FILED
December 22, 2016
INDIANA UTILITY
REGULATORY COMMISSION

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF THE CITY OF EAST CHICAGO, INDIANA FOR AUTHORITY TO ISSUE BONDS, NOTES, OR OTHER OBLIGATIONS FOR AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR WATER SERVICE, AND FOR APPROVAL OF NEW SCHEDULES OF WATER RATES AND CHARGES.	)	**CAUSE NO. 44826**

SETTLEMENT TESTIMONY OF

EDWARD R. KAUFMAN – PUBLIC'S EXHIBIT NO. 3

ON BEHALF OF THE

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

DECEMBER 22, 2016

Respectfully submitted,

Daniel M. Le Vay, Atty. No. 22184-49
Deputy Consumer Counselor

TESTIMONY OF OUCC WITNESS EDWARD R. KAUFMAN, CRRA
CAUSE NO. 44826
CITY OF EAST CHICAGO MUNICIPAL WATER

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 a Chief Technical Advisor with the Water-Wastewater Division. My Qualifications and experience are set forth in Appendix A.

Q: What is the purpose of your testimony?

A: The OUCC and Petitioner have entered into a settlement. My testimony discusses the financial issues that were resolved as part of the settlement. I recommend the Commission approve the City of East Chicago's ("Petitioner" or "Water Utility") proposed $14,900,000 debt issuance, subject to certain adjustments and reporting requirement. I also recommend placing restrictions on Petitioner's debt service reserve that should be implemented to ensure the funds are available if needed.

II. ANNUAL DEBT SERVICE

Q: Please describe Petitioner's proposed debt issuance.

A: Petitioner proposes to borrow $14,900,000 for specified capital projects. The OUCC and Petitioner agreed on an amount for Petitioner's annual debt service and resolved several other concerns.

Q: Please describe the OUCC's concerns regarding Petitioner's proposed annual debt service.

A: First, Petitioner used its maximum annual debt service for its proposed revenue requirements, instead of its 5 year average annual debt service. Using the maximum debt service for Petitioner's proposed revenue requirements, overstates Petitioner's annual revenue requirements. Petitioner agreed to use a 5-year average debt service for its revenue requirements. However, the OUCC recognizes that Petitioner will use its maximum debt service to calculate its debt-service coverage ratio.

Second, the OUCC had concerns about Petitioner including in its proposed revenue requirements funds to pay for property that is not owned by the utility but that is owned by some but not all customers. More specifically, this refers to Petitioner's planned program to replace customer owned lead service lines through its "Customer Owned Replacement Match." While the OUCC does not wish to discourage this program, the OUCC considers it more appropriate that it be funded through other means. The parties agreed on an amortization schedule (total debt $14,900,000) that excludes the funds from the debt service calculation that would have been applied for Petitioner's proposed "Customer Owned Replacement Match" on its lead line replacement program.

Third, there are several items that should be expensed and amortized instead of being included in debt. OUCC witness, Richard Corey discusses these items.

Finally, the OUCC's position is that Petitioner should not issue debt and incur expenses before it needs to do so. Moreover, if Petitioner's rates are increased before debt is issued, Petitioner will collect funds in rates without a corresponding

expense. The ratemaking effect of collecting funds without a corresponding expense should be minimized to the extent possible.

A. <u>Debt Timing</u>

Q: Will there be a gap between the time Petitioner receives an order in this Cause and when it issues its proposed debt?

A: Petitioner cannot issue its proposed long-term debt until the Commission issues an order in this Cause, so there will necessarily be some amount of time between the date of the final order and the issuance of Petitioner's debt. However, between the implementation of the new rates and the issuance of debt, Petitioner will receive revenues to pay a debt service expense that is not being incurred. Therefore, Petitioner should expeditiously pursue the issuance of the debt through the State Revolving Fund after the approval has been given in the rate case.

Q: When does Petitioner anticipate it will issue its proposed debt?

A: Petitioner anticipates issuing its 2017 Bonds on June 1, 2017, which could create a gap of several months depending on when the order is issued.

Q: At what point would the gap between an order and the debt issuance become a concern?

A: Petitioner has agreed if it does not or cannot issue its debt within four months of a final order in this Cause, Petitioner will temporarily reserve the funds collected in rates for its 2017 debt and use those funds to reduce the amount it needs to fund its debt service reserve. For example, if Petitioner issued its proposed debt four months after the final order in this Cause, over which period it collected $25,000 per month for its 2017 debt, then it would use the $100,000 (4 * $25,000) it collected to reduce the amount it needs to collect for its debt service reserve.

Q: Is this proposal intended to be a penalty for not timely issuing debt?

A: No. This proposal matches revenues collected for Petitioner's proposed 2017 bonds against its actual expense for its 2017 bonds.

B. <u>True-up and Other Issues</u>

Q: Should reporting requirements be included as part of Petitioner's proposed debt issuance?

