

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

**PETITION OF JACKSON COUNTY WATER)
UTILITY, INC., FOR AUTHORITY TO ISSUE) CAUSE NO. 44986
LONG TERM DEBT AND CHANGES TO ITS)
RATES, CHARGES AND TARIFF)**

TESTIMONY

OF

EDWARD R. KAUFMAN, CRRA - PUBLIC'S EXHIBIT NO. 6

ON BEHALF OF THE

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

November 8, 2018

Respectfully Submitted,



Daniel M. Le Vay, Atty. No. 22184-49

CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing *Office of Utility Consumer Counselor Testimony of Edward R. Kaufman, CRRA* has been served upon the following counsel of record in the captioned proceeding by electronic service on November 8, 2018.

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TESTIMONY OF OUCC WITNESS EDWARD R. KAUFMAN, CRRA
CAUSE NO. 44986 – PHASE II
JACKSON COUNTY WATER UTILITY, INC.

I. INTRODUCTION

1 **Q: Please state your name and business address.**

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

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

5 A: I am employed by the Indiana Office of Utility Consumer Counselor (“OUCC”) as
6 the Assistant Director with the Water-Wastewater Division. My Qualifications and
7 experience are set forth in Appendix A.

8 **Q: In Phase I of this case, Petitioner sought and was granted Commission**
9 **authority to issue up to \$7,500,000 in long term debt. What is Petitioner**
10 **seeking in Phase II?**

11 A: The Phase I portion of this rate case did not actually include an increase to
12 Petitioner’s rates. Petitioner now seeks revenue requirements that includes debt
13 service and debt service reserve for the loan it was authorized to issue in Phase I of
14 this cause.

15 **Q: Has Petitioner closed on its proposed debt authorized in Phase I?**

16 A: Yes. According to its September 14, 2018 filing, on August 16, 2018 Petitioner
17 issued long term debt of \$6,680,000 at a 2.30% interest rate for a term of 35 years.

18 **Q: What is the purpose of your Phase II testimony?**

19 A: Petitioner proposes to include its maximum annual debt service of \$1,160,255 in
20 its proposed pro forma annual revenue requirements.¹ My testimony explains that

¹ Petitioner’s highest annual debt service payment will occur in 2019.

Petitioner's request departs from good regulatory practice, which is to base the *pro forma* annual revenue requirement on an average debt service. I explain that setting rates based on the highest annual debt service results in rates that exceed the utility's annual revenue requirements. My testimony also explains why Petitioner's request to include \$74,119 in its annual revenue requirements for its proposed debt service reserve should be rejected.

Q: What have you done to prepare yourself to provide testimony in this cause?

A: I read the Petition and testimony provided in this cause. I also familiarized myself with Petitioner's Phase I rate request.

II. ANNUAL DEBT SERVICE

Q: What is the five year average annual debt service for Petitioner's combined loans?

A: The five year average annual debt service for Petitioner's combined loans, including its new SRF debt, is \$1,123,889. (See Petitioner's Exhibit E 1/1/2020 – 1/1/2024.)² Petitioner seeks to include its maximum annual debt service in rates, which it calculates as \$1,160,255. This amount is \$36,366 above the five year average.

Q: Is annual debt service typically based on an average annual expense?

A: Yes. Based on my experience, utilities that recover debt service in rates typically base their debt service revenue requirement on an average of the annual cost of debt service over a reasonable period. This period is usually based on the expected life of the anticipated rates (e.g. 5 years).

² Because a rate order will not be issued until early 2019, the payment due on 1/1/2019 should not be included in the five year average.

1 The Commission has expressed its belief that debt service revenue
2 requirements should be tied to the expense to be incurred over the life of the rates.
3 In the final order it issued in Cause No. 44306, the Commission expressed that
4 position in Citizens Water's rate case: "The Commission believes the rates should
5 match the actual expense incurred over the life of the rates." Final order, Cause
6 No. 44306, p. 33. If Jackson County is permitted to include its maximum annual
7 debt service in revenue requirements as it has proposed, Jackson County's rates
8 would not match its actual expense over the expected life of its rates.

