THE CITY OF EAST CHICAGO, INDIANA

INDIANA UTILITY REGULATORY COMMISSION

CAUSE NO. 44826

SETTLEMENT REBUTTAL TESTIMONY

OF

TED SOMMER

CITY OF EAST CHICAGO, INDIANA

CAUSE NO. 44826

SETTLEMENT REBUTTAL TESTIMONY OF TED SOMMER

Q. Please state your name, business address, and title.

A. My name is Ted Sommer. I am a Partner with the Firm of London Witte Group, LLC. My business address is 1776 North Meridian, Suite 500, Indianapolis Indiana 46202.

Q. Are you the same Ted Sommer that prefiled testimony in this Cause on behalf of Petitioner City of East Chicago?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. To respond to the Testimony and Exhibits of Mr. Michael P. Gorman filed in this cause.

Q. Are you convinced by Mr. Gorman's Testimony that the stipulation entered into between the OUCC and East Chicago is unreasonable?

A. No. In my prefiled direct testimony and testimony in support of settlement, I indicated that, consistent with my understanding of the statutory elements that govern the establishment of rates for municipalities in the State of Indiana, LWG's analysis indicates that an increase to the current water rates in excess of 100% is justified.

Q. Have you prepared additional support for that statement in response to Mr. Gorman's assertion that the settlement proposed increase will result in excess revenues?

A. Yes. Attachment TJS-A shows that the City would be justified to raise its rates by 125.91% by including the depreciation, PILT and Debt on plant at its full level, as well as the debt service that was issued in the amount of $27,200,000 through the State Revolving Fund in November of 2009.

Q. Would you please provide more detail on the $27,200,000 bond issue that you reference above?

A. Yes. In 2009, the City issued debt supported by Gaming Tax Revenues together with any other legally available funds of the Water Department the Department makes available and further secured by a Special Benefit Tax upon all property of the waterworks district. The debt was used solely to fund the new water plant. At that time the decision was made to not request that the water ratepayers pay for the new plant. The City is not currently requesting that the Bond Issue be funded by water rates, and it may never request that. However, Casino Fund availability has been declining and is anticipated to decline further, and so it may become necessary to ask the Commission to allow the City to recover what remains of that debt through revenue requirements of the water utility. Attachment TJS-B is the amortization schedule associated with that debt.

Q. Why are you providing all this information now?

A. My purpose in providing this information is to substantiate my prior assertions that an increase in excess of 100% would be statutorily justified. In spite of this justified increase, the City and the OUCC agreed to a settlement that results in only a 55% revenue increase. For all of the reasons stated in my settlement testimony, I believe that the settlement and the resulting rates are reasonable. Mr. Gorman's proposal that revenue requirements be lowered further should be rejected.

Q. Ironically, Mr. Gorman is critical that the City has not come in and previously raised its water rates and that the rate increase currently requested is too small. Do you have any comments?

A. Yes I do. I do not believe that the City should apologize for having some of the lowest water rates in Indiana. Mr. Gorman is critical of the City because it has not raised its rates in the past, yet his clients would be very much impacted by any such rate increases had they occurred. Based on 2015 revenues, Industrial customers make up 60% of the revenues collected by the City of East Chicago water utility. If the City requested rates that included the full level of PILT and Depreciation alone, Industrial Class rates would increase by $1,091,805 per year over the amount applicable to them in this case.

Q. Is Mr. Gorman correct that the Settlement overstates the cash needed to support East Chicago's E&R program and cash reserves by approximately $360,000 over the five-year period?

A. No, he is not. Mr. Gorman is assuming that the level of annual expenditures for Extensions & Replacements will never exceed the annual Depreciation Revenue Requirement for the life of Attachment MPG-A. As I have calculated in Attachment TJS-C, lines 20 through 26, an annual average of actual expenditures for Extensions & Replacements amounts to $1,236,185 which exceeds the annual Depreciation Revenue Requirement by $371,146. Thus, for the life of MPG-A, expenditures for Annual Extensions & Replacements would exceed the Depreciation Revenue Requirement for the same period by $1,855,730.

