

**FILED**  
March 27, 2020  
INDIANA UTILITY  
REGULATORY COMMISSION

**STATE OF INDIANA**

**INDIANA UTILITY REGULATORY COMMISSION**

**IN THE MATTER OF THE PETITION OF LMH )  
UTILITIES, INC. FOR A NEW SCHEDULE OF ) CAUSE NO. 45307-U  
RATES AND CHARGES. )**

**PREFILED TESTIMONY**

**SHAWN DELLINGER – PUBLIC’S EXHIBIT NO. 4**

**ON BEHALF OF THE**

**INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR**

**March 27, 2020**

Respectfully submitted,



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

**CERTIFICATE OF SERVICE**

This is to certify that a copy of the foregoing *Office of Utility Consumer Counselor* *Prefiled Testimony of Shawn Dellinger* has been served upon the following counsel of record in the captioned proceeding by electronic service on March 27, 2020.

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**TESTIMONY OF OUCC WITNESS SHAWN DELLINGER**  
**CAUSE NO. 45307-U**  
**LMH UTILITIES, INC.**

**I. INTRODUCTION**

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

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

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

5 A: I am a Utility Analyst II in the Water/Wastewater division employed by the Indiana  
6 Office of Utility Consumer Counselor (OUCC). My focus is on financial matters.

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

8 A: My credentials are set forth in Appendix A.

9 **Q: What is the purpose of your testimony?**

10 A: LMH Utilities, Inc. (hereafter "LMH" or "Applicant") is a small investor owned  
11 utility that seeks a return on its investment in this application. My testimony  
12 addresses LMH's Cost of Debt and Cost of Equity as components of its Weighted  
13 Average Cost of Capital (WACC). Based on my review and analysis, I recommend  
14 the Commission find for ratemaking purposes that LMH's Cost of Equity is 8.5%.  
15 I also recommend that LMH be required to refinance its debt and file a true-up  
16 incorporating a lower interest rate. OUCC witness Margaret Stull will recommend  
17 a Weighted Average Cost of Capital for LMH and address how it should be  
18 incorporated into LMH's rates.

1 **Q: Please describe the review and analysis you conducted in order to prepare**  
2 **your testimony.**

3 A: I reviewed the application LMH filed in this Cause. I reviewed past Commission  
4 orders regarding LMH – particularly LMH's last rate case (Cause No. 43431) and  
5 its last financing case (Cause No. 43798). I reviewed LMH's response to OUCC  
6 discovery requests.

## II. COST OF DEBT

7 **Q: What is the current Cost of Debt according to the Applicant?**

8 A: LMH's Application indicates that, as of December 31, 2018, its weighted cost of  
9 debt is 6.17%<sup>1</sup>.

10 **Q: Is this the correct cost of debt?**

11 A: No. The calculations are correct in terms of taking the total interest paid for the  
12 test year for each of the three loans outstanding at that time, and the total ending  
13 balance of those three loans. However, this is not the true cost of debt since the  
14 outstanding balances are being paid down through the test year. The correct  
15 weighted cost of debt should be 6.42%. See OUCC Attachment SD-1 for my  
16 worksheet regarding this calculation, with individual loan rates based on  
17 Applicant's responses to OUCC DR-2-2.

18 **Q: What is LMH's Cost of Debt?**

19 A: LMH's application stated its cost of debt is 6.17%, but I have calculated it to be  
20 slightly higher. Based on my calculation applied to LMH's inputs, the cost of debt  
21 for all three loans, as of the end of the test year, is 6.42%. LMH's cost of debt is  
22 much higher than it should reasonably be. The primary loan (more than 95% of

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<sup>1</sup> Cause No. 45307-U, Application Schedule 8

1 LMH's total debt as of December 31, 2018) is currently at a 6.5% interest rate. The  
2 two other loans have been paid off as of the time of this testimony. The interest  
3 rate of the remaining loan is Prime plus 1%. However, the terms of the loan put a  
4 floor in place of 6.5%. Without the floor in place, the current interest rate on this  
5 loan would be about 4.25%<sup>2</sup>.