9 **Q: What figures does the OUCC recommend the Commission use for Petitioner's**
10 **annual debt service?**

11 A: The OUCC recommends the Commission base Petitioner's rates on its five year
12 average debt service, or \$1,123,899.

III. DEBT SERVICE RESERVE

13 **Q: What is Petitioner's proposed revenue requirements for debt service reserve?**

14 A: Petitioner seeks to include \$74,119 per year in its revenue requirements for the debt
15 service reserve on its combined SRF debt. Mr. Ridlen's Exhibit F presents his
16 calculation of Petitioner's *pro forma* annual debt service reserve.

17 **Q: Do you agree with Petitioner's proposed *pro forma* annual debt service**
18 **reserve?**

19 A: No. Mr. Ridlen's Exhibit F shows that Petitioner needs \$370,594.20 to fund the
20 debt service reserve for its current debt, which includes its 2018 debt issuance. But
21 Mr. Ridlen's Exhibit F, Line 3 shows that the debt service reserve for Jackson
22 County's 2013 bonds is overfunded by \$378,692.50. Thus, Petitioner currently has
23 sufficient funds in its debt service reserve. Petitioner, therefore, does not need to

1 include funds for debt service reserve in its current revenue requirements.

2 Accordingly, I propose removing Petitioner's proposed debt service reserve from
3 its proposed revenue requirements.

4 **Q: Is there any reason Petitioner would not be able to use the excess funds in its**
5 **2013 debt service service reserve to fund the debt service reserve for its**
6 **proposed debt?**

7 A: I am not aware of any reason. However, if there is a restriction that prohibits
8 Petitioner from using its *excess* debt service reserve from one bond issuance to
9 another, then the funds in its 2013 debt service service reserve could be used to pay
10 off its 2013 debt.

11 **Q: Please explain how the funds in Petitioner's debt service reserve could be used**
12 **to pay off its 2013 bonds.**

13 A: Petitioner's Series 2013 Notes are scheduled to be paid off in full on January 1,
14 2023 (*See* Mr. Ridlen's Schedule E-3). A utility can use its debt service reserve
15 funds to pay off a loan, once the balance in the reserve account exceeds the
16 remaining balance on the loan.³ This is meaningful because the debt service reserve
17 associated with Petitioner's 2013 Note has a balance of \$519,725. (*See* Petitioner's
18 Exhibit F, line 2). By the time an order is issued in this cause, the remaining balance
19 for Jackson County's 2013 debt will be \$523,675. Thus, Petitioner has sufficient
20 funds in the debt service reserve associated with its 2013 note to entirely pay the
21 loan off in 2019.

³ The utility does not need to pay off its loan in advance, but could simply recognize it has funds specifically dedicated to pay-off the designated loan.

1 **Q: If Petitioner used the debt service reserve for its 2013 bonds, how would that**
2 **effect its revenue requirements?**

3 A: Petitioner's revenue requirements should be reduced so that it does not include debt
4 service for its 2013 bonds. Removing the annual debt service associated with
5 Petitioner's 2013 bond from its revenue requirements reduces its 5 year average
6 annual debt service by \$104,735 ($\$523,675 / 5 = \$104,735$).⁴

7 **Q: If the debt service for Petitioner's 2013 bonds are removed from revenue**
8 **requirements, should Petitioner's proposed debt service reserve be included in**
9 **its proposed revenue requirements?**

10 A: Yes. Petitioner has \$519,725 in the debt service reserve associated with its 2013
11 bonds. The maximum debt service for Petitioner's 2013 debt is \$140,000. Thus,
12 Petitioner has excess funds \$378,962.50 in the debt service reserve for its 2013
13 bonds. I have proposed that the excess funds be used to fund the debt service
14 reserve for Petitioner's proposed 2018 bonds. Alternatively, these funds could be
15 used to pay-off Petitioner's 2013 debt. But if these funds are used to pay off its
16 2013 debt, then Petitioner will need to include funds in its current revenue
17 requirements for the debt service reserve for its 2018 bonds.