Q. Would you please address Mr. Gorman's Attachment MPG-A?

A. Yes. Mr. Gorman provides as Attachment MPG-A a schedule that shows excess cash of $1,014,707 being generated over the next five calendar years. That is not going to happen. First, a test year is a snapshot of operations. It is normalized and annualized with the understanding that what you are doing is painting a picture at a single point in time. The reader can be virtually assured that any one future year will be different from the projection. I have caused to be prepared Attachment TJS-C that differs from that of Mr. Gorman in certain key respects and, I believe, more accurately represents what may happen over the next five years. I have incorporated an expense inflation factor amounting to 3% applicable to O&M and Taxes Other than Income Taxes and 2.0% applicable to purchased power. Expenses will increase. Mr. Gorman assumes that every year the Depreciation and Extensions & Replacements are identical and that there are remaining funds that are available for putting in a cash reserve. Attachment TJS-C shows a negative cash balance each year and going forward through 2021. The primary differences lie in the following:

1) Actual Capital Improvement expenditures by or on behalf of the Water Department during 2014 and 2015 totaled $2,472,370.

2) The City through Resolution has determined that the Water Department shall pay back its Water Tank Refurbishment Fund.

3) The City has determined through ordinance, that the Water Department shall pay back the amount it owes the Sewer Utility.

Attachment TJS-C includes the funding for the Tank Refurbishment Fund and repayment of the Funds owed to the Sewer Utility over 4 years and 10 years, and uses a two-year average of historical Capital Improvements. These adjustments leave the water utility with a significant deficiency in cash reserves, not excess cash as Mr. Gorman suggests.

Q. Mr. Gorman indicates that the City should refinance the 2002 and 2006 debt to reduce revenue requirements. Can that be done?

A. Not at this time and likely not in the future. The 2002 SRF issue bears an interest rate of 2.90% which renders this issue non- refundable under current market rates. The 2006 bond issue cannot be refunded until at least March of 2017, and then only with a 2% premium. When last we checked the issue could not be refunded. We cannot even consider refunding either of these issues until the utility has adequate coverage to do so, and it will not have adequate coverage until and unless the Commission approves the proposed stipulation. Even then it is highly doubtful that we will be able to refund either of them given the current rising interest rate environment.

Q. Mr. Gorman suggests that the 2017 bond issue be reduced by $4.325 million dollars. Do you agree?

A. No. His proposed adjustment is based on using funds generated from the depreciation expense revenue requirement to fund a portion of the $14.9 million program budget for planned capital projects and that ignores non-debt funded annual capital improvement projects which would use the depreciation expense revenue requirement. The SRF staff does a careful job of vetting the requests of municipalities requesting funds. If it concludes that any of the capital improvements within the requested issue are unnecessary or inappropriate it will not allow the City to finance them.

Q. Does the stipulation envision a true up following the issuance of the SRF bonds as requested by Petitioner?

A. The City has agreed to file a true-up report describing the final terms of the 2017 Bonds, stating the amount of the debt service reserve, disclosing the final issuance costs, and including a final amortization schedule for the 2017 Bonds. Because the OUCC and the City have agreed that the overall rate increase will be held to 55%, it is not anticipated that a revised tariff (or hearing) will be required. The stipulation provides, however, a process for the OUCC to object to the true-up report and bring the matter before the Commission if necessary.

Q. On Page 8 of his testimony Mr. Gorman indicates that he is aware of a rate decision from 1988 that finds repaying inter-fund transfers through prospective rates is retroactive ratemaking. Do you have any comments on this?

A. Yes. The City has not included the repayment of these inter-fund loans as an adjustment to revenue requirements. Rather, the City has included within its work papers the Resolutions indicating that the funds were borrowed and need to be repaid as part of the explanation of why it is requesting the level of revenue requirements in this case.

Q. Mr. Gorman expresses an opinion that the woes of the City of East Chicago are at least partially of its own making, and that the customers are suffering negative consequences because of that. Do you have an opinion related to that testimony?

A. I fail to see how customers are suffering negative consequences. East Chicago water rates have not increased for ten years. Notwithstanding that, the City has not failed to deliver quality water in a timely manner. Under the Settlement, all customers are receiving quality water in a timely manner at a rate that is lower than it would be if the City requested full revenue requirements. The City has requested an increase that it believes it must have at this time to continue to provide quality service, and the OUCC agrees.

Q. On page 12 of his Testimony Mr. Gorman indicates that a short-term solution to a Cost of Service Study would be to hold rate block 4 where it is,

and only increase the other rate classes across the board. Do you have any comments on that recommendation?

A. Yes. Attachment TJS-D uses the total volumes from Confidential Attachment MPG-E to illustrate that just using those block 4 volumes (there are additional block 4 volumes not reflected in his exhibit) as identified in this schedule would result in a revenue requirement of at least 97.17% to all other customers who use less than 1,000,000 gallons per month. That exhibit also shows that a customer using 4,000 gal/mo. would pay under Mr. Gorman's proposal a rate at least 27% higher than the corresponding rate under the Settlement Agreement. This is unreasonable. The City filed its direct testimony on August 4th, 2016. The OUCC and the City filed its evidence supporting a stipulation on December 22nd. The City and the OUCC reached a stipulation following extensive data requests, discussions and visits by the OUCC to the utility. The Industrial Group declined to file testimony responding to East Chicago's case-in-chief, and no evidence was presented regarding rate design issues that would justify a departure from an across-the-board increase. The OUCC agrees that the City requires all of the revenue increase that it is requesting, and that it is acceptable to apply that revenue increase on an across-the-board basis. In my opinion, there is no need or basis to allocate the proposed revenue requirement differently across the base rate and the four volumetric blocks.

Q. Do you agree with Mr. Gorman's recommendations as to requiring the City to conduct a cost of service study before the next rate case and a revised cost of service study in any subsequent rate case?

A. No, I do not. Mr. Gorman suggests placing multiple future burdens on a community dealing with various circumstances and whose citizens are among those with the lowest median income in the State of Indiana. It is not prudent to make commitments now. In the event of a future rate case, the City may choose to conduct a cost of service study, especially given the additional information the AMI infrastructure will provide after installation. And even if it does not, the Industrial Group may also intervene at an earlier stage and request data permitting it to conduct its own cost of service study if it desires to interject concerns related to rate design. For these reasons, it is neither sensible nor necessary to order future cost of service studies be performed by the City.

Q Does that conclude your testimony?

A. Yes it does.

VERIFICATION

I, Theodore Sommer, affirm under penalties of perjury that the foregoing representations are true and correct to the best of my knowledge, information, and belief.

Theodore Sommer gdw

Theodore Sommer
Date: 1-13-16

Cause No. 44826

City of East Chicago Water Utility

Schedule of Revenue Requirements Not Requested

Line No.				
1	Full Depreciation (Petitioner's Case-In-Chief)		$ 1,652,694	
2	Depreciation Requested		$ (803,000)	
3	Depreciation Not Requested			$ 849,694
4	Full PILT (Petitioner's Case-In-Chief)		$ 1,569,981	
5	PILT Requested		$ (600,000)	
6	PILT Not Requested			$ 969,981
7	Depreciation and PILT not Requested			$ 1,819,675
8	Industrial portion of not requested amount (60%)		$ 1,091,805	
9	Debt Associated with New Plant*			
10		2018	$ 1,856,630.75	
11		2019	$ 1,858,274.25	
12		2020	$ 1,853,864.00	
13		2021	$ 1,853,400.00	
14		2022	$ 1,856,741.75	
15	Total New Plant Debt Paid over 5 Years		$ 9,278,910.75	
16	5 year average New Plant debt service			$ 1,855,782
17	Revenue Requirement Not Requested			$ 3,675,457
18	Revenue Requirements Requested			$ 2,552,584
19	Revenue Requirements Possible			$ 6,228,041
20	Proforma Present Rates (Petitioner's Case-In-Chief)			$ 4,946,304
21	Revenue Increase Request Possible			125.91%
22	* Funded by City resources other than Water Rates			

Dated: 11/12/2009
Delivered: 11/12/2009

Sizing Debt Service Schedule
EAST CHICAGO
$27,200,000 SRF LOAN @ 2.81% OVER 20 YRS

Fiscal Yr	Coupon Date	Zer Cpn	Cpn Rate	Maturing Principal	Periodic Interest	Gross Semi-Annl Dbt Svc	Cap Int	DbtSvcRsv Int & Prin	Constr. Fund Interest	Net Semi-Annl Dbt Svc	Net Fiscal Dbt Svc
10	1/15/10										
11	7/15/10				515,916.03	515,916.03				515,916.03	
11	1/15/11	N	2.810	980,000.00	382,160.00	1,362,160.00				1,362,160.00	1,878,076.03
12	7/15/11				368,391.00	368,391.00				368,391.00	
12	1/15/12	N	2.810	1,140,000.00	368,391.00	1,508,391.00				1,508,391.00	1,876,782.00
13	7/15/12				352,374.00	352,374.00				352,374.00	
13	1/15/13	N	2.810	1,170,000.00	352,374.00	1,522,374.00				1,522,374.00	1,874,748.00
14	7/15/13				335,935.50	335,935.50				335,935.50	
14	1/15/14	N	2.810	1,205,000.00	335,935.50	1,540,935.50				1,540,935.50	1,876,871.00
15	7/15/14				319,005.25	319,005.25				319,005.25	
15	1/15/15	N	2.810	1,240,000.00	319,005.25	1,559,005.25				1,559,005.25	1,878,010.50
16	7/15/15				301,583.25	301,583.25				301,583.25	
16	1/15/16	N	2.810	1,275,000.00	301,583.25	1,576,583.25				1,576,583.25	1,878,166.50
17	7/15/16				283,669.50	283,669.50				283,669.50	
17	1/15/17	N	2.810	1,310,000.00	283,669.50	1,593,669.50				1,593,669.50	1,877,339.00
18	7/15/17				265,264.00	265,264.00				265,264.00	
18	1/15/18	N	2.810	1,345,000.00	265,264.00	1,610,264.00				1,610,264.00	1,875,528.00
19	7/15/18				246,366.75	246,366.75				246,366.75	
19	1/15/19	N	2.810	1,385,000.00	246,366.75	1,631,366.75				1,631,366.75	1,877,733.50
20	7/15/19				226,907.50	226,907.50				226,907.50	
20	1/15/20	N	2.810	1,420,000.00	226,907.50	1,646,907.50				1,646,907.50	1,873,815.00
21	7/15/20				206,956.50	206,956.50				206,956.50	
21	1/15/21	N	2.810	1,460,000.00	206,956.50	1,666,956.50				1,666,956.50	1,873,913.00
22	7/15/21				186,443.50	186,443.50				186,443.50	
22	1/15/22	N	2.810	1,505,000.00	186,443.50	1,691,443.50				1,691,443.50	1,877,887.00
23	7/15/22				165,298.25	165,298.25				165,298.25	
23	1/15/23	N	2.810	1,545,000.00	165,298.25	1,710,298.25				1,710,298.25	1,875,596.50
24	7/15/23				143,591.00	143,591.00				143,591.00	
24	1/15/24	N	2.810	1,590,000.00	143,591.00	1,733,591.00				1,733,591.00	1,877,182.00
25	7/15/24				121,251.50	121,251.50				121,251.50	
25	1/15/25	N	2.810	1,630,000.00	121,251.50	1,751,251.50				1,751,251.50	1,872,503.00
26	7/15/25				98,350.00	98,350.00				98,350.00	
26	1/15/26	N	2.810	1,675,000.00	98,350.00	1,773,350.00				1,773,350.00	1,871,700.00
27	7/15/26				74,816.25	74,816.25				74,816.25	
27	1/15/27	N	2.810	1,725,000.00	74,816.25	1,799,816.25				1,799,816.25	1,874,632.50
28	7/15/27				50,580.00	50,580.00				50,580.00	
28	1/15/28	N	2.810	1,775,000.00	50,580.00	1,825,580.00				1,825,580.00	1,876,160.00
29	7/15/28				25,641.25	25,641.25				25,641.25	
29	1/15/29	N	2.810	1,825,000.00	25,641.25	1,850,641.25				1,850,641.25	1,876,282.50
				27,200,000.00	*8,442,926.03*	*35,642,926.03*	*0.00*	*0.00*	*0.00*	*35,642,926.03*	