6 **Q: Do you believe that the 6.5% interest rate is appropriate to include in the**  
7 **calculation of the weighted cost of capital?**

8 A: No. The interest rate is unreasonable as it is higher than reasonably necessary. In  
9 response to OUCC DR-5-8, LMH stated it could refinance this loan at 5.5%, with  
10 fees of approximately \$4,000-\$6,000. (See OUCC Attachment SD-3.) Taking the  
11 midpoint of these fees and assuming a ten year amortization, the total cost of debt  
12 would be 5.54%<sup>3</sup>. However, after this response from Applicant, I procured from  
13 Regions Bank an indicative rate quote of 4.1%-4.25%. (See OUCC Attachment  
14 SD-2.)

15 **Q: Has LMH previously recognized the opportunity to lower its cost of debt?**

16 A: Yes. In LMH's last financing case (Cause No. 43798), Mr. Tucker expressed his  
17 intent "to watch the interest rates and if appropriate, pre-pay this loan and lock it in  
18 at a reasonable fixed rate."<sup>4</sup> Prudency dictates this debt should be refinanced at this

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<sup>2</sup> The Prime Rate effective March 16th, 2020 is 3.25%. My source is [www.fedprimerate.com](http://www.fedprimerate.com). This was not the prime rate at the time of the Application or at the time of the Applicant's response to DR-5-8. Due to the recent extreme volatility in the financial markets, this rate has changed multiple times since this cause has been filed.

<sup>3</sup> Taking a balance of \$689,915, adding \$5,000, and taking 5.5% interest on this total amount, but determining rate based only on the \$689,915 existing balance. Total Interest would be \$38,220.33 annualized for this balance.

<sup>4</sup> Cause No. 43798, Direct Testimony of Mr. Jay T. Tucker. Page 3, lines 8-9.

1 time. This recommendation to refinance the loan to achieve a cost savings is  
2 consistent with Mr. Tucker's previous statement.

3 **Q: Do you recommend rates be based on a cost of debt of 4.1%-4.25%?**

4 A: No. I recommend that rates be based on LMH's actual cost of debt of 6.42% with  
5 the requirement that within 30 days of the order LMH refinance its single  
6 outstanding loan to secure a more reasonable interest rate. Thereafter, LMH should  
7 file a report indicating its revised cost of debt and provide a revised tariff  
8 incorporating that change. There may be fees and other costs that would affect the  
9 cost of debt. Therefore, I would expect LMH should be able to secure refinancing  
10 at an interest rate of approximately 4.3%.<sup>5</sup>

### **III. COST OF EQUITY**

11 **Q: What is the LMH's requested cost of equity?**

12 A: As of its revised submission dated January 17, 2020, LMH is requesting a cost of  
13 equity of 9.00%.<sup>6</sup>

14 **Q: Did LMH provide any support for its proposed 9.0% cost of equity?**

15 A: No. The Application provided no detail on how LMH determined that a 9.00%  
16 return on equity was appropriate.

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<sup>5</sup> This is based on 4.25% (the high end of the indicative range) and an additional .05% added for potential fees (rounded up from the .04% reflected on the potential refinancing referenced in DR-5-8). The Prime rate has fallen since this indicative rate was provided, so this is providing a further conservative bias to the true rate that may be able to be attained. It is also very similar to the interest rate on the primary loan for the applicant if the floor is removed (Prime +1%).

<sup>6</sup> In the LMH's original Application dated 10/16/19, the requested Cost Rate for Common Equity was provided as 8.75%. No reason was given for either this original rate or the revision in the updated application on 1/17/20.

1 **Q: How does the current interest rate environment affect the cost of equity?**

2 A: I did not perform a full cost of equity analysis as part of this cause. However, some  
3 factors are worth noting. Using the CAPM (Capital Asset Pricing Model) method,  
4 the cost of equity consists of the risk free rate of return + the risk premium. If we  
5 use the current 10 year treasury as the risk free rate, the risk free rate has fallen from  
6 1.84% to 1.02%<sup>7</sup>. The specific numbers aren't as important as the current general  
7 trend of lowering interest rates. Since this is a substantial portion of the cost of  
8 equity formulation, this implies that the cost of equity should have changed by a  
9 similar magnitude, and in a similar direction.

10 **Q: How does the capital structure affect the cost of equity?**

11 A: The cost of equity represents the return that the owner of a business should expect  
12 in the future. It is affected by the type of business (railroads or biotechnology will  
13 generally be higher, utilities will generally be lower<sup>8</sup>), the size of the company  
14 (larger companies will generally be lower, and smaller companies correspondingly  
15 higher), the capital structure and company specific factors. The focus here is on  
16 the capital structure impact. Cost of equity increases as the percentage of debt in  
17 the capital structure increases. This is basic financial theory, and is shown in the  
18 graph below<sup>9</sup>, where the cost of equity is labeled  $k_e$ .

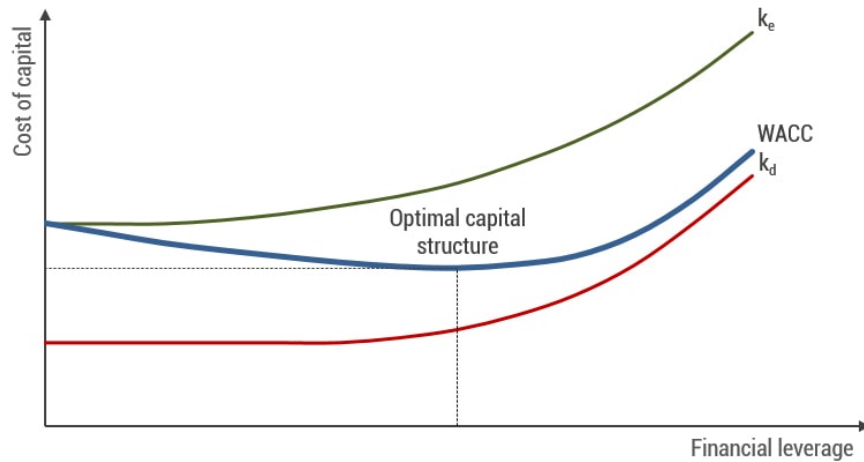
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<sup>7</sup> From ycharts.com, rate of 1.84% on January 17<sup>th</sup>, 2020 and 1.02% on March 17<sup>th</sup>, 2020.  
[https://ycharts.com/indicators/10\\_year\\_treasury\\_rate](https://ycharts.com/indicators/10_year_treasury_rate)

<sup>8</sup> Railroads are 2.05 unlevered Beta, Biotech is 1.32 unlevered Beta, and General Utilities are 0.17 unlevered Beta. For 2019, from Damodoran of Stern business school. <http://pages.stern.nyu.edu/~adamodar/>

<sup>9</sup> This particular graph is from www.financial managementpro.com, but the same general graph would be available from hundreds of sources.





1 The graphic above illustrates that the cost of equity is relatively low when the  
2 amount of debt in the capital structure is low. This is because there is less risk for  
3 the owner when there is less debt. As debt increases, risk increases. Thereafter,  
4 the return the owner will require will also increase.

5 **Q: Does the graph illustrate that 9% COE is too high?**

6 A: No. There are no numbers on this graph. Every company and situation is different.  
7 What the graph does illustrate is the logical certainty that the cost of equity will  
8 increase as the capital structure includes a lower percentage of equity and a  
9 correspondingly higher percentage of debt. All other things being equal, a capital  
10 structure with debt of 50% is more risky than a capital structure of 80% equity and  
11 only 20% debt. As of December 31, 2018, LMH has a capital structure broadly  
12 similar to the latter. As of the time of this testimony, the percentage of debt is lower  
13 still, and it appears the goal is now to lower the percentage of debt in the capital

1 structure substantially to zero over the next decade.<sup>10</sup>

2 **Q: What is an appropriate cost of equity for LMH?**

3 A: I believe 8.5% would be appropriate at the current capital structure. I believe the  
4 9% rate requested by the Applicant would be appropriate if the capital structure was  
5 more weighted to debt. Therefore, unless other proposals are made by Applicant  
6 to leverage the capital structure by taking on more debt, I believe an 8.5% cost of  
7 equity is in the best interest of the ratepayers, while being fair to the Applicant.

