STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

APPLICATION OF AMERICAN SUBURBAN UTILITIES, INC., FOR AUTHORITY TO INCREASE RATES AND CHARGES THROUGH THE SMALL UTILITY PROCEDURE PURSUANT TO IND. CODE § 8-1-2-61.5 AND 170 IAC 14-1-1 ET SEQ.	**)**	**CAUSE NO. 45649-U**

APPLICANT'S MOTION TO STRIKE
OUCC WITNESS SHAWN DELLINGER'S TESTIMONY

American Suburban Utilities, Inc. ("Applicant" or "ASU"), moves to strike the testimony and exhibits of Indiana Office of the Utility Consumer Counselor ("OUCC") witness Shawn Dellinger in its entirety because witness Dellinger's testimony and attachments suggest a hypothetical capital structure based on ASU's relationship with another Company, which is contrary to Indiana Law and therefore should not be admitted as evidence.

Hypothetical Capital Structures are Unlawful

Hypothetical capital structures have long been held to be contrary to Indiana law and repeatedly rejected by the Indiana Utility Regulatory Commission ("IURC" or "Commission"). In *Northern Ind. Pub. Serv. Co.*, Cause No. 43526 (IURC 8/25/2010) ("*NIPSCO*") the Commission included a thorough and clear discussion of Indiana law. In *NIPSCO* Intervenor Industrial Group and the OUCC offered testimony that NIPSCO's equity ratio was too high and that NIPSCO's holding company capital structure should be used instead, both for purposes of computing allowable return and income taxes. The Commission rejected this approach as unlawful under Ind. Code § 8-1-2-6. *Id.* at 18-20. In making its determination in *NIPSCO*, the Commission cited to previous Indiana Supreme Court decisions which support the rejection and explained:

> Hypothetical capital structures such as those proposed here by the OUCC and IG have long been held to be contrary to Indiana law. In *Pub. Service Comm 'n of Ind. v. Ind. Bell Tel. Co.*, 235 Ind. 1, 130 N.E.2d 467 (Ind. 1955) ("*Indiana Bell*"), the Indiana Supreme Court reviewed a rate order for a telephone utility (Indiana Bell) which had a 100% equity capital structure but was a subsidiary of a holding company (AT&T) that had a 50% equity and 50% debt capital structure. In the case below, the Commission reduced the utility's rate of return to reflect the parent company's cost of capital and imputed to the Indiana utility tax savings that would exist if its capital structure were two-third equity and one-third debt. 235 Ind. at 29, 130 N.E.2d at 480. The Indiana Supreme Court held the Commission's order was unlawful in both respects. Using the parent company's capital raising ability as the measure of a reasonable return was improper because Indiana Bell was "an Indiana corporation having its own separate identity even though a part of the general Bell System." 235 Ind. at 26, 130 N.E.2d at 479.

In *Indiana Bell* in finding that the Commission's order to use the parent company's capital structure was unlawful, the Indiana Supreme Court explained:

> [Indiana Bell] is an Indiana corporation, a separate and distinct utility as defined by statute and it is the duty of the Commission to establish for it a schedule of rates which will produce a fair and non-confiscatory return upon its used and useful intrastate property, whether its stockholders are one or many, and without regard to its relationship to other companies.
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> The fact that appellee has not used its own credit with which to raise additional capital is immaterial, and its ability to do so cannot be measured by the yardstick of the ability of the parent company to raise additional capital. The intrastate properties and operations of appellee are the ones to be considered in fixing a fair rate of return upon its used and useful property and not those of the entire Bell System.
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> The acts of [the Commission] in considering the cost of money to the parent company, A.T. & T., and the "entire Bell System" rather than considering only the properties and operations of appellee is in violation of [Ind. Code § 8-1-2-6] and is unlawful.

The *Indiana Bell* case was soon followed by a second capital structure decision, *Public Service Commission of Indiana v. City of Indianapolis*, 235 Ind. 70, 131 N.E.2d 308 (Ind. 1956) ("City of Indianapolis"). In *City of Indianapolis*, the Indiana Supreme Court rejected the City's position that Indianapolis Water Company should have issued preferred stock and bonds to finance its system and reiterated that "The statute does not permit the fixing of rates on a hypothesis or a situation never in existence." *Id.*, 235 Ind. at 91, 131 N.E.2d at 317. Based on this Indiana

Supreme Court precedent, the Commission has consistently rejected hypothetical capital structures as unlawful.[1]

Similarly, in *NIPSCO*, the Commission rejected the Intervenors' attempt to impose the capital structure of NIPSCO's holding company on NIPSCO as unlawful under Ind. Code § 8-1-2-6. pp. 18-20. Instead, the Commission found that NIPSCO's actual capital structure shall be used to determine NIPSCO's cost of capital. *Id*.

In rejecting hypothetical capital structures in *NIPSCO* and dozens of other Commission orders, the Commission has unquestioningly followed Indiana Supreme Court precedent and Indiana law.[2]

In *Indianapolis Water Company*, Cause No. 37612, March 20, 1985, the Commission explained why it and other regulatory bodies reject hypothetical capital structures stating:

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[1] Many examples exist of Commission Orders rejecting hypothetical capital structures, including those based on parent company capitalization ratios.., Pub. Serv. Co. of Ind., Cause No. 28364, 37 PUR3d 485, 498-499 (Jan. 31, 1961) (rejecting the Intervenor's argument that the utility should have issued more debt as contrary to the City of Indianapolis case); Ind. Bell Tel. Co., Cause No. 36732, p. 7, 1982 Ind. PUC LEXIS 191 at *14-15 (Sept. 7, 1982) (rejecting OUCC's proposal to use the more leveraged and less costly consolidated Bell system capital structure because "the capital structure of Petitioner as it actually exists . . . should be used in determining a fair rate of return for Petitioner"); Indianapolis Water Co., Cause No. 37612, p. 17, 1985 Ind. PUC LEXIS 490 at *38 (March 20, 1985) (rejecting the OUCC's proposal to treat equity as debt because "[w]e cannot, as a matter of law, use this hypothetical capital structure to fix rates in this case"); Hoosier Gas Corp., Cause No. 37541, p. 17, 1985 Ind. PUC LEXIS 522 at *34, 65 PUR4th 463, 475-476 (Feb. 28, 1985) (OUCC's proposal to use a more leveraged "typical" gas utility capital structure for cost of capital and tax expense purposes rejected as contrary to the "the statutes we are sworn to administer"); N. Ind. Public Serv. Co., Cause No. 38045, p. 48, 1987 Ind. PUC LEXIS 180 at *122-123, 85 PUR4th 605, 652 (July 15, 1987) (use of pre-Bailly nuclear plant write-off equity ratio rejected as a hypothetical capital structure); Terre Haute Gas Corp., Cause No. 38515, pp. 27-28, 1989 Ind. PUC LEXIS 113 at *76-78 (OUCC proposal to use a cost of equity that would reach the same result as a "proper" capital structure rejected because "[t]his Commission has consistently held in accord with Indiana law stated above that it cannot use a hypothetical capital structure to fix rates"); Flowing Wells, Inc. , Cause No. 38719 U, p. 7, 1989 Ind. PUC LEXIS 310 at *19 (Aug. 30, 1989) (use of parent company's debt equity ratios rejected); Ind. Cities Water Corp. , Cause No. 38851, pp. 9-10, 1990 Ind. PUC LEXIS 229 at *15-16, 115 PUR4th 470, 478 (July 5, 1990) (OUCC's proposal to treat equity as debt and preferred stock at parent company's costs rejected because "artificially rais[ing] the utility's percentage of debt or artificially lower[ing] the utility's cost of equity" is inconsistent with the Indiana Bell case and "our guidance [from the Court] could not be clearer").

[2] The Commission has previously found that "under Indiana law, [the Commission] must take the capital structure of this Petitioner, and any other utility subject to its jurisdiction, as its finds it. [The Commission's findings] are based on facts, not speculation. *Hoosier Gas Corporation*, Cause No. 37541, February 28, 1985 ("*Hoosier Gas"*) at 16.

> One of the compelling reasons why regulatory bodies reject establishing rates based upon a hypothetical capital structure is quite simply that such ratemaking ignores reality. Such ratemaking would presume an ideal mixture of capital components which is theoretically beneficial to consumers, normally by "hypotheticating" the inclusion of a higher percentage of debt capital structure.

Id. at 19. In other words a hypothetical capital structure ignores the actual facts in existence at the time of the general rate proceeding and creates "phantom debt" to obtain an arguably more favorable result for the consumer. Whatever the methodology used to create and explain the use of phantom debt, in Indiana any use of a capital structure other than Petitioner's actual capital structure is illegal. Acknowledging that it cannot do indirectly what it cannot do directly, the Commission has refused to use testimony using creative accounting exercises to disguise the use of a hypothetical capital structure. *Terre Haute Gas*, Cause No. 38515, March 8, 1989, at 27.

OUCC Witness Dellinger's Testimony is Based on Hypothetical Capital Structure and Should be Struck from the Record

OUCC witness Dellinger's attempt to impose the debts of a wholly separate entity, L3 Corp. ("L3") on ASU, and to adjust ASU's capital structure based on this additional debt, is plainly unlawful and should be rejected. Instead of reviewing the actual capital structure of the Applicant, ASU, Mr. Dellinger attempts to impose a hypothetical capital structure on ASU based off of borrowings made by L3 Corp. The Indiana Supreme Court made clear in *Indiana Bell* it is the Commission's duty "to establish for [a utility] a schedule of rates which will produce a fair and non-confiscatory return upon its used and useful intrastate property…without regard to its relationship to other companies." Mr. Dellinger's testimony and recommendation regarding ASU's capital structure ignores the fact that L3 and ASU are wholly separate entities and improperly collapses the capital structures of the two entities. Mr. Dellinger's recommendation is therefore unlawful and must be rejected.