True Interest Cost (TIC)	2.8095008	*Arbitrage Yield Limit (AYL)*	2.8095008
Net Interest Cost (NIC)...........................	2.8100000	*Arbitrage Net Interest Cost (ANIC)*	2.8100000

EAST CHICAGO MUNICIPAL WATER DEPARTMENT
East Chicago, Indiana

Line No.		OUCC Settlement	2017	2018	2019	2020	2021
1	Total Revenue	$ 7,579,345	$ 7,579,345	$ 7,579,345	$ 7,579,345	$ 7,579,345	$ 7,579,345
2	O&M	$ 3,250,211	$ 3,250,211	$ 3,347,717	$ 3,448,149	$ 3,551,593	$ 3,658,141
3	Purchased Power	821,401	821,401	837,829	854,586	871,677	871,677
4	Taxes Other Than Income Taxes	179,081	179,081	184,453	189,987	195,687	201,557
5	Debt Service - 5 Yr average	1,680,993					
6	Debt Service Reserve	64,332	-	-	-	-	-
7	PILT	600,000					
8	Working Capital	84,148	-	-	-	-	-
9	Depreciation	865,039					
10	URT	34,140	34,140	34,140	34,140	34,140	34,140
11	Operating Expenditures	$ 7,579,345	$ 4,284,833	$ 4,404,140	$ 4,526,861	$ 4,653,097	$ 4,765,515
12	Net Operating Income	$ 0	$ 3,294,512	$ 3,175,205	$ 3,052,483	$ 2,926,248	$ 2,813,829
13	Debt Service Reserve		(64,332)	(64,332)	(64,332)	(64,332)	(64,332)
14	PILT		(600,000)	(600,000)	(600,000)	(600,000)	(600,000)
15	Working Capital for build-up of required operating reserve		(84,148)	(84,148)	(84,148)	(84,148)	(84,148)
16	Debt Service		(1,574,109)	(1,703,678)	(1,708,159)	(1,709,699)	(1,709,318)
17	Available for payback to Sewer Fund, reconstitution of water tank fund and E&R		$ 971,923	$ 723,047	$ 595,845	$ 468,069	$ 356,031
18	Paybacks and E&R funded through rates (historical average)		(1,468,685)	(1,468,685)	(1,468,685)	(1,468,685)	(1,468,685)
19	Net Revenue Available for debt buy down		$ (496,762)	$ (745,638)	$ (872,840)	$ (1,000,616)	$ (1,112,654)
20	Capital Improvements through Water Department Funds						
21	2014	$ 1,080,820					
22	2015	476,550					
23	Capital Improvements for Water through City Funds						
24	2014 & 2015	915,000					
25	Total Improvements 2014 - 2015	$ 2,472,370					
26	Improvements - Annual Average	$ 1,236,185					
27	Amount Owed to Sewer Utility	1,400,000					
28	Amount Owed to Water Tank Refurbishment Fund	925,000					
29	Total Need in 2017 without amortization of the Repayments	$ 3,561,185					
30	Total Annual Need if amortize Repayments over four years	$ 1,817,435					
31	Total Annual Need if amortize Repayments over ten years	$ 1,468,685					

Repayments are in addition to the annual Working Capital actual set aside.

