STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF WATER SERVICE COMPANY OF INDIANA FOR AUTHORITY TO INCREASE ITS WATER AND SEWER RATES AND CHARGES AND FOR APPROVAL OF A NEW SCHEDULE OF RATES AND CHARGES APPLICABLE THERETO	))))))	**CAUSE NO. 44104**

PREFILED TESTIMONY

OF

HAROLD H. RICEMAN – PUBLIC'S EXHIBIT #1

ON BEHALF OF

THE INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

MAY 23, 2012

Respectfully submitted,

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

CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing testimony has been served upon the following parties of record in the captioned proceeding by electronic service, on May 23, 2012.

Nicholas Kile
Jeffrey M. Peabody
BARNES & THORNBURG, LLP
11 South Meridian Street
Indianapolis, IN 46204
nkile@btlaw.com
jpeabody@btlaw.com

Daniel M. Le Vay
Deputy Consumer Counselor

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR
115 West Washington Street
Suite 1500 South
Indianapolis, IN 46204
infomgt@oucc.in.gov
317/232-2494 – Phone
317/232-5923 – Facsimile

TESTIMONY OF OUCC WITNESS HAROLD H RICEMAN
CAUSE NO. 44104
WATER SERVICE COMPANY OF INDIANA

I. INTRODUCTION

Q: Please state your name and business address.

A: My name is Harold H. Riceman, and my business address is 115 West Washington Street, Suite 1500 South, Indianapolis, Indiana 46204.

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

A: I am employed by the Indiana Office of Utility Consumer Counselor ("OUCC") as a Utility Analyst II in the Water/Wastewater Division.

Q: Please describe your educational background and experience.

A: I graduated from Butler University in Indianapolis, Indiana in May, 1968, with a Bachelor of Science degree, majoring in accounting. In June, 1968 I accepted a position with Citizens Gas & Coke Utility as a Junior Accountant. I held accounting positions in both the Property Records and General Ledger sections of the Utility, retiring as a Systems Applications Coordinator in September, 2001. In February, 2004 I accepted an accounting position with the State of Indiana in the Family and Social Services Administration. In January, 2006 I accepted a position as a Utility Analyst with the OUCC. Since joining the OUCC I attended the NARUC Eastern Utility Rate School in Clearwater Beach, Florida, and other related training. I have prepared testimony and reports in a number of causes before the Indiana Utility Regulatory Commission ("IURC" or "Commission").

Q: What is the purpose of your testimony?

A: The purpose of my testimony is to identify and discuss various proposed adjustments to Water Service Company of Indiana's ("Petitioner", "the Utility" or "WSCI") test year operating revenues and expenses.

Q: Have you previously testified before the Commission?

A: Yes.

Q: Please describe the review and analysis you conducted to prepare your testimony.

A: I read Petitioner's pre-filed testimony and reviewed the schedules and workpapers filed in this Cause. I participated in the preparation of discovery questions and reviewed the responses provided by Petitioner. Further, I participated in the OUCC's financial review of Petitioner's books and records as they relate to this rate case. Finally, I attended numerous meetings with other OUCC staff to identify and discuss the issues in this Cause.

Q: What schedules and attachments are you sponsoring?

A: I sponsor the following schedules and attachments:

Common Schedules

OUCC Schedule 2 –	Comparative Income Statement for the Year Ended June 30, 2011
OUCC Schedule 3 –	Income Statement for the Year Ending June 30, 2011
OUCC Schedule 5 –	Water and Sewer Revenue Adjustments
OUCC Schedule 6 –	Water and Sewer Expense Adjustments
OUCC Schedule 8 –	*Pro Forma* Capital Structure and Calculation of Synchronized Interest

Water Schedules:

OUCC Schedule 1W –	Comparison of Petitioner's and OUCC's Revenue Requirement

OUCC Schedule 4W –	*Pro forma* Net Operating Income Statement
OUCC Schedule 7W –	Calculation of Rate Base
Sewer Schedules:	
OUCC Schedule 1S –	Comparison of Petitioner's and OUCC's Revenue Requirement
OUCC Schedule 4S –	*Pro forma* Net Operating Income Statement
OUCC Schedule 7S –	Calculation of Rate Base
Attachments:	
HHR Attachment 1 –	Response to OUCC Data Request Question 3-6 - Purchased Power Adjustment
HHR Attachment 2 –	Corrected Water Revenue Requirement
HHR Attachment 3 –	Corrected Sewer Revenue requirement
HHR Attachment 4 –	Response to OUCC Data Request Question 9-6 – Land Costs

II. EXECUTIVE SUMMARY

A. Water Service

Q: What increase does Petitioner request for water service?

A: WSCI requests an 8.5319% weighted cost of capital return on an original cost rate base of $568,090 or rates that will yield an operating income of $48,477 and a net revenue requirement of $76,710. Applying Petitioner's proposed gross revenue conversion factor of 169.5818% results in a recommended revenue increase of $130,087.

Per Petitioner's case-in-chief, the average residential customer's water service bill will increase 216% over present rates (Neyzelman testimony, page 6, line 12). Petitioner did not state in its Petition or in its testimony the overall rate increase resulting from its proposal. However, based on present rate water operating revenues subject to increase of $72,629, I calculated that the overall rate increase proposed by Petitioner is 179.11%.

As discussed further in the testimony of OUCC witnesses Margaret Stull and Jeff Fish, Petitioner proposes changes in its rate design and non-recurring charges included in its tariff.

Q: Did the OUCC discover an error in Petitioner's original rate request?

A: Yes. Petitioner inadvertently misallocated purchased power costs between its water and sewer utilities. Purchased Power costs for its water utility should have been $42,803 less than originally proposed. Removing this expense from Petitioner's revenue requirement yields a proposed over-all rate increase of approximately 79% (Attachment HHR-2).

Q: What rate increase for water service does the OUCC believe Petitioner has justified?

A: Based on the evidence the OUCC recommends the Commission authorize an overall rate increase of 62.05% to produce an increase in revenues of $45,673 per year. More specifically, the OUCC recommends the Commission approve a Cost of Equity of 9.25% and a weighted cost of capital of 7.9332%. The OUCC disagrees with WSCI's calculation of its rate base and recommends a rate base of $485,751. Further, as discussed by OUCC witness Ms. Stull, the OUCC recommends changes to Petitioner's proposed rate design due to modifications to the classification of costs between fixed and variable. Finally, as addressed in the testimonies of Mr. Fish and Ms. Stull, the OUCC disagrees with Petitioner's proposed changes to its connection charge and after hours call-out charge.

B. Sewer Service

Q: What increase does Petitioner request for sewer service?

A: WSCI requests an 8.5319% weighted cost of capital return on an original cost rate base of $2,685,618 or rates that will yield an operating income of $229,126 and a net revenue requirement of $223,176. Applying Petitioner's proposed gross revenue conversion factor of 169.5214% results in a recommended revenue increase of $378,332.

Per Petitioner's case-in-chief, the average residential customer's sewer service bill will increase 57% over present rates (Neyzelman testimony, page 6, line 13). Petitioner did not state the overall rate increase resulting from its proposal. However, according to Petitioner's presentation, based on present rate sewer operating revenues (subject to increase) of $121,969, the overall rate increase proposed by Petitioner is 310.19%.

Q: Did the OUCC discover an error in Petitioner's original rate request?

A: Yes. Petitioner inadvertently misallocated purchased power costs between its water and sewer utilities. Purchased Power costs for its sewer utility should have been $39,061, more than originally proposed. Including this expense in Petitioner's revenue requirement means that Petitioner was actually requesting an over-all rate increase of approximately 364% (Attachment HHR-3).

Q: What rate increase for sewer service does the OUCC believe Petitioner has justified?

A: Based on the evidence the OUCC recommends the Commission deny the level of rates requested by Petitioner and authorize an overall increase of 268.04% to produce an increase in revenues of $334,034 per year. Underlying this increase, the OUCC recommends the Commission approve a Cost of Equity of 9.25% and a weighted cost of capital of 7.9332%. Also, the OUCC disagrees with WSCI's calculation of its rate base and recommends a rate base of $2,567,437. As addressed by OUCC witness Ms. Stull, the OUCC also recommends changes to Petitioner's proposed rate design due to modifications to the classification of costs between fixed and variable. Finally, as addressed in the testimonies of Mr. Fish and Ms. Stull, the OUCC disagrees with Petitioner's proposed changes to its connection charge and reconnection charge.

III. REVENUE REQUIREMENTS AND CALCULATION OF REVENUE INCREASE

Q: Briefly describe how rates are determined for an investor-owned utility such as WSCI.

A: For an investor-owned utility, rates are calculated by first determining the return on rate base. This calculation determines what the net operating income should be in order to provide an opportunity for a reasonable return to the shareholders. Next, a determination is made as to the amount of the adjusted (*pro forma*) net operating income based on the utility's current rates. These *pro forma* amounts are based upon the known, historical test year revenues and expenses updated to include changes that are fixed within the time period (twelve months from the end of the test year – June 30, 2011), known to occur (and are recurring), and measurable in amount.

By subtracting the net operating income determined through the adjustment process from the net operating income required by the return on rate base, one can determine the dollar amount of the increase needed to achieve the net operating income that is expected to provide a reasonable return to the shareholders. The increase in net operating income is then "grossed up" for taxes and fees related to the increased revenue and income. These calculations can be seen on page 1 of OUCC Schedules 1W and 1S, attached to this testimony.

Q: Which schedules contain information concerning *pro forma* amounts and adjustments to test year balances related to net operating income?