1. L3 is a wholly separate entity and its debt is not ASU's debt.

Mr. Dellinger acknowledges in his testimony that L3 is a wholly separate entity from ASU and his own testimony supports that L3's debt is not ASU's. Mr. Dellinger in his first page of testimony admits that L3 is ASU's affiliate, *see* Public's Exhibit No. 1 (Dellinger Testimony) at p. 1, lines 11-13. Further, ASU's financial statements attached to Mr. Dellinger's testimony as Attachment SD-5 clearly show ASU and L3 are separate entities. These financial statements were prepared pursuant to generally accepted accounting principles ("GAAP)" and L3's debt does not appear as liabilities anywhere on them. If L3's debts were ASU's debt for purposes of GAAP, these debts would have been included on the balance sheet. They were not, and trying to combine the debts for purposes of ASU's capital structure as Mr. Dellinger does would violate GAAP in addition to Indiana law.

Mr. Dellinger's testimony provides further proof that L3's debt is not ASU's and should not be treated as such. Mr. Dellinger says he *adjusts*: "ASU's capital structure to reflect the amount of debt for which ASU is *effectively responsible*." (*Emphasis added)*. Mr. Dellinger does not claim nor present evidence that the debt he is discussing is actually ASU's debt. The facts are that L3 and not ASU is the holder of the debt, yet Mr. Dellinger argues the Commission should consider L3's debt in ASU's capital structure: "ASU's proposed capital structure only recognizes the $5.1 Million of debt that was approved by the Commission in consolidated Cause Nos. 44676 and 44700. However, ASU's capital structure should recognize $12.7 Million of debt *incurred by its affiliate*…." Dellinger, p. 3, lines 11-14. (*Emphasis added)*. The Supreme Court found this unlawful 67 years ago. As described above *Indiana Bell* specifically found: "the fact that appellee [utility] has not used its own credit with which to raise additional capital is immaterial…." Mr. Dellinger dedicates a large portion of his testimony (pp. 5-33) discussing L3's debt. Mr. Dellinger attempts to push into ASU's capital structure additional debt in an

attempt to better consumers, which is precisely what the Commission warned against in *Indianapolis Water Company*.

2. Witness Dellinger raises extraneous issues, such as the guaranty, as a red herring to distract from the actual issue at hand.

Mr. Dellinger spends the majority of his testimony (pp. 3-40) arguing that because ASU guaranteed the payment of L3's debt this means L3 debts' should be recognized as ASU's. These arguments are red herrings meant to distract the reader from the real issue, which is that Mr. Dellinger asks the Commission to ignore 67 years of precedent and impose a hypothetical capital structure on ASU for purposes of this case.

Regarding the guaranty, Mr. Dellinger argues that because payments on the L3 debt depend on cash generated by ASU, and because ASU guaranties this debt, L3's borrowings are functionally the debt of ASU. *See* Dellinger Testimony at pp. 5-6. However, the Indiana Court of Appeals determined in *Kentucky-Indiana Municipal Power Assoc. v. Public Serv. Comm'n*, 181 Ind. App. 639, 393 N.E.2d 776, 782 (1979) that the Commission does not have jurisdiction to approve guaranties, and therefore the Commission does not have jurisdiction to interpret the effect of the guaranty on ASU's debt in this case. Numerous orders of the Commission subsequent to and in reliance on *Kentucky-Indiana* have ruled that the Commission has no jurisdiction to approve guaranties. *See Page American Communications of Indiana*, Cause No. 37767 (PSCI 6/27/1985); *Page American Communications of Indiana*, Cause No. 37683 (PSCI 2/6/1985); *Indiana Gas Co.*, Cause No. 36681, p. 9 (PSCI 12/10/1981) ("It is noted for this purpose that the loan would be indebtedness of the subsidiary. The guaranty of Petitioner would constitute only a contingent contractual liability of the subsidiary's obligations under the latter's indebtedness. In those circumstances the Commission finds and hereby determines that it does

not have jurisdiction to either grant or deny such request since a contingent liability of the character here involved does not constitute the issuance by the guarantor of an 'evidence of indebtedness.'"). To underscore this point, the Commission has no jurisdiction over these matters, and therefore has no jurisdiction to interpret the effect of either the guaranty on ASU's debt or its relationship to L3. For this reason, Mr. Dellinger's testimony regarding the effect of the guaranty on ASU's debt must be disregarded and should not be considered for purposes of determining ASU's capital structure.

Conclusion

Mr. Dellinger's testimony should be stricken, in its entirety, because it asks the Commission to impose a hypothetical capital structure on ASU which is unlawful under Indiana law and therefore has no bearing on this case. Additionally, because the Commission is duty bound to follow the law, as articulated in *Hoosier Gas*, and therefore will not approve a hypothetical capital structure the most efficient way to proceed in regards to Mr. Dellinger's unlawful testimony is to strike it from the record. Applicant should not be forced to waste time and resources responding to Mr. Dellinger's testimony.

WHEREFORE, ASU respectfully requests that the Commission strike Mr. Dellinger's testimony and granting to ASU such other relief as may be appropriate.

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned certifies that a copy of the foregoing has been served upon the following counsel of record by electronic mail this 10th day of May, 2022:

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