EAST CHICAGO MUNICIPAL WATER DEPARTMENT
East Chicago, Indiana

Line No.		OUCC Settlement	2017	2018	2019	2020	2021
1	Total Revenue	$ 7,579,345	$ 7,579,345	$ 7,579,345	$ 7,579,345	$ 7,579,345	$ 7,579,345
2	O&M	$ 3,250,211	$ 3,250,211	$ 3,347,717	$ 3,448,149	$ 3,551,593	$ 3,658,141
3	Purchased Power	821,401	821,401	837,829	854,586	871,677	871,677
4	Taxes Other Than Income Taxes	179,081	179,081	184,453	189,987	195,687	201,557
5	Debt Service - 5 Yr average	1,680,993					
6	Debt Service Reserve	64,332	-	-	-	-	-
7	PILT	600,000					
8	Working Capital	84,148	-	-	-	-	-
9	Depreciation	865,039					
10	URT	34,140	34,140	34,140	34,140	34,140	34,140
11	Operating Expenditures	$ 7,579,345	$ 4,284,833	$ 4,404,140	$ 4,526,861	$ 4,653,097	$ 4,765,515
12	Net Operating Income	$ 0	$ 3,294,512	$ 3,175,205	$ 3,052,483	$ 2,926,248	$ 2,813,829
13	Debt Service Reserve		(64,332)	(64,332)	(64,332)	(64,332)	(64,332)
14	PILT		(600,000)	(600,000)	(600,000)	(600,000)	(600,000)
15	Working Capital for build-up of required operating reserve		(84,148)	(84,148)	(84,148)	(84,148)	(84,148)
16	Debt Service		(1,574,109)	(1,703,678)	(1,708,159)	(1,709,699)	(1,709,318)
17	Available for payback to Sewer Fund, reconstitution of water tank fund and E&R		$ 971,923	$ 723,047	$ 595,845	$ 468,069	$ 356,031
18	Paybacks and E&R funded through rates (historical average)		(1,817,435)	(1,817,435)	(1,817,435)	(1,817,435)	(1,236,185)
19	Net Revenue Available for debt buy down		$ (845,512)	$ (1,094,388)	$ (1,221,590)	$ (1,349,366)	$ (880,154)
20	Capital Improvements through Water Department Funds						
21	2014	$ 1,080,820					
22	2015	476,550					
23	Capital Improvements for Water through City Funds						
24	2014 & 2015	915,000					
25	Total Improvements 2014 - 2015	$ 2,472,370					
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Repayments are in addition to the annual Working Capital actual set aside.

EAST CHICAGO MUNICIPAL WATER DEPARTMENT
East Chicago, Indiana

Analysis of Industrial Group Proposal

Line No.		Existing	Settlement	Difference	
			NO INCREASE TO BLOCK 4		
1	Average monthly Revenues from Blk 4	$ 170,078.00	$ -	$ -	
2	Months/year	12.00	12.00	12.00	
3	Average monthly revenue from Blk 4	$ 2,040,936.00	$ -	$ -	0.00%
4	Settlement offer to IG - Reduction to Blk 4			-	0.00%
5	Net Revenues from Blk 4			$ -	0.00%
6	Revenues at Current Rates	$ 4,703,042.00			
7	Percent of Revenues from Blk 4	43.40%			
8	Percent of Revenues from Base and Blks 1 - 3	56.60%			
9	Increased Revenues Needed ($100,000 decrease to OUCC Settlement)		$ 2,586,725.00	55.00%	
10	Revenues at Current Rates		$ 4,703,042.00		
11	Less: Estimated Blk 4 Revenues		(2,040,936.00)		
12	Revenues from Base Rate and Blks 1 - 3		$ 2,662,106.00		
13	Increased Revenues Needed ($100,000 decrease to OUCC Settlement)		$ 2,586,725.00		
14	Applicable increase to 4th Blk		-		
15	Increase applicable to Base and Blks 1 - 3		$ 2,586,725.00		
16	Percent Increase to Base Rates and Blks 1 - 3		97.17%		
17		Current	OUCC Settlement	IG Proposed	
18	Rate for 4,000 Gallons	$10.86	$16.83	$21.41	
19	Percentage Increase over Current Rates		55%	97%	
20	Percentage Increase ovse OUCC Settlement Rates			27%	
21	Additional Annual Rates Paid By 4,000 gals/mo. Customer		$71.64	$126.63	
22	Annual Impact to 4,000 gals./mo. Customers for IG's proposal over OUCC Settlement			$54.99	
23	Annual Savings to Users of Block 4 for no increase to Blk 4 (increase not applied across the board)			$ 1,122,537.32	