A: OUCC Schedules 4, 5 and 6 provide detail of *pro forma* amounts and adjustments to test year amounts for both water and wastewater. OUCC Schedule 4 is the *pro forma* net operating income statement. It shows the test year revenues and expenses, the adjustments to test year amounts, and the resulting *pro forma* amounts under current rates. OUCC Schedule 4 also shows the revenue increase or decrease necessary to achieve the required net operating income. It also shows the expenses that will change due to the change in revenue. OUCC Schedule 5 provides the detail for *pro forma* revenue items, and Schedule 6 the detail for *pro forma* expense items that needed to be adjusted from test year amounts.

IV. WATER REVENUE REQUIREMENT

A. Comparison of Proposed Revenue Requirements

Q: Please explain the primary differences between the revenue requirements requested by WSCI and those recommended by the OUCC.

A: WSCI proposed a net operating income of $48,477, which would require an overall operating revenue increase of $130,087. The OUCC proposes a net operating income of $38,555, which would require an overall operating revenue increase of $45,673. (See OUCC Schedule 1, page 1 of 1.) As shown on Table HHR-1, which compares the revenue requirements requested by WSCI with those proposed by the OUCC, the difference in proposed rate base is due primarily to reclassification of costs capitalized by Petitioner. (See testimony of Ms. Stull.) The difference in weighted cost of capital is primarily due to cost of equity – Petitioner proposed 10.44% and the OUCC proposes 9.25%. (See testimony of OUCC witness Edward Kaufman.) The difference in adjusted net income is due to various operating revenue and expense adjustments proposed by both parties with the primary drivers being test year customer growth revenue adjustment, rate case expense, maintenance expense, and depreciation expense as well as the correction to purchased power expense.

Table HHR-1: Comparison of Revenue Requirements

	Per Pet	Per OUCC	OUCC More (Less)
Original Cost Rate Base	$ 568,091	$ 485,751	$ (82,340)
Times: Weighted Cost of Capital	8.53%	7.93%	-0.60%
Net Operating Income Required for Return on Rate Base	48,477	38,555	(9,922)
Less: Adjusted Net Operating Income	(28,233)	10,236	38,469
Net Revenue Requirement	76,710	28,319	(48,391)
Gross Revenue Conversion Factor	169.5818%	161.2784%	-8.3034%
Recommended Revenue Increase	$ 130,087	$ 45,673	$ (84,414)
Recommended Percentage Increase	179.11%	62.05%	-117.06%

B. Gross Revenue Conversion Factor

Q: Please explain the purpose of a gross revenue conversion factor.

A: A gross revenue conversion factor calculates the amount of certain operating expenses and taxes associated with the proposed revenue increase (or decrease). Altogether, these operating expenses and taxes typically include bad debt expense, the IURC fee, utility receipts taxes, and state and federal income taxes. Any proposed revenue increase must be "grossed up" for a Utility to earn its authorized net operating income.

Q: Please explain how your proposed Gross Revenue Conversion Factor differs from Petitioner's.

A: Petitioner calculated a gross revenue conversion factor of 169.5817%. I determined that a gross revenue conversion factor of 161.278357% is more appropriate. There are two reasons my conversion factor differs from Petitioner's. First, I used the current IURC fee for 2011 (.117851%). Second, I adjusted the calculation of the state income tax rate to reflect the fact that utility receipts tax is not deductible for state income tax purposes.

Q: What state income tax rate did you use to calculate your gross revenue conversion factor?

A: I used the current state income tax rate of 8.5%. This rate will decrease to 8.0% on July 1, 2012 and will continue to decrease by 0.5% on July 1 of each subsequent year until the rate reaches 6.5%.

Q: Do you have any other comments regarding the decline in the state income tax rate?

A: Yes. I would note that this decrease in the state income tax rate (July 1, 2012) will occur the day after the twelve month adjustment period ends (June 30, 2012) and well before the the rates ordered in this case take effect.

Q: Why didn't you use the reduced rate to calculate state income tax expense?

A: Even though we know the rate will decline, each decline becomes effective after the adjustment period prescribed by the pre-hearing conference order. Consequently, the decline in this operating expense cannot be incorporated in rates at this time.

C. Weighted Average Cost of Capital

Q: What Weighted Average Cost of Capital does Petitioner Propose?

A: Petitioner proposed a weighted average cost of capital of 8.5319%, which is based on a 10.44% cost of equity and a 6.60% cost of debt.

Q: Does the OUCC accept Petitioner's proposed Weighted Average Cost of Capital?

A: No. The OUCC proposes a 7.9332% weighted average cost of capital based on its proposed 9.25% cost of equity and WSCI's 6.60% cost of debt. OUCC witness Edward Kaufman discusses the OUCC's proposed cost of equity. (See OUCC Schedule 8.)

D. Rate Base

1. **General**

Q: What rate base does Petitioner propose?

A: WSCI proposes a total rate base of $568,090. The OUCC proposes a total rate base of $485,571 (Table HHR-2). OUCC witness Margaret Stull discusses the OUCC's proposed adjustments to Petitioner's proposed rate base.

Table HHR-2: Rate Base Comparison

	Per Petitioner	Per OUCC	OUCC More (Less)
Utility Plant in Service at 06/30/11, as adjusted	$ 717,514	$ 633,365	$ 84,149
Accum. Depr. at 06/30/2011	38,743	34,017	4,726
Net Utility Plant in Service at 06/30/2011	678,771	599,348	79,423
CIAC, net	1,355	1,355	-
Utility Plant in Service net of CIAC	677,416	597,993	79,423
Add: Acquisition Adjustment	9,192	9,192	-
Working Capital	8,047	5,131	(2,916)
Less: Customer Deposits	1,729	1,729	-
Deferred Income Taxes	124,836	124,836	-
Total Original Cost Rate Base	$ 568,090	$ 485,751	$ 82,339

Q: What have you done to confirm Petitioner's Utility Plant in Service as of June 30, 2011?

A: I reviewed extensive samples of invoices documenting additions to utility plant from 2006 through the rate base cutoff date of June 30, 2011. Additionally, I tested and traced samples of labor and journal entries relating to utility plant for the same period. In total I examined documentation that supports more than 42% of the total additions to utility plant since 2002. As discussed further in the testimony of OUCC witnesses Margaret Stull and Jeff Fish, certain invoices related to meter costs, wells and springs, and pumps were removed from rate base.

2. **Working Capital**

Q: Briefly describe how working capital is calculated for an investor-owned utility such as WSCI.

A: Working capital is the money a utility needs to pay its operating expenses necessary to provide service until the revenues from that service are collected. Some expenses are incurred and paid for before the related revenues are collected and other expenses are paid for after the related service revenues are collected (paid for "in arrears"). Working capital is the net amount of money needed on an ongoing basis to fund daily utility operations. Working capital is considered an investment necessary to provide utility service and is included in rate base for investor-owned utilities.

Q: What is the best method to determine Working Capital?

A: The best method to determine working capital is the lead/lag study. This methodology measures the differences between (1) the time services are rendered until the revenues for that service are received, and (2) the time expenses are incurred until those expenses are paid. The difference between these periods is expressed in terms of days. The number of days calculated multiplied by the average daily operating expenses produces the cash working capital required for operations. A lead/lag study requires an in-depth analysis of the timing of a specific utility's operating revenues and expenses. The primary advantage of the lead/lag study method is that it produces an accurate estimate of working capital since it is based on that specific utility's actual operating conditions coupled with its billing, collecting and cash disbursement practices. The primary disadvantage of a lead/lag study is the time and expense to produce the study. For this reason most utilities do not attempt to calculate their working capital in this manner.

Q: Is there an alternative methodology to determine Working Capital?

A: Yes. An alternative method, called the 45 day formula method, has been devised to estimate the working capital needs of a utility and has been accepted by this Commission and FERC. The 45 day formula method calculates a percentage of operating expenses as the estimate of the working capital requirements for a utility.

This method assumes the difference between the lead/lag periods discussed above is 45 days and calculates 12.5% (45 days/ 360 days) of adjusted annual operating expenses as cash working capital. This methodology typically adjusts operating expenses for those items known to be paid after the receipt of revenues or paid "in arrears". The advantage of the formula method is that it is quick and inexpensive and is generally thought to be a reasonable estimate of what a lead/lag study would produce without the related expense of a lead/lag study. The disadvantage is the formula approach does not provide evidence that the resulting allowance represents actual investment of capital for a specific utility.

Q: What method did WSCI use and how does your calculation of Working Capital differ?

A: WSCI used the 45-day method to calculate its proposed working capital component of rate base. A comparison of working capital calculations is presented in OUCC Schedule 7W. Although I used the same 45-day methodology as WSCI, there are two primary differences between our calculations. First, due to various proposed test year expense adjustments, annual operating and maintenance expense differs by $62,306. Second, WSCI did not adjust its calculation to exclude purchased power expenses. Purchased power expense is paid in arrears and should be excluded from the calculation of working capital investment. I propose a Working Capital investment of $5,131 be included in rate base. (OUCC Schedule 7W)

E. <u>Revenue Adjustments</u>

Q: What adjustments to test year revenue did Petitioner propose?

A: Petitioner proposed one adjustment to increase test year water revenues by $1,772 based on test year billing determinants. This adjustment used test year billings and did not attempt to annualize or normalize the number of billings based on the customer count as of June 30, 2011.

Q: Did you accept Petitioner's proposed billing determinant revenue adjustment?

A: Yes. Based on my review of the test year water revenues recorded in Petitioner's books and records, the proposed billing determinant adjustment is reasonable and necessary to reflect test year water revenues as billed.

Q: Are you proposing any additional revenue adjustments?

A: Yes. I propose an additional normalization adjustment to water revenues for customer growth during the test year. Using the customer counts provided by Petitioner, I calculated that residential customers increased from 164 customers in July, 2010 to 171 customers at June 30, 2011 – an increase of 7 customers. Normalizing test year for customer growth provides an additional 33 bills. Multiplying these additional bills by the average residential rate of $19.59 yields a revenue adjustment of $646 (Schedule 5, Adjustment 1).

F. Operating Expense Adjustments

Q: Do you accept any of Petitioner's expense adjustments?

A: Yes. I accepted Petitioner's' adjustments to salaries and wages, capitalization of labor, pensions and other benefits, transportation and payroll tax. I propose adjustments for purchased power and utilities receipts tax. OUCC witness

Margaret Stull discusses the OUCC's proposed adjustments to salaries and wages from Service Company personnel, amortization of PAA, and maintenance expense. The remaining adjustments have been rejected or modified for the reasons described below.

1. **Rate Case Expense**

Q: Please explain the adjustment you've made to rate case expense.

A: The OUCC proposes to amortize total rate case expenses of $47,703 over a five year period to yield an annual operating expense of $4,621 ($47,703/5 x 48.45% Water share). Please see the testimony of Ms. Stull for a discussion of the OUCC's proposed adjustment for rate case expense. (OUCC Schedule 6, Adjustment 2)

2. **Depreciation Expense**

Q: Please explain the differences between the Petitioner's and the OUCC's calculation of the amounts for depreciation expense.

A. The primary difference is the depreciation rate applied to vehicles and computers. Absent a depreciation study a utility should depreciate all property at the 2% composite rate for water property and 2.5% composite rates for wastewater property, which are standardized by the Commission. Petitioner depreciated water plant at 2% and proposed depreciation rates of 25% for vehicles and 12.5% for computers. Additionally, the OUCC removed land costs from Utility Plant in Service in response to OUCC Data Request Question 9-6 which requested the amount of land included in Petitioner's rate base (Attachment HHR-4). Schedule

6, Adjustment 6, yields a *pro forma* decrease of $3,800 to test year operating expense.

Q: Does the OUCC have any further recommendations regarding depreciation of assets?

A: Yes. The OUCC recommends the composite rate for all depreciable assets be used in rate cases until Petitioner obtains approval from the Commission to use anything other than a composite rate.

3. **Purchased Power**

Q: Please explain your Purchased Power Expense adjustment.

A: Petitioner's response to OUCC Data Request Q3-6 (Attachment HHR-1) corrected the *pro forma* purchased power expense amounts included in both the water and sewer revenue requirement. Water's *pro forma* expense should be $6,968, not the previously reported $49,071. OUCC Schedule 6, Adjustment 3, yields a *pro forma* decrease of $42,803 to test year operating expense.

4. **Utility Receipts Tax**

Q: Please explain your Utility Receipts Tax adjustment.

A: Utility Receipts Tax is computed by multiplying *pro forma* present rate revenues (less bad debt expense and the annual deduction) by the 1.4% tax rate. Based on the taxable present rate revenues of $72,743, *pro forma* utility receipts tax expense is $1,018. OUCC Schedule 6, Adjustment 7, yields a *pro forma* decrease of $30 to test year operating expense.

5. **<u>Income Taxes</u>**

Q: Have you made a calculation for *pro forma* present rate federal and state income taxes?

A: Yes. *Pro forma* present rate State and Federal Income Tax adjustments are calculated on OUCC Schedule 6, Adjustments 8 and 9 respectively.

Q: In what way does your calculation of State income tax differ from that of Petitioner's?

A: Other than the differences in various proposed revenue and expense items, there is no material difference between my calculation of state income taxes and Petitioner's. My calculation appropriately excludes the deduction of utility receipts tax expense. OUCC Schedule 6, Adjustment 8, yields a *pro forma* decrease of $3,685 to test year operating expense.

Q: In what way does your calculation of Federal income tax differ from Petitioner's?

A: Other than the differences in various proposed revenue and expense items, there is one material difference between my calculation of federal income taxes and Petitioner's. As discussed further by OUCC witness Margaret Stull, the OUCC treated Petitioner as a stand-alone tax entity and used an effective tax rate of 30.66% compared to Petitioner's 34% tax rate. OUCC Schedule 6, Adjustment 9, yields a *pro forma* increase of $6,883 to test year operating expense.

Q: How are taxes adjusted to reflect the <u>proposed</u> increase in revenues?

A: The gross revenue conversion factor found on Schedule 1, page 2 has been used to determine the adjustment necessary to increase taxes based on the increased revenues recommended.

V. SEWER REVENUE REQUIREMENT

A. Comparison of Proposed Revenue Requirements

Q: Please explain the primary differences between the revenue requirements requested by WSCI and those recommended by the OUCC.

A: WSCI proposed a net operating income of $229,126, which would require an overall operating revenue increase of $378,332. The OUCC proposes a net operating income of $203,723, which would require an overall operating revenue increase of $334,034. (See OUCC Schedule 1, page 1 of 1.) As shown on Table HHR-4, which compares the revenue requirements requested by WSCI with those proposed by the OUCC, the difference in proposed rate base is primarily due to the treatment of an acquisition adjustment (see testimony of Ms. Stull). The difference in weighted cost of capital is primarily due to cost of equity – Petitioner proposed 10.44% and the OUCC proposes 9.25%. (See testimony of OUCC witness Edward Kaufman.) The difference in adjusted net income is due to various operating revenue and expense adjustments proposed by both parties with the primary drivers being test year customer growth revenue adjustment, rate case expense, depreciation expense as well as the correction to purchased power expense.

Table HHR-4: Comparison of Revenue Requirements

	Per Pet	Per OUCC	OUCC More (Less)
Original Cost Rate Base	$ 2,685,618	$ 2,567,437	$ (118,181)
Times: Weighted Cost of Capital	8.53%	7.93%	-0.60%
Net Operating Income Required for Return on Rate Base	229,126	203,723	(25,403)
Less: Adjusted Net Operating Income	5,950	(3,465)	(9,415)
Net Revenue Requirement	223,176	207,189	(15,988)
Gross Revenue Conversion Factor	169.5214%	161.2220%	-8.2994%
Recommended Revenue Increase	$ 378,332	$ 334,034	$ (44,298)
Recommended Percentage Increase	310.19%	268.04%	-42.15%

B. Gross Revenue Conversion Factor

Q: Please explain the purpose of a gross revenue conversion factor.

A: A gross revenue conversion factor calculates the amount of certain operating expenses and taxes associated with a proposed revenue increase. Altogether, these operating expenses and taxes typically include bad debt expense, the IURC fee, utility receipts taxes, and state and federal income taxes. The proposed revenue increase must be "grossed up" for a Utility to earn its authorized net operating income.

Q: Please explain how your proposed Gross Revenue Conversion Factor differs from Petitioner's.

A: Petitioner calculated a gross revenue conversion factor of 169.5214%. I determined that a gross revenue conversion factor of 161.2220% is more appropriate. There are three reasons my conversion factor differs from Petitioner's. First, I used the current IURC fee for 2011 (.117851%). Second, I adjusted the calculation of the state income tax rate to reflect the fact that utility receipts tax is not deductible for state income tax purposes.

Q: What state income tax rate did you use to calculate your gross revenue conversion factor?

A: I used the current state income tax rate of 8.5%. This rate will decrease to 8.0% on July 1, 2012 and will continue to decrease by 0.5% on July 1 of each subsequent year until the rate reaches 6.5%.

Q: Do you have any other comments regarding the decline in the state income tax rate?

A: Yes. I would note that this decrease in the state income tax rate (July 1, 2012) will occur the day after the twelve month adjustment period ends (June 30, 2012) and well before the rates ordered in this case take effect.

Q: Why didn't you use the reduced rate to calculate state income tax expense?

A: Even though we know the rate will decline, each decline becomes effective after the adjustment period prescribed by the pre-hearing conference order in this Cause. Consequently, the decline in this operating expense cannot be incorporated in rates at this time.

C. Weighted Average Cost of Capital

Q: What Weighted Average Cost of Capital does Petitioner Propose?

A: Petitioner proposes a weighted average cost of capital of 8.5319%, which is based on a 10.44% cost of equity and a 6.60% cost of debt.

Q: Does the OUCC accept Petitioner's proposed Weighted Average Cost of Capital?

A: No. The OUCC proposes a 7.9332% weighted average cost of capital based on its proposed 9.25% cost of equity and WSCI's 6.60% cost of debt. OUCC witness Edward Kaufman discusses the OUCC's proposed cost of equity. (See OUCC Schedule 8.)

D. Rate Base

1. General

Q: What rate base does WSCI propose?

A: WSCI proposes a total rate base of $2,685,618. The OUCC proposes a total rate base of $2,567,437 (Table HHR-5). OUCC witness Margaret Stull discusses the OUCC's proposed adjustments to Petitioner's proposed rate base.

Table HHR-5: Rate Base Comparison

	Per Petitioner	Per OUCC	OUCC More (Less)
Utility Plant in Service at 06/30/11, as adjusted	$ 3,069,064	$ 3,069,064	$ -
Accum. Depr. at 06/30/2011	371,913	371,913	-
Net Utility Plant in Service at 06/30/2011	2,697,151	2,697,151	-
CIAC, net	2,053	2,053	-
Utility Plant in Service net of CIAC	2,695,098	2,695,098	-
Add: Acquisition Adjustment, net	114,157	-	(114,157)
Working Capital	10,778	6,754	(4,024)
Less: Customer Deposits	1,840	1,840	-
Deferred Income Taxes	132,575	132,575	-
Total Original Cost Rate Base	$ 2,685,618	$ 2,567,437	$ (118,181)

Q: What have you done to confirm Petitioner's Utility Plant in Service as of June 30, 2011?

A: I reviewed extensive samples of invoices documenting additions to utility plant from 2002 through the rate base cutoff date of June 30, 2011. Additionally, I tested and traced samples of labor and journal entries relating to utility plant for the same period. In total I examined documentation that supports more than 51% of the total additions to utility plant since 2002.

2. Working Capital

Q: What method did WSCI use and how does your calculation of Working Capital differ?

A: WSCI used the 45-day method to calculate its proposed working capital component of rate base. A comparison of working capital calculations is presented in OUCC Schedule 7W. Although I used the same 45-day methodology as WSCI, there are two primary differences between our calculations. First, due to various proposed test year expense adjustments, annual operating and maintenance expense differs by $11,254. Second, WSCI did not adjust its calculation to exclude purchased power expenses. Purchased power is paid in arrears and should be excluded from the calculation of working capital investment. I propose a Working Capital investment of $6,754 be included in rate base. (OUCC Schedule 7S)

E. Revenue Adjustments

Q: What adjustments to test year revenue did Petitioner propose?

A: Petitioner proposed one adjustment to increase test year sewer revenues by $7,883 based on test year billing determinants. This adjustment used test year billings and did not attempt to annualize or normalize the number of billings based on the customer count as of June 30, 2011.

Q: Did you accept Petitioner's proposed billing determinant revenue adjustment?

A: Yes. Based on my review of the test year water revenues recorded in Petitioner's books and records, the proposed billing determinant adjustment is reasonable and necessary to reflect test year sewer revenues as billed.

Q: Are you proposing any additional revenue adjustments?

A: Yes. I propose an additional normalization adjustment to sewer revenues for customer growth during the test year. Using the customer counts provided by Petitioner, I calculated that residential customers increased from 162 customers in

July, 2010 to 178 customers at June 30, 2011 – an increase of 16 customers. Normalizing test year for customer growth provides an additional 77 bills. Multiplying these additional bills by the average residential rate of $23.23 yields a revenue adjustment of $1,789 (Schedule 5, Adjustment 2).

F. Operating Expense Adjustments

Q: Does the OUCC accept any of Petitioner's expense adjustments?

A: Yes. I accepted Petitioner's' adjustment to salaries and wages, capitalization of labor, pensions and other benefits, transportation and payroll tax. I propose adjustments for purchased power and utilities receipts tax. OUCC witness Margaret Stull discusses the OUCC's proposed adjustment to salaries and wages from Service Company personnel and amortization of PAA. The remaining adjustments have been rejected or modified for the reasons described below.

1. Rate Case Expense

Q: Please explain the adjustment you've made to Sewer Utility rate case expense.

A: The OUCC proposes to amortize total rate case expenses of $47,703 over a five year period to yield an annual operating expense of $4,921 ($47,703/5 x 51.55% Sewer share). OUCC witness Margaret Stull discusses the OUCC's proposed adjustment for rate case expense.

2. Depreciation Expense

Q: Please explain the differences between the Petitioner's and the OUCC's calculation of the amounts for depreciation expense.

A: As explained above in water expense adjustments, the primary difference is the depreciation rate applied to vehicles and computers. Petitioner depreciated vehicles at 25% and computers at 12.5%. The OUCC used the 2.5% composite rates for wastewater property standardized by the Commission. Additionally, the OUCC removed land costs from Utility Plant in Service in response to OUCC Data Request Question 9-6 which requested the amount of land included in Petitioner's rate base (Attachment HHR-4). Schedule 6, Adjustment 6, yields a *pro forma* decrease of $68,356 to test year operating expense.

3. **Purchased Power Expense**

Q: Please explain your Purchased Power Expense adjustment.

A: Petitioner's response to OUCC Data Request Q3-6 (Attachment HHR-1) corrected the *pro forma* purchased power expense amounts included in both the water and sewer revenue requirement. Sewer's *pro forma* expense should be $40,424, not the previously reported $1,363. Schedule 6, Adjustment 3 yields a *pro forma* increase of $39,061 to test year operating expense.

4. **Utility Receipts Tax**

Q: Please explain your Utility Receipts Tax adjustment.

A: Utility Receipts Tax is computed by multiplying *pro forma* present rate revenues (less bad debt expense and the annual deduction) by the 1.4% tax rate. Based on the taxable present rate revenues of $123,166, *pro forma* utility receipts tax expense is 41,724. OUCC Schedule 6, Adjustment 7, yields a *pro forma* decrease of $60 to test year operating expense.

5. **<u>Income taxes</u>**

Q: Have you made a calculation for *pro forma* present rate federal and state income taxes?

A: Yes. *Pro forma* present rate State and Federal Income Tax adjustments are calculated on Schedule 6, Adjustments 8 and 9 respectively.

Q: In what way does your calculation of State income tax differ from that of Petitioner's?

A: Other than the differences in various proposed revenue and expense items, there is no material difference between my calculation of state income taxes and Petitioner's. My calculation appropriately excludes the deduction of utility receipts tax expense. Schedule 6, Adjustment 8 yields a *pro forma* decrease of $16,499 to test year operating expense.

Q: In what way does your calculation of Federal income tax differ from Petitioner's?

A: Other than the differences in various proposed revenue and expense items, there is one material difference between my calculation of federal income taxes and Petitioner's. As discussed further by OUCC witness Margaret Stull, the OUCC treated Petitioner as a stand-alone tax entity and used an effective tax rate of 30.66% compared to Petitioner's 34% tax rate. Schedule 6, Adjustment 9 yields a *pro forma* decrease of $23,639 to test year operating expense.

Q: How are taxes adjusted to reflect the <u>proposed</u> increase in revenues?

A: The gross revenue conversion factor found on Schedule 1, page 2 has been used to determine the adjustment necessary to increase taxes based on the increased revenues recommended.

VI. <u>CONCLUSION</u>

Q: Please summarize your recommendations to the Commission.

A: In addition to accepting the OUCC's proposed revenue, expense and rate base adjustments, I recommend the Commission address the following:

- Petitioner's allocation of Service Company costs should be addressed in the next Utilities, Inc. rate case.
- Petitioner calculate the tax benefit of Water Service Company of Indiana being a member of its parent's consolidated federal tax return and include it in the next Utilities, Inc. rate case.

Q: Does this conclude your testimony?

A: Yes.

AFFIRMATION

I affirm, under the penalties for perjury, that the foregoing representations are true.

Harold H. Riceman

Harold H. Riceman
Indiana Office of Utility Consumer Counselor

5/22/12

Date

Cause No. 44104
Water Service Company of Indiana, Inc.

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

DATA REQUEST

WATER SERVICE CO. OF INDIANA

CAUSE NO. 44104

OUCC Data Request Set No. 3 Date: February 6, 2012

Q3-6. Regarding Purchased Power expenses reported in the utility's Case-in-Chief, Schedule B, the water and sewer utility amounts appear to be incorrect, are they correct? If yes, please provide supporting documentation. If no, provide correct amounts with supporting documentation.

Response: No, they are incorrect. Please see the attached files for the correct amounts.

Summary of Purchased Power Adjustments
WSCI Test Year ended 6/30/11

	AC 5465 Water	AC 5470 Sewer	AC 5935 Gas
Per books	49,770.98	1,363.04	
Pro Forma			
Should be	6,968.34	40,423.83	
Adjustment Necessary	(42,802.64)	39,060.79	135.91

WATER SERVICE COMPANY OF INDIANA
CAUSE NO. 44104

Petitioner's Revenue Requirement - Corrected
Water

	Original Filing	Purchased Power Adj.	Corrected
Original Cost Rate Base	$ 568,090		$ 568,090
Times: Weighted Cost of Capital	8.5319%		8.5319%
Net Operating Income Required	48,477		48,477
Less: Adjusted Net Operating Income	(28,233)	42,803	14,570
Additional NOI Required	76,710		33,907
Times: Gross Revenue Conversion Factor	1.695818		1.69581770
Recommended Revenue Increase	$ 130,087		$ 57,501
Calculated Percentage Increase	179.11%		78.18%

WATER SERVICE COMPANY OF INDIANA
CAUSE NO. 44104

Petitioner's Revenue Requirement - Corrected
Sewer

	Original Filing	Purchased Power Adj.	Corrected
Original Cost Rate Base	$ 2,685,618		$ 2,685,618
Times: Weighted Cost of Capital	8.5319%		8.5319%
Net Operating Income Required	229,126		229,126
Less: Adjusted Net Operating Income	5,950	(39,061)	(33,111)
Additional NOI Required	223,176		262,237
Times: Gross Revenue Conversion Factor	1.695214		1.69521
Recommended Revenue Increase	$ 378,332		$ 444,548
Calculated Percentage Increase	310.19%		364.48%

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

DATA REQUEST

WATER SERVICE CO. OF INDIANA

CAUSE NO. 44104

OUCC Data Request Set No. 9 Date: March 2, 2012

Q 9-6: In Cause No. 42969, there was $6,761 of land costs included in the $295,429 of utility plant in service as of 12/31/05. Please state the amount of land included in Petitioner's proposed rate base in this case and the account it is included in. If no land cost is included, please explain what happened to the land and provide the entry to record the disposition of the land.

Response. The $6,761 of land costs is part of the original acquisition journal entry. This cost is booked as a total plant in service number. Please refer to response provided in Q9-18. The land costs should have been booked separately. A journal entry to reclassify the original acquisition entry will be booked after an Order in this proceeding has been issued. In addition, $133 was included in ratebase in account 1045 (Land) which was allocated from WSC.