#### IV. OUCC RECOMMENDATIONS

8 **Q: Please summarize your recommendations to the Commission in this cause.**

9 A: I recommend a Cost of Equity of 8.5% and a Cost of Debt of 6.42%. I also  
10 recommend that the Commission require LMH to refinance its single outstanding  
11 loan to secure a more reasonable interest rate within 30 days of the order.  
12 Thereafter, LMH should file a report indicating its revised cost of debt and provide  
13 a revised tariff incorporating that change.

14 **Q: Does this conclude your testimony?**

15 A: Yes.

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<sup>10</sup> In the response to DR-5-8, Applicant states it does not intend to extend the 10 year amortization on the \$389,915 loan. Based on the provided amortization schedules, this loan will thus be completely paid off in December 2029. See OUCC Attachment SD-3.

**Appendix A**

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

2 A: I graduated from Indiana University with a degree in Biology, a minor in  
3 Economics and a certificate from the Liberal Arts and Management Program  
4 (LAMP) which is an honors certificate program through the Kelley School of  
5 Business and the College of Arts and Sciences, at the time restricted to twenty five  
6 (25) students per year. After spending time in the job market, I received my MBA  
7 from Indiana University with a concentration in finance. During my educational  
8 career I was invited and joined both Phi Beta Kappa honor society for  
9 undergraduate work and Beta Gamma Sigma honor society for graduate work.

10 **Q: Please describe your work experience.**

11 A: My first positions after graduating with my undergraduate degree were in New  
12 York in finance at Grant's Interest Rate Observer, which is a financial newsletter  
13 and Lebenthal and Co., which was a municipal bond brokerage. I worked at RCI  
14 Sales, which was a manufacturer's representative/distributor in the commercial and  
15 institutional plumbing space, as the owner for a number of years, leaving when I  
16 sold the company and merged it into a competitor. After receiving my MBA, I  
17 worked at Amazon as a financial analyst in their fulfillment division.

18 **Q: How long have you been at the OUCC?**

19 A: I have been a Utility Analyst II in the water division at the OUCC since December  
20 of 2019. My focus is financial issues, such as ROE's, Capital Structures, etc.

Cost of Debt Calculation

Interest Rates from Petitioners Response to DR-2-2

First page from each loan amortization from DR-2-2 Follows

Description	Balance	Interest Rate	Weighted Rate
Bank Loan 1 (CiVista)	\$ 389,915.00	6.50%	6.27%
Bank Loan 2 (CiVista)	\$ 6,705.00	2.03%	0.03%
Bank Loan 3 (Ally)	\$ 7,560.00	6.18%	0.12%
Total	\$ 404,180.00		6.42%

LMH CiVista

Compound Period ..... : Monthly

Nominal Annual Rate .... : 6.500 %

CASH FLOW DATA

Event	Date	Amount	Number	Period	End Date
1 Loan	12/12/2018	389,915.00	1		
2 Payment	01/12/2019	4,147.47	131	Monthly	11/12/2029
3 Payment	12/12/2029	3,167.33	1		

AMORTIZATION SCHEDULE - Normal Amortization

	Date	Payment	Interest	Principal	Balance
Loan	12/12/2018				389,915.00
2018 Totals		0.00	0.00	0.00	
1	01/12/2019	4,147.47	2,112.04	2,035.43	387,879.57
2	02/12/2019	4,147.47	2,101.01	2,046.46	385,833.11
3	03/12/2019	4,147.47	2,089.93	2,057.54	383,775.57
4	04/12/2019	4,147.47	2,078.78	2,068.69	381,706.88
5	05/12/2019	4,147.47	2,067.58	2,079.89	379,626.99
6	06/12/2019	4,147.47	2,056.31	2,091.16	377,535.83
7	07/12/2019	4,147.47	2,044.99	2,102.48	375,433.35
8	08/12/2019	4,147.47	2,033.60	2,113.87	373,319.48
9	09/12/2019	4,147.47	2,022.15	2,125.32	371,194.16
10	10/12/2019	4,147.47	2,010.64	2,136.83	369,057.33
11	11/12/2019	4,147.47	1,999.06	2,148.41	366,908.92
12	12/12/2019	4,147.47	1,987.42	2,160.05	364,748.87
2019 Totals		49,769.64	24,603.51	25,166.13	
13	01/12/2020	4,147.47	1,975.72	2,171.75	362,577.12
14	02/12/2020	4,147.47	1,963.96	2,183.51	360,393.61
15	03/12/2020	4,147.47	1,952.13	2,195.34	358,198.27
16	04/12/2020	4,147.47	1,940.24	2,207.23	355,991.04
17	05/12/2020	4,147.47	1,928.28	2,219.19	353,771.85
18	06/12/2020	4,147.47	1,916.26	2,231.21	351,540.64
19	07/12/2020	4,147.47	1,904.18	2,243.29	349,297.35
20	08/12/2020	4,147.47	1,892.03	2,255.44	347,041.91
21	09/12/2020	4,147.47	1,879.81	2,267.66	344,774.25
22	10/12/2020	4,147.47	1,867.53	2,279.94	342,494.31
23	11/12/2020	4,147.47	1,855.18	2,292.29	340,202.02
24	12/12/2020	4,147.47	1,842.76	2,304.71	337,897.31
2020 Totals		49,769.64	22,918.08	26,851.56	
25	01/12/2021	4,147.47	1,830.28	2,317.19	335,580.12
26	02/12/2021	4,147.47	1,817.73	2,329.74	333,250.38
27	03/12/2021	4,147.47	1,805.11	2,342.36	330,908.02
28	04/12/2021	4,147.47	1,792.42	2,355.05	328,552.97

LMH CiVista Passport

Compound Period ..... : Monthly

Nominal Annual Rate .... : 2.025 %

CASH FLOW DATA

Event	Date	Amount	Number	Period	End Date
1 Loan	12/22/2018	6,705.00	1		
2 Payment	01/22/2019	565.84	11	Monthly	11/22/2019
3 Payment	12/22/2019	554.42	1		

AMORTIZATION SCHEDULE - Normal Amortization

Date	Payment	Interest	Principal	Balance
Loan 12/22/2018				6,705.00
2018 Totals	0.00	0.00	0.00	
1 01/22/2019	565.84	11.31	554.53	6,150.47
2 02/22/2019	565.84	10.38	555.46	5,595.01
3 03/22/2019	565.84	9.44	556.40	5,038.61
4 04/22/2019	565.84	8.50	557.34	4,481.27
5 05/22/2019	565.84	7.56	558.28	3,922.99
6 06/22/2019	565.84	6.62	559.22	3,363.77
7 07/22/2019	565.84	5.68	560.16	2,803.61
8 08/22/2019	565.84	4.73	561.11	2,242.50
9 09/22/2019	565.84	3.78	562.06	1,680.44
10 10/22/2019	565.84	2.84	563.00	1,117.44
11 11/22/2019	565.84	1.89	563.95	553.49
12 12/22/2019	554.42	0.93	553.49	0.00
2019 Totals	6,778.66	73.66	6,705.00	
Grand Totals	6,778.66	73.66	6,705.00	

LMH Ally

Compound Period ..... : Monthly

Nominal Annual Rate .... : 6.180 %

CASH FLOW DATA

Event	Date	Amount	Number	Period	End Date
1 Loan	12/09/2018	7,560.00	1		
2 Payment	01/09/2019	611.62	12	Monthly	12/09/2019
3 Payment	01/09/2020	492.25	1		

AMORTIZATION SCHEDULE - Normal Amortization

Date	Payment	Interest	Principal	Balance
Loan 12/09/2018				7,560.00
2018 Totals	0.00	0.00	0.00	
1 01/09/2019	611.62	38.93	572.69	6,987.31
2 02/09/2019	611.62	35.98	575.64	6,411.67
3 03/09/2019	611.62	33.02	578.60	5,833.07
4 04/09/2019	611.62	30.04	581.58	5,251.49
5 05/09/2019	611.62	27.05	584.57	4,666.92
6 06/09/2019	611.62	24.03	587.59	4,079.33
7 07/09/2019	611.62	21.01	590.61	3,488.72
8 08/09/2019	611.62	17.97	593.65	2,895.07
9 09/09/2019	611.62	14.91	596.71	2,298.36
10 10/09/2019	611.62	11.84	599.78	1,698.58
11 11/09/2019	611.62	8.75	602.87	1,095.71
12 12/09/2019	611.62	5.64	605.98	489.73
2019 Totals	7,339.44	269.17	7,070.27	
13 01/09/2020	492.25	2.52	489.73	0.00
2020 Totals	492.25	2.52	489.73	
Grand Totals	7,831.69	271.69	7,560.00	



March 6, 2020

Indiana Office of Utility  
Consumer Counselor  
115 West Washington Street  
Suite 1500 South  
Indianapolis, IN 46204  
ATTN: Shawn Dellinger

Re: Indicative Interest Rate for LMH Utilities

Dear Shawn:

On behalf of Regions Bank, I am pleased to present you an indicative rate range for a \$390,000 10-year taxable loan for LMH Utilities. The range would be between 4.10% and 4.25% if closed today. Please note that this rate range is an indicative and **should not be considered a commitment** from Regions Bank. Regions Bank would need to perform a full credit review and determine if there is potential for other banking services with the Utility before a commitment can be offered for this transaction.

Please let me know if you have any questions, or if I can be of any further assistance.

Sincerely,

A handwritten signature in black ink, appearing to read "William J. Harris II" with a stylized flourish and the letters "VP" at the end.

William J. Harris II  
Vice President  
Government and Institutional Banking



A.

- a. There was no formal agreement.
- b. The loan originated in 2009 to pay for legal fees incurred when a lender for common shareholders demanded payment on a note. No services were rendered.
- c. The receivable is non-interest bearing.
- d. The receivable is non-interest bearing.
- e. No stated maturity.
- f. The receivable was paid in full during 2019.

**Q-5-8:** Regarding Bank Loan 1 (balance of \$389,915 as of 12/2019), with United Community Bank:

- a. Please advise if this loan may be refinanced with United Community Bank or an alternate lender, at a fixed rate and appropriate term.
- b. Please advise at what rate this may be refinanced and what fees would be incurred.

A.

- a. United Community Bank was purchased by CiVista. CiVista is willing to refinance. The loan is currently in the 10th year of a 20-year amortization and the Applicant does not wish to extend that term.
- b. The Applicant did not request a formal loan proposal, but rates for a 10-year amortization are estimated at 5.5% with closing costs of \$4,000-\$6,000.

**Q-5-9:** Applicant is requesting recovery of \$66,934 of rate case expense per expense adjustment no. 8. Please answer the following questions:

- a. Do these costs relate only to Cause No. 45307-U?
- b. If the response to (a) is no, please state the amount of estimated costs included in the \$66,934 related to the rate case, Cause No. 45307-U.
- c. Please provide the estimated rate case costs for CN 45307-U by legal, accounting, engineering, or other consulting fees as well as any other costs included in the estimate. Please include the estimated number of hours and the hourly rates agreed upon.
- d. Please provide each consultant contract entered into for rate case services.
- e. Please state the amount of rate case costs incurred to date for each type of rate case expense.
- f. Please state the basis for Applicant's three-year amortization period.
- g. Do any of these costs relate to Cause No. 45032-S17? If yes, please state the amount included and provide all supporting documentation for these costs, including invoices and contracts.