual depreciation expense would decrease by $116,606 upon the issuance of an order in this cause.

However, if the revised depreciation rate goes into effect upon the issuance of an order, but Westfield Water does not have new revenue requirements go into effect until four years after an order is issued in this cause, its accumulated depreciation would be $466,424 lower than it would be with the current depreciation rates. Thus, its rate base would be $466,424 higher and ratepayers will be denied the benefit of a lower depreciation rate.

Q: Based on the OUCC's proposed depreciation rate for Westfield Water (1.64% vs. 2.00%) how would the OUCC's proposal increase Westfield Water's future rate base?

A: Based on Mr. Garrett's analysis, Westfield Wastewater's annual depreciation expense would decrease by $267,071. Thus, if Westfield Wastewater does not have new rates go into effect until four years after an order is issued in this cause its accumulated depreciation would be $1,068,284 lower than it would be with the current depreciation rates. Thus, its rate base would be $1,068,284 higher.

C. <u>Shared Services</u>

Q: Please discuss your concerns with CEG's Shared Services ("Shared Services").

A: Shared Services is not a separate "utility", but CEG charges the costs of Shared Services (including depreciation and a return for CEG's investor-owned utilities) to its utilities. Because depreciation expense from Shared Services is allocated across all of CEG's utilities, any change to its depreciation rate influences the expenses and subsequent revenue requirements of all of CEG's utilities. As discussed above, the OUCC is proposing that any revised depreciation rate should not go into effect until the utility's next rate case. It is infeasible to propose that the revised depreciation rate not go into effect until Shared Services' next rate case, because Shared Services is not a utility and therefore does not have its own, separate rate case. Therefore any concerns regarding the immediate implementation of CEG's revised depreciation rates still apply to Shared Services.

Q: What is the OUCC recommending for the depreciation rate for Shared Services?

A: The revised depreciation rate should not go into effect (that is, be applied to depreciable plant) until an order is issued in the first rate case of a CEG investor-owned utility. If the revised depreciation rate is implemented in this manner, the rate base for Shared Services would not be inflated, and would prevent CEG and its investor-owned utilities from earning an excess return. An excess return would occur if the revised (lower) depreciation rates are implemented when an order is issued in this cause.

Q: Based on CEG's proposed depreciation rate for Shared Services (8.40% vs. 12.75%) how would CEG's proposal increase Shared Services' future "rate base"?[2]

A: Based on Mr. Spanos' analysis, annual depreciation expense would decrease by $4,027,020.

Q: Based on the OUCC's proposed depreciation rate for CEG's Shared Services (5.27% vs. 12.75%), how would the OUCC's proposal increase CEG's future rate base?

A: Based on Mr. Garrett's analysis, CEG's Shared Services' annual depreciation expense would decrease by $6,928,758. Thus, if any of CEG's investor-owned utilities do not have new rates go into effect until four years after an order is issued

[2] While Shared Services does not technically have a "rate base," CEG's investor owned utilities will pay a return on their allocated portion of Shared Services' rate base.

in this cause, accumulated depreciation would be $27,715,032 lower than with current depreciation rates. Thus, rate base would be $27,715,032 higher.

D. <u>CWA Authority and Citizens Water of Indianapolis</u>

Q: Do you have the same concerns about the timing of implementing the depreciation rates for CWA Authority and Citizens Water of Indianapolis as you do for Westfield Wastewater, Westfield Water and Shared Services?

A: I do not have the same concerns. Implementing the revised depreciation rates for CWA Authority and Citizens Water of Indianapolis upon the issuance of an order in this cause would not overstate rate base and would not subsequently result in inflated NOI in future rate cases. However, it is a basic goal for accounting purposes that revenues should match expenses that gave rise to those revenues, which is the same principle used in setting regulated utility service rates. Revenue requirement should be based on a level of operating expenses consistent with that revenue requirement. Moreover, to be consistent with the recommendations I have made above and those made by OUCC witnesses Edward Rutter and Michael Eckert, any revised depreciation rates should not be applied to depreciable plant until an order is issued in the utility's next rate case.

E. <u>General</u>

Q: When a utility seeks to revise its depreciation rates, is it typical for it to defer changing its depreciation rate(s) until their next rate case?