18 **Q: Would applying the excess 2013 debt service reserve funds to Petitioner's 2013**
19 **debt produce a similar reduction to revenue requirements as your proposed**
20 **adjustments to debt service and debt service reserve?**

21 A: Yes. I have proposed a \$33,366 reduction to debt service and a \$74,119 reduction
22 to debt service reserve (a total annual reduction of \$110,485). Applying the 2013
23 debt service reserve to pay off Petitioner's 2013 debt reduces Petitioner's annual

⁴ While Petitioner only has 4 years remaining on its 2013 loan, it is still appropriate to divide the remaining balance by five years to match my average annual debt service calculation. If a five year average is used to determine average annual debt service dividing the remaining loan balance by four years would overstate the impact of removing the 2013 loan from Petitioner's revenue requirements.

1 debt service by \$104,735, but it does not affect Petitioner's *pro forma* debt service
2 reserve revenue requirement.

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

4 A: Yes. If Petitioner spends any funds from its debt service reserve for any reason
5 other than to make the final payment(s) on its currently outstanding debt issuances,
6 Petitioner should be required to provide a report to the Commission and the OUCC
7 within five (5) business days of said transaction. The report should state how much
8 Petitioner spent from its debt service reserve, explain why it spent funds from its
9 debt service reserve, provide a citation to any applicable loan documents that allow
10 it to spend funds from its debt service reserve, describe its plans to replenish its
11 debt service reserve, and explain any cost-cutting activities it has implemented to
12 forestall spending funds from its debt service reserve.

IV. UNUSED BORROWING AUTHORITY

13 **Q: Because Petitioner was granted authority to issue long term debt of \$7,500,000**
14 **but only issued \$6,680,000, it still has \$820,000 in unused borrowing authority.**
15 **Should Petitioner's unused borrowing authority be considered retained by**
16 **Petitioner?**

17 A: No. If the unused borrowing authority is considered retained, then Petitioner could
18 seek to issue long term debt of up \$820,000 without first disclosing the terms to the
19 OUCC or the IURC. Petitioner was authorized to issue long term debt based on a
20 specified need and specified terms. If Petitioner is permitted to use this debt
21 authority it would do so without establishing the need and without disclosing the
22 terms. Thus, it would circumvent any review by the OUCC or the Commission. If
23 Petitioner has needs for future debt authority, it should apply for permission from
24 the Commission. Debt issuances need to be transparent and properly reviewed.

1 Allowing Petitioner to retain unused debt authority to use at a future point with
2 undisclosed terms circumvents any proper review. Allowing a utility to indefinitely
3 retain unused borrowing authority reduces transparency and prevents the OUCC
4 and the IURC from evaluating future debt issuances. Petitioner has not indicated it
5 has plans to use its remaining unused borrow authority. Nonetheless, the
6 Commission should consider making it explicitly clear that Petitioner has already
7 used the authority it received to issue debt in Phase I of this Cause.

V. SUMMARY AND CONCLUSION

8 **Q: Please state the OUCC's recommendations.**

9 A: I recommend that the Commission use a five year average to calculated Petitioner's
10 annual debt service. A five year average results in an average debt service of
11 \$1,123,899. I recommend Petitioner's request to include \$74,119 in revenue
12 requirements for debt service reserve be determined unnecessary and rejected. I
13 recommend Petitioner's debt service reserve be restricted as described above.
14 Finally, I recommend the Commission explicitly state that Petitioner does not retain
15 unused borrowing authority of \$820,000.

16 **Q: Does this conclude your direct testimony?**

17 A: Yes.

APPENDIX A

1 **Q: Please describe your educational background and experience.**

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

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

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

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

AFFIRMATION

I affirm the representations I made in the foregoing testimony are true to the best of my knowledge, information, and belief.




By: Edward R. Kaufman

Cause No. 44986

Indiana Office of

Utility Consumer Counselor



Date: