

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF COMMUNITY NATURAL GAS)
CO. INC. FOR AUTHORITY TO CHANGE ITS)
RATES, CHARGES, TARIFFS, RULES, AND) CAUSE NO. 45214
REGULATIONS)

DIRECT TESTIMONY

OF

EARL L. RIDLEN

ON BEHALF OF

COMMUNITY NATURAL GAS CO., INC.

**COMMUNITY NATURAL GAS CO., INC.
PRE-FILED DIRECT TESTIMONY OF EARL L RIDLEN, III**

Q.1. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Earl L. Ridlen, III; my business address is 1776 N. Meridian, Suite 500, Indianapolis, Indiana 46202.

Q.2. WHAT IS YOUR OCCUPATION?

A. I am a Certified Public Accountant and financial advisor. The vast majority of my work relates to various utility entities including natural gas distributing companies, such as Community Natural Gas Company, Inc., the Petitioner in this Cause.

Q.3. BY WHOM ARE YOU EMPLOYED?

A. I am employed by LWG CPA's & Advisors ("LWG").

Q.4. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND, OR PROFESSIONAL EXPERIENCES WHICH YOU BELIEVE ARE RELEVANT TO THE OPINIONS YOU OFFER IN THIS TESTIMONY?

A. I hold a Bachelor of Arts degree from Franklin College where my major was accounting. I am licensed by the state of Indiana as a Certified Public Accountant. I have held various positions with the accounting firms of Dauby, O'Connor, and Zaleski; Kelley, Hardesty and Smith; and LWG. In 2011, I was elected by the partners of LWG to manage our firm following in the footsteps of the long time managing partner Duane C. Mercer. I am a member of the Indiana CPA Society, and the American Institute of Certified Public Accountants. My past work has included preparing market valuation studies for purposes of determining the appropriate return on invested capital; assisting clients with income tax issues; testifying before this

Commission on return on equity capital; and testifying before this Commission in Cause No. 45032.

Q.5. MR. RIDLEN WERE YOU RETAINED BY THE PETITIONER TO USE YOUR PRIOR EXPERIENCE AND EXPERTISE FOR ITS BENEFIT IN THIS CAUSE?

A. Yes. I, and my firm LWG were retained by the Petitioner to review its books and records, offer various opinions, and to provide testimony in this Cause. My work for this Petitioner has focused on a reasonable return on equity capital used by the Petitioner; and addresses the issues remaining to be addressed from the Tax Cuts and Jobs Act of 2017 (TCJA) and the Commission's Order of January 16, 2019 in Cause No. 45032-S7 for this Petitioner.

Q.6. MR. RIDLEN HAVE YOU PREVIOUSLY ANALYZED FINANCIAL INFORMATION AND PROVIDED YOUR OPINION ON REASONABLE RATES OF RETURN ON EQUITY FOR NATURAL GAS UTILITIES?

A. Yes I have. I have analyzed financial information and provided my opinion on reasonable rates of return for the recent cases of Midwest Natural Gas Corporation, South Eastern Indiana Natural Gas Company, Inc., and Indiana Utilities Corporation all decided by this Commission.

Q.7. TURNING TO THIS PETITIONER IN THIS PARTICULAR CAUSE, WOULD YOU DESCRIBE IN GENERAL THE ANALYSIS YOU HAVE MADE RELATIVE TO DETERMINING AN APPROPRIATE RETURN ON ITS EQUITY CAPITAL?

1 A. In addition to the review of Petitioner's books and records, and consideration of the
2 elements of its capital structure; I considered unique factors associated with the risks
3 this Petitioner faces, including that its stock is not listed and its small size. I also
4 considered other Indiana utilities' reported earnings on equity. I reviewed the
5 Commission's Orders in numerous cases. I also considered several market approaches
6 to valuation as defined in the Statement of Standards for Valuation Services of the
7 American Institute of Certified Public Accountants. Based on that analysis, I was able
8 to form an opinion as to a reasonable rate of return for this Petitioner.

9 **Q.8. HAS THE ISSUE OF A REASONABLE RATE OF RETURN BEEN SETTLED**
10 **BETWEEN THE PETITIONER AND THE OFFICE OF UTILITY**
11 **CONSUMER COUNSELOR (OUCC)?**

12 A. Yes. Representative of the Petitioner and the OUCC met prior to the filing of this case
13 and concluded that 10.1% would be a reasonable compromise return on equity for the
14 Petitioner in this Cause.

15 **Q.9. DO YOU BELIEVE THAT 10.1% IS A REASONABLE RETURN ON**
16 **EQUITY?**

17 A. I believe that 10.1% is a reasonable compromise return on equity. If this issue had not
18 been settled prior to the initiation of this Cause, I would have been filing testimony
19 recommending a higher return on equity for this Petitioner. Recently I have testified
20 before the Commission in other natural gas proceedings that a 10.25% return on equity
21 is reasonable. For this Petitioner in this Cause, I would have filed a return on equity
22 that was higher than 10.25%. But I also recognize that the OUCC would likely have

1 filed a return on equity which was lower than 10.1% based on their filings in other
2 proceedings. Thus I believe 10.1% is a reasonable compromise return on equity.

3 **Q.10. ARE YOU FAMILIAR WITH THE COMMISSION'S RECENT ORDER IN**
4 **CAUSE NO. 45032-S7?**

5 **A.** Yes, I am.

6 **Q.11. HAS THE PETITIONER MADE A COMPLIANCE FILING REFLECTING**
7 **THE CALCULATION OF THE AMOUNT OF EXCESS ACCUMULATED**
8 **DEFERRED INCOME TAX (EADIT)?**

9 **A.** I believe it has, though I have not been directly involved with such compliance filing.
10 My colleague Ms. Mann was directly involved with that filing.

11 **Q.12. IS IT YOUR UNDERSTANDING THAT THE PETITIONER IS TO REFUND**
12 **TO RATEPAYERS EADIT DOLLARS THROUGH AN AMORTIZATION**
13 **OVER 15.91 YEARS BASED ON PETITIONER'S LAST BASE RATE CASE?**

14 **A.** Yes.

15 **Q.13. FOR AN INDIANA REGULATED UTILITY TO REFUND EADIT DOLLARS,**
16 **WOULD THE UTILITY HAVE HAD TO COLLECT THOSE DOLLARS**
17 **FROM RATEPAYERS?**

18 **A.** Yes. In fact this is the crux of the issue. If the Petitioner had not collected dollars from
19 ratepayers, there would be nothing to refund to those ratepayers.

20 **Q.14. DIDN'T THE PETITIONER REDUCE ITS ANNUAL FEDERAL INCOME**
21 **TAX LIABILITY BY USING PERMITTED DEFERRALS OF FEDERAL**
22 **INCOME TAX ON ITS TAX RETURNS?**

23 **A.** Yes it did.

1 **Q.15. WOULD SOME OF THE DEFERRALS ASSOCIATED WITH THE FEDERAL**
2 **INCOME TAX BE BASED ON DEPRECIATION OF UTILITY PLANT?**

3 A. Yes. In fact the majority of the deferrals would relate to depreciation of utility plant.

4 **Q.16. WEREN'T THOSE DEPRECIATION AMOUNTS INCLUDED IN BASE**
5 **RATES?**

6 A. No. Only to the extent that Petitioner had depreciable plant as of the cutoff date for
7 its last base rate case would those depreciation amounts have been included in rates
8 charged to ratepayer.

9 **Q.17. MR. RIDLEN LET'S RETURN TO THE COMMISSION'S ORDER IN 45032-**
10 **S7. PLEASE EXPLAIN YOUR UNDERSTANDING OF THE COMMISSION'S**
11 **ORDER RELATIVE TO EADIT DOLLARS TO BE RETURNED TO**
12 **CUSTOMERS.**

13 A. I reviewed the Commission's Order and also considered the evidence that was offered
14 in that sub docket as referenced by that Order. The Commission's Order references the
15 OUCC's evidence as reflecting that ratepayers contributed to depreciation expense for
16 the period between the last rate case and the date of the most current deferred income
17 tax balance before the TCJA went into effect (essentially, December 31, 2017). The
18 Commission also recognized that the OUCC argued that Petitioner's schedules in that
19 case were insufficient suggesting that this Petitioner's Exhibit 3 was not supported by
20 any other schedules (Order at page 3).

21 The Commission's Order referencing the Petitioner's (Respondent in that proceeding)
22 evidence focused on my rebuttal testimony related to the amount of rates allocated to
23 deferred taxes and the fact that those rates had not changed since Respondent's last rate

1 case. Further the Commission referenced my testimony that the approach on returning
2 deferred taxes embedded in Respondent's base rates was the same method that the
3 Commission required to be used in the Phase I compliance filings (Order at page 4).
4 The Commission in its Discussion and Findings found this Petitioner's approach to
5 follow the construct used in Phase I a reasonable place to begin. But the Commission
6 then found that some portion of the ratemaking process created a mismatch between
7 income tax and the addition of new customers and new utility plant. The Commission
8 appeared to conclude that because new customers had been added; and new utility plant
9 had been invested by the Petitioner to serve those customers; this Petitioner should
10 address such mismatch and any TCJA adjustment that remain to be normalized in the
11 next base rate case (Order at pages 5 and 6).

12 **Q.18. DID THE RATEPAYERS CONTRIBUTE TO FEDERAL INCOME TAXES**
13 **OR DEPRECIATION EXPENSE THROUGH THE RATES ESTABLISHED IN**
14 **PETITIONER'S LAST BASE RATE CASE?**

15 A. Yes they did. But the depreciation expense and the income tax expense were
16 essentially cutoff as of September 30, 2016. Thus depreciation expense and income
17 tax expenses that were incurred in excess of that September 30, 2016 base amount are
18 not included in those rates and thus have not been contributed by ratepayers.

19 **Q.19. DO YOU AGREE THAT SOME COLLECTION OF EADIT THROUGH**
20 **DECEMBER 31, 2017 IS ESSENTIALLY AN OVER COLLECTION NOW**
21 **BECAUSE OF THE TAX CUTS AND JOBS ACT OF 2017?**

22 A. I accept that the tax rate that this Petitioner will pay on federal income tax going
23 forward will be lower. I also accept that collection of rate revenue including taxes that

1 will not be paid now creates an over-collection that needs to be refunded. But beyond
2 the potential argument that new customers paid in new rate revenue that was not
3 previously considered, I do not agree that the Petitioner can return something to
4 ratepayers that it never collected.

5 **Q.20. THE COMMISSION'S ORDER IN 45032-S7 SUGGESTS THAT THE**
6 **ESTABLISHMENT OF BASE RATES IS BASED ON A SNAP SHOT IN TIME.**
7 **DO YOU AGREE?**

8 A. Yes I do.

9 **Q.21. DOESN'T THAT MEAN THAT THIS PETITIONER HAS IN FACT**
10 **COLLECTED EADIT DOLLARS ON ALL OF ITS PLANT THROUGH**
11 **DECEMBER 31, 2017?**

12 A. No. Simply put, Petitioner's base rates were designed to recover a certain level of
13 income tax expense based on the amount of rate base as of the cutoff date in that
14 proceeding. The Commission's Order in Cause No. 45032-S7 appears to recognize
15 this on page 5, where it states "it is reasonable to conclude that the income tax and the
16 [ADIT] balance associated with the approved rate base at that snapshot in time created
17 a condition in which customer rates paid for income taxes that Respondent was not
18 required to pay the government in that same period." Petitioner has agreed to and is
19 already refunding the EADIT balance related to the rate base included in Petitioner's
20 last rate case. New plant that Petitioner has placed into service since the rate base
21 cutoff in its last rate case has not been reflected in rates, and no associated income tax
22 or depreciation expense has been recovered from Petitioner's customers. In other
23 words, if one were to take a new "snapshot" as of December 31, 2017, the "approved

1 rate base” and “customer rates” are unchanged from Petitioner’s last rate case. Since
2 Petitioner never recovered any depreciation or income taxes from ratepayers on such
3 new utility plant, there should be nothing to refund.

4 **Q.22. BUT ISN'T IT TRUE THAT THE PETITIONER ACTUALLY CONNECTED**
5 **NEW RATEPAYERS BEYOND ITS LAST BASE RATE CASE?**

6 A. Yes it did periodically. However, it had additional operating expenses associated with
7 serving those new ratepayers which it also never collected and will never collect. I
8 would point out that at the time this base rate case is complete, Petitioner’s federal
9 income tax rate used in establishing rates will be the lower federal income tax rates
10 created by the TCJA and it will finally have included new utility plant in its rate base.
11 Further, those new customers and the rates they paid will be reduced by the tariff to
12 be filed which will amortize the refund of excess ADIT. Going forward ratepayers will
13 receive all benefits of the TCJA through the rates established in this proceeding.

14 **Q.23. MR. RIDLEN HOW MANY ADDITIONAL FEDERAL INCOME TAX**
15 **DOLLARS DID THE NEW CUSTOMER CONTRIBUTE TO PETITIONER?**

16 A. Based on discussions with Mr. Kerry Heid and the cost of service study filed in the
17 Petitioner’s last base rate case, each residential customer contributed \$38.25 per year
18 on average. Since the new customers added by Petitioner since its last base rate case
19 were residential customers, I accept that the new customer provided up to \$18,744.

20 **Q.24. SHOULD ALL OF THOSE FEDERAL INCOME TAX CONTRIBUTIONS**
21 **FROM NEW CUSTOMERS BE REFUNDED?**

22 A. No. At most those federal income tax dollars should recognize that federal income tax
23 will be paid based on the lower 21% tax rate.

1 **Q.25. WOULD THIS ADDITIONAL REFUND PROPERLY NORMALIZE THE**
2 **EFFECTS OF THE TCJA?**


3 **A.** Yes. That portion of Petitioner's revenue requirement established in its last base rate
4 case related to excess deferred income taxes driven primarily by depreciation and
5 federal income tax averages \$38.25 per customer per year. Since September 30, 2016,
6 the Petitioner has added 245 customers. I recognize that not all of those customers
7 began taking service and paying rates on October 1, 2016. This approach suggests that
8 the maximum additional EADIT dollars that could be required to be refunded under
9 any normalization approach would be. I come to this conclusion because the new
10 customers were added periodically and the period since the prior base rate case to
11 December 31, 2017 is only 15 months.

12
13 **Q.26. DOES THIS CONCLUDE YOUR PRE-FILED DIRECT TESTIMONY?**

14 **A.** Yes, it does.
15

VERIFICATION

I affirm under the penalties of perjury that the foregoing is true to the best of my knowledge, information and belief as of the date here filed.

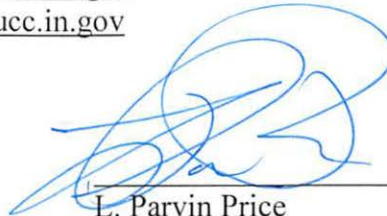


Earl L. Ridlen, III

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 11th day of March, 2019:

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