A: Yes. The precise interest rates and annual debt service will not be known until Petitioner's debt is issued; therefore, Petitioner's rates should be trued-up to reflect the actual cost of the debt. I recommend the Commission require Petitioner to file a report, within thirty (30) days of closing on its long term debt issuance with the Commission and serve a copy on the OUCC, explaining the terms of the new loan, including an amortization schedule, the amount of debt service reserve and an itemized account of all issuance costs. Regardless of the cost of the debt, the parties have agreed that the rate increase will not exceed 55%, and so there will be no changes to the tariff submitted with the Settlement Agreement.

Q: What other conditions should be placed on Petitioner's proposed debt issuance?

A: If Petitioner issues its debt for less than the amount authorized by the Commission, (unless otherwise agreed to by the parties) any unused financing authority should terminate.

C. <u>Debt Service Reserve</u>

Q: Is Petitioner seeking to recover funds for the debt service reserve on its proposed 2017 bonds through rates?

A: Yes. Petitioner's proposed rates include $64,332 per year to fund its debt service reserve for its 2017 bonds.

Q: How is Petitioner's debt service reserve calculated?

A: Petitioner's proposed rates include $64,332 per year to fund its debt service reserve. If Petitioner is authorized to issue its full proposed debt, I accept its estimated debt service reserve calculation.

Q: Should there be any restrictions on Petitioner's proposed debt service reserve?

A: Yes. Once an order is issued in this cause, Petitioner should deposit $64,332 per year into its debt service reserve fund. If Petitioner does not deposit $64,332 annually (through monthly deposits) into its debt service reserve fund during the five years following an order in this cause or spends any funds from its debt service reserves for any reason other than to make the last payment on its proposed 2017 debt issuance, Petitioner should be required to provide a report to the Commission and the OUCC within five (5) business days of said transaction. The report should state how much Petitioner spent from its debt service reserve, explain why it spent funds from its debt service reserve, provide a cite to any applicable loan documents that allow it to spend funds from its debt service reserve, describe its plans to replenish its debt service reserve, and explain any cost-cutting activities Petitioner has implemented to forestall spending funds from its debt service reserve.

III. OUCC RECOMMENDATIONS

Q: Please summarize your recommendations to the Commission in this Cause.

A:

1) I recommend the Commission authorize Petitioner to issue up to $14,900,000 in long-term debt at a maximum interest rate of 5.0%.

2) I recommend the Commission include $1,680,993 in Petitioner's rates for the annual debt service on its current debt and its proposed 2017 Bonds.

3) The following provisions have been included in the Settlement Agreement:

A. If Petitioner does not issue its proposed debt within 4 months after it has filed a revised tariff with the Commission, it should temporarily reserve the funds collected in rates for its 2017 debt and use those funds to prefund the debt service reserve.

B. Within thirty (30) days of closing on its long term debt issuance, Petitioner shall file a report with the Commission and serve a copy on the OUCC, explaining the terms of the new loan, including an amortization schedule, the amount of debt service reserve and all issuance costs. The report will not include a revised tariff because the parties have agreed that, regardless of the cost of the debt, the rate increase in this matter will not exceed 55%.

C. If Petitioner spends any of the funds from its debt service reserves for any reason other than to make the last payment on its proposed 2015 debt issuance; Petitioner shall provide a report (as described above) to the Commission and the OUCC within five (5) business days.

Q: Does this conclude your testimony?

A: Yes.

IV. APPENDIX A

Q: Please describe your educational background and experience.

A: I graduated from Bentley College in Waltham, Massachusetts with a Bachelors degree in Economics/Finance and an Associates 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 Masters of Science degree in Management with a concentration in finance.

I was hired as a Utility Analyst in the Economics and Finance Division of the OUCC in October 1990. 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.

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

A: Yes. I have testified before the Indiana Utility Regulatory Commission (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 also provided testimony on trackers, guaranteed performance contracts, declining consumption adjustments, and other issues.

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

A: I reviewed the Petition, testimony, and exhibits filed by Petitioner in this Cause. I participated in conducting discovery and reviewed Petitioner's responses. Finally, I reviewed publications such as Value Line which provide forecasted interest rates.

AFFIRMATION

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

Edward R. Kaufman
Indiana Office of Utility Consumer Counselor

December 22, 2016
Date

Cause No. 44826
City of East Chicago, Indiana
East Chicago Municipal Water

CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing ***OUCC'S Settlement Testimony of Edward R. Kaufman – Public's Exhibit No. 3*** has been served upon the following counsel of record in the captioned proceeding by electronic service on December 22, 2016.

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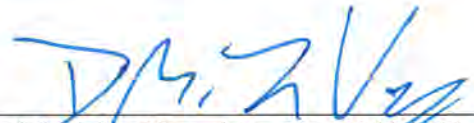

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