A: Yes. In Cause No. 44992, Indiana American Water Company proposed to revise its depreciation rates between rate cases, but proposed that the change not take place until the end of their next rate case. The Commission accepted Indiana American's proposal to defer changing its depreciation rate(s) until their next rate case.

In Indiana Michigan ("I&M"), Cause No. 42959 (order dated October 19, 2006), I&M sought to decrease depreciation rates between rate cases. The Commission rejected I&M's proposal, and stated on page 24 the following:

> While the Petitioner indicates that a revision to its depreciation rates is needed to achieve a certain result, under [Indiana Code § 8-1-2-19] it is up to the Commission to reach such a conclusion. Our review of the definition of "necessary" in the statutory context presented in [I.C. § 8-1-2-19], leads us to conclude that granting the relief requested in this Cause is not *absolutely essential, indispensable, or inevitable,* as an outcome that must be reached by the Commission in its consideration of a stand-alone presentation of the depreciation issue. As the Commission has historically considered the issue of revised depreciation rates either as part of, or in preparation for, a rate case and has, on occasion, reviewed depreciation rates as a stand-alone issue, we find that we have the statutory flexibility to determine the appropriate context in which depreciation issues should be considered based on the specific facts presented in a proceeding.

Emphasis in original.

The Commission also stated on page 25:

> Unlike the telecommunications proceedings considered by the Commission in which requested revisions to depreciation rates, largely driven by growth, consolidation, and technological changes, were approved on a stand-alone basis, such issues are not present in this proceeding.
>
> While [I.C. § 8-1-2-]19 and 20 allow for the revision of depreciation rates outside of rate proceeding, these statutory provisions are not a substitute for the comprehensive review of all costs and cost savings that the periodic filing of a rate case provides….
>
> Accordingly, based on the specific facts presented in this matter, we reject I&M's request in this Cause and find that it is not necessary or appropriate to revise I&M's depreciation rates on a stand-alone basis.

I agree with the Commission that depreciation rates should not be revised between rate cases. Ratepayers should not be subjected to higher revenue requirements caused by an immediate implementation of lower, revised depreciation rates.

III. AMORTIZATION OF ACQUISITION ADJUSTMENTS

Q: Do the Westfield utilities (Gas, Water and Wastewater) have acquisition adjustments on CEG’s books?

A: Yes.

Q: According to page 19 of Ms. Karner’s testimony, CEG proposes “to update the amortization rates applied to the acquisition adjustments[.]” Do you agree with that portion of CEG’s proposal?

A: It depends on what CEG’s proposal means and how it is implemented.

Q: Please explain why you believe CEG’s proposal is unclear.

A: I initially presumed that CEG’s acquisition adjustment would be the same as its fair value increment. In Cause No. 44723 (CEG’s purchase of the water and wastewater assets from the City of Westfield), the parties agreed that Westfield Water would be authorized a fair value increment of $6,960,000 and Westfield Wastewater would be authorized a fair value increment of $17,040,000. However, CEG’s Attachment SEK-2 in this case shows an acquisition adjustment balance of $4,829,801 for Westfield Water and $8,447,539 for Westfield Wastewater. Thus, it appears that CEG’s use of the terms “acquisition adjustment and “fair value increment” are not synonymous.

Q: Why does this difference matter?

A: In Cause No. 44726 the parties agreed (and the Commission approved) that Westfield Water and Westfield Wastewater would earn a return on, but not of, the remaining fair value increment, and the fair value increments would be amortized over 40 years (2.5% per year). To the extent that CEG’s proposal to revise the amortization rates of the Westfield acquisition adjustments is also a proposal to revise the amortization rates of the respective fair value increments, that proposal would alter the approved settlement agreement. The amortization period for the fair value increment was an important element of the settlement. Moreover, reducing the amortization rate of the fair value increments(s) will cause rate base (of Westfield Water and Wastewater) to be higher than it otherwise would be. This proposal would harm ratepayers. The OUCC would oppose CEG's proposal to unilaterally revise the settlement from Cause No. 44726.

IV. <u>DIG-INDY TUNNEL SYSTEM</u>

Q: What is the DigIndy Tunnel System?

A: According to CEG's web site, the DigIndy Tunnel System is a 28-mile long network of 18-foot diameter deep rock tunnels being built 250-feet beneath the city. Along with other projects in the combined sewer system and at Citizens' two advanced wastewater treatment plants, the $2 billion program is Indy's solution to reducing combined sewer overflows into area waterways, and keeping the utility in compliance with a Consent Decree with the U.S. EPA.

Q: Does the DigIndy Tunnel system create any future concerns regarding CWA's future depreciation rates?

A: Yes. Compared to the rest of CWA Authority's current UPIS ($2.7 billion), the scope of the DigIndy project is huge. The DigIndy tunnel will have a service life and characteristics that are different from the rest of CWA Authority's UPIS. The tunnel will have a service life that exceeds the life of CWA Authority's other utility plant. Moreover, unlike most other utility plant, a portion of the tunnel cannot be retired and replaced. The DigIndy tunnel is unique. Due to its magnitude and long service life, completion of DigIndy will change the composition of CWA Authority's UPIS.

Q: How can your concerns regarding the DigIndy tunnel be addressed?

A: The DigIndy project is scheduled to be completed in 2025. When a utility has significant growth or adds a large construction project that changes the characteristics of the composition of UPIS, it should update its depreciation rates. The completion of the DigIndy project is the type of project that necessitates a new depreciation study. CWA Authority should be required to file a revised depreciation study that will coincide with the completion of CWA Authority's DigIndy project that applies an appropriate depreciation rate to the DigIndy tunnel. Failure to have a proper depreciation rate that reflects the nature of the DigIndy tunnel may allow CWA Authority to over-collect its depreciation expense.

V. CONCLUSION

Q: Please state the OUCC's recommendations.

A: The OUCC recommends the depreciation rates proposed by OUCC witness David Garrett be approved by the Commission. As discussed by me and OUCC witnesses Edward Rutter and Michael Eckert, any revised depreciation rate should not go into effect until an order is issued in each utility's next rate case. The OUCC is also proposing that CWA Authority be required to present a revised depreciation rate once it has completed its DigIndy Project.

Q: Does this conclude your testimony?

A: Yes.

APPENDIX A

Q: Please describe your educational background and experience.

A: I graduated from Bentley College in Waltham, Massachusetts, with a Bachelor's degree in Economics & Finance and an Associate's degree in Accounting. Before attending graduate school, I worked as an escheatable property accountant at State Street Bank and Trust Company in Boston, Massachusetts. I was awarded a graduate fellowship to attend Purdue University where I earned a Master's of Science degree in Management with a concentration in finance.

I was hired as Utility Analyst in the Economics and Finance Division of the OUCC in October 1990. Since then, my primary areas of responsibility have been in utility finance, utility cost of capital, and regulatory policy. I was promoted to Principal Utility Analyst in August 1993 and to Assistant Chief of Economics and Finance in July 1994. As part of an agency-wide reorganization in July 1999, my position was reclassified as Lead Financial Analyst within the Rates/Water/Sewer Division. In October 2005, I was promoted to Assistant Director of the Water/Wastewater Division. In October 2012, I was promoted to Chief Technical Advisor. I have participated in numerous conferences and seminars regarding utility regulation and financial issues. I was awarded the professional designation of Certified Rate of Return Analyst (CRRA) by the Society of Utility and Regulatory Financial Analysts (SURFA). This designation is awarded based upon experience and the successful completion of a written examination. In April 2012, I was elected to SURFA's Board of Directors and continue to serve on SURFA's Board.

Q: Have you previously testified before the Indiana Utility Regulatory Commission?

A: Yes. I have testified before the Indiana Utility Regulatory Commission ("IURC" or "Commission") in a number of different cases and issues. I have testified in water, wastewater, natural gas, telecommunication and electric utility cases. While my primary areas of responsibility have been in cost of equity, utility financing, fair value, utility valuation and regulatory policy, I have provided testimony on trackers, guaranteed performance contracts, declining consumption adjustments, and other issue.

AFFIRMATION

I affirm, under the penalties for perjury, that the foregoing representations are true.

Edward R Kaufman

By: Edward R. Kaufman
Cause No. 45039
Indiana Office of
Utility Consumer Counselor

6/22/18

Date: