

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

**IN THE MATTER OF THE PETITION OF
GIBSON WATER, INC., A NONPROFIT
CORPORATION, FOR AUTHORITY TO
ISSUE LONG-TERM DEBT AND FOR
APPROVAL OF A CHANGE IN RATES
AND CHARGES**

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CAUSE NO. 45080

TESTIMONY

OF

EDWARD R. KAUFMAN, CRRA - PUBLIC'S EXHIBIT NO. 3

ON BEHALF OF THE

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

August 24, 2018

Respectfully Submitted,



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* *Testimony of Edward R. Kaufman, CRRA* has been served upon the following counsel of record in the captioned proceeding by electronic service on August 24, 2018.

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TESTIMONY OF OUCC WITNESS EDWARD R. KAUFMAN, CRRA
CAUSE NO. 45080
GIBSON WATER, 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: What is the purpose of your testimony?**

9 A: I discuss Gibson Water, Inc.'s ("Petitioner" or "Gibson") request for authority to
10 issue long term debt and I recommend the request be approved subject to some
11 reporting requirements. I also recommend restrictions be placed on Petitioner's
12 debt service reserve to ensure the funds are available as needed.

II. PETITIONER'S DEBT ISSUANCE

A. Introduction

13 **Q: Please describe Petitioner's proposed debt issuance as set forth in its case.**

14 A: Petitioner proposes to issue a forty year loan through Rural Development for
15 \$2,438,000 and a thirty five year loan through the Indiana State Revolving Fund
16 ("SRF") for \$1,143,000. However, Petitioner explains that it may need to include
17 a third party lender for approximately one million dollars of its loan from Rural

1 Development ("RD loan"). In this circumstance, Rural Development would provide
2 a loan guarantee for the third party loan. If Petitioner is not able to obtain a loan
3 from a third party under favorable terms, the SRF has indicated it would be willing
4 to fund the balance of project not funded by the RD loan. According to Petitioner,
5 Rural Development has consented to this arrangement.

6 **Q: Does the OUCC accept Petitioner's proposed borrowing?**

7 A: Yes. Petitioner has established the reasonableness of its proposed borrowings from
8 Rural Development and SRF. But Petitioner has not provided evidence to establish
9 the terms of borrowing from any other lender is appropriate or reasonable.
10 Therefore, the OUCC's position is that financing approval should extend only to
11 the proposed borrowings from Rural Development and SRF. In the event of a
12 proposed debt issuance by an entity other than Rural Development or SRF,
13 Petitioner should secure Commission approval through a new Cause or
14 modification of the final order in this Cause. In any case, before such debt issuance
15 the OUCC should have an opportunity to review the terms of the proposed debt
16 issuance to ensure such terms are reasonable. The OUCC cannot recommend the
17 Commission provide authority for a municipal utility to issue debt and include the
18 cost of service on that debt before the terms on that debt have been disclosed.

19 **Q: How might the terms affect the reasonableness of the borrowing?**

20 A: For example, the terms of a loan from a third party borrow would likely lead to a
21 higher annual debt service than the Rural Development loan. The interest rate
22 would likely be higher and the length of the loan would likely be for less than 40
23 years. Both of these factors would increase the debt service payment on a third

1 party loan. Higher annual debt service could lead to an overall rate increase for
2 Petitioner's ratepayers materially above the 17.2% it has proposed. (Petitioner's
3 ratepayers were notified of proposed a rate increase of 17.2%.)

III. DEBT TIMING

4 **Q: Will there be a gap between the time Petitioner receives an order in this Cause**
5 **and when its proposed debt is issued?**

6 A: Yes. Therefore, Petitioner should reserve any funds collected in rates for its 2018
7 debt issuances, and use those funds to offset the amount it needs to borrow. In the
8 alternative, Petitioner should apply such funds to its debt service reserve. For
9 example, if a Petitioner issues its proposed debt three months after a final order in
10 this cause, over which period it would have collected \$25,000 per month for its
11 proposed debt, then it should use the \$75,000 (3 * \$25,000) it collected to reduce
12 the amount of debt that is issued (or to prefund its debt service reserve). This
13 mechanism is a means to match revenues collected for a Petitioner's proposed
14 bonds with its actual bond expense.

15 **Q: Could this gap become immaterial?**

16 A: Yes. If the gap in timing between a Commission order in this cause and when
17 Petitioner closes on its debt is less than two months, then the funds collected could
18 be considered immaterial, and Petitioner need not apply the funds collected against
19 its proposed debt.

IV. TRUE-UP AND OTHER ISSUES

1 **Q: Should Petitioner be required to true-up its proposed annual debt service once**
2 **the interest rates on its proposed debt are known?**

3 A: Yes. The precise interest rates and annual debt service will not be known until
4 Petitioner's debt is issued; therefore, Petitioner's rates should be trued-up to reflect
5 the actual cost of the debt. I recommend the Commission require Petitioner to file
6 a report within thirty (30) days of closing on each of its long term debt issuances
7 explaining the terms of the new loan, the amount of debt service reserve and an
8 itemized account of all issuance costs. The report should include a revised tariff,
9 amortization schedule and also calculate the rate impact in a manner similar to the
10 OUCC's schedules. Because Petitioner is proposing two debt issuances, a true-up
11 becomes slightly more complicated

12 **Q: How should disputes regarding Petitioner's true up report be identified?**

13 A: The OUCC should have no less than fourteen (14) days after service of the true-up
14 to challenge Petitioner's proposed true-up. Petitioner should similarly have
15 fourteen (14) days to file a response to the OUCC if it has challenged Petitioner's
16 calculation. Thereafter, the Commission should resolve the issue through a process
17 it deems appropriate. Any true-up report should state the time frames for objections
18 or responses.

19 **Q: Should there be any exceptions to the requirement for a true-up?**

20 A: Yes. If both parties agree in writing that the increase or decrease would be
21 immaterial, the true-up need not be implemented.

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

3 A: Unused financing authority should not continue indefinitely. Any unused financing
4 authority should expire 360 days after a final order has been issued in this cause.

V. DEBT SERVICE RESERVE

5 **Q: Do you agree with Petitioner's proposed debt service reserve?**

6 A: Yes.

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

8 A: Yes. Petitioner's debt service reserve should be placed in a restricted account, and
9 Petitioner should notify the Commission and the OUCC if it spends any funds from
10 its debt service reserves for any reason other than to make the last payment on its
11 current or proposed debt issuances. Petitioner should be required to provide a
12 report to the Commission and the OUCC within five (5) business days of said
13 transaction. The report should state how much Petitioner spent from its debt service
14 reserve, explain why it spent funds from its debt service reserve, provide a cite to
15 any applicable loan documents that allow it to spend funds from its debt service
16 reserve, describe its plans to replenish its debt service reserve, and explain any cost-
17 cutting activities it has implemented to forestall spending funds from its debt
18 service reserve.

VI. OUCC RECOMMENDATIONS

19 **Q: Please state your recommendations.**

20 A: 1) Petitioner should be authorized to issue up to \$2,438,000 of long term debt
21 from Rural Development. Petitioner should also be authorized to issue up to
22 \$1,143,000 from the SRF.

1 2) I recommend the Commission include the following in its findings:

2 A. For each of its proposed debt issuances, Petitioner should
3 temporarily reserve the funds collected in rates for its 2018 debt
4 issuances and use those funds to offset/reduce the amount it
5 borrows. If the proposed debt is issued within two (2) months after
6 it has filed a revised tariff with the Commission, the funds collected
7 should be considered immaterial and need not be applied to its
8 proposed debt issuance (or debt service reserve).

9 B. Within thirty (30) days of closing on its long term debt issuance,
10 Petitioner shall file a report with the Commission and serve a copy
11 on the OUCC, explaining the terms of the new loan, including an
12 amortization schedule, the amount of debt service reserve and all
13 issuance costs. The report should include a revised tariff and also
14 calculate the rate impact in a manner similar to the OUCC's
15 schedules. Petitioner's rates should be trued-up, if necessary, to
16 match its actual cost of debt service.

17 C. If Petitioner spends any of the funds from its debt service reserves
18 for any reason other than to make the last payment on its proposed
19 2018 debt issuance, Petitioner shall provide a report (as described
20 above) to the Commission and the OUCC within five (5) business
21 days.

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

23 A: Yes.

VII. APPENDIX A

QUALIFICATIONS

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

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

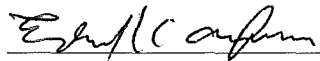
8 I was hired as a Utility Analyst in the OUCC's Economics and Finance
9 Division in October 1990. My primary areas of responsibility have been in utility
10 finance, utility cost of capital, and regulatory policy. I was promoted to Principal
11 Utility Analyst in August 1993 and to Assistant Chief of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

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

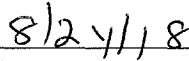
3 A: Yes. I have testified before the Indiana Utility Regulatory Commission
4 ("Commission") in a number of different cases and on numerous issues. I have
5 testified in water, wastewater, natural gas, telecommunication and electric utility
6 cases. While my primary areas of responsibility have been in cost of equity, utility
7 financing, fair value, utility valuation and regulatory policy, I have also provided
8 testimony on trackers, guaranteed performance contracts, declining consumption
9 adjustments, 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. 45080
Indiana Office of
Utility Consumer Counselor



Date: