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IN THE
COURT OF APPEALS OF INDIANA

No. 20A-EX-01404

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR, DUKE INDUSTRIAL GROUP, SIERRA CLUB, CITIZENS ACTION COALITION OF INDIANA, INC., ENVIRONMENTAL WORKING GROUP, and INDIANA COMMUNITY ACTION ASSOCIATION, *Appellants*, v. DUKE ENERGY INDIANA, LLC, and INDIANA UTILITY REGULATORY COMMISSION, *Appellees*.	Appeal from the Indiana Utility Regulatory Commission, No. 45253, Hon. James F. Huston, Chairman, Hon. Sarah E. Freeman, Commissioner, Hon. Stefanie Krevda, Commissioner, Hon. David L. Ober, Commissioner, Hon. David E. Ziegner, Commissioner, Hon. David E. Veleta Senior Administrative Law Judge.

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STATEMENT OF THE ISSUES

The issues in this appeal of Duke Energy Indiana, LLC's base rate case are:

I. Whether the Indiana Utility Regulatory Commission appropriately approved Duke's jurisdictional separation study as a reasonable allocation of costs between its retail, wholesale, and steam customers, with approximately the same allocation percentages as the previous rate case.

II. Whether the Commission appropriately approved the coal ash pond remediation costs as a recoverable regulatory asset.

III. Whether the Commission made specific findings supported by evidence in the record in its approval of operating costs attributable to Edwardsport Generating Station's use of gasified coal as a fuel source.

STATEMENT OF THE CASE

On July 9, 2019, Duke initiated a base rate case by filing a petition with the Commission, requesting that the Commission increase its authorized annual revenue requirement by approximately $390 million, a 15.43% increase. 2 Exs. at 57. Duke later amended its petition with the Commission's leave. II App. 23. Along with the Office of Utility Consumer Counselor (OUCC), 16 other parties, including the Duke Industrial Group, Citizens Action Coalition of Indiana, Inc. (CAC), the Indiana Community Action Association (ICAA), the Environmental Working Group (EWG), and the Sierra Club, participated to some degree in the rate case. II App. 22–27.

Between January 22 and February 7, 2020, the Commission held an 11-day evidentiary hearing during which the parties presented their testimony and evidence and cross-examined opposing parties. II App. 16–17, 25.

On June 29, 2020, the Commission issued its final 175-page order, approving a $145.9 million (5.7%) increase to Duke's annual authorized revenue requirement. II App. 18, 20, 192–93. On July 29, OUCC timely filed a notice of appeal, which the Industrial Group, CAC, ICAA, EWG, and the Sierra Club joined.

STATEMENT OF THE FACTS

A. Background on traditional ratemaking

The bedrock principle underlying utility regulation is a "regulatory compact" under "which the State sanctions a utility's monopoly within a defined service area and subjects the utility to various regulatory restrictions and responsibilities." *NIPSCO Industrial Group v. Northern Indiana Pub. Serv. Co.*, 100 N.E.3d 234, 238 (Ind. 2018). In exchange for the geographic monopoly, "the utility is subject to regulation by the state to ensure that it is prudently investing its revenues in order to provide the best and most efficient service possible to the consumer." *United States Gypsum, Inc. v. Indiana Gas Co., Inc.*, 735 N.E.2d 790, 797 (Ind. 2000) (citation omitted). Although the utility is not allowed "to charge rates at the level which its status as a monopolist could command in a free market," it "is allowed to earn a 'fair rate of return' on its 'rate base.'" *Id.*

The General Assembly has charged the Commission with responsibility for ratemaking, which is a legislative function. *Hamilton Southeastern Utilities, Inc. v.*

Indiana Utility Regulatory Comm'n, 101 N.E.3d 229, 233 (Ind. 2018); *see* Ind. Code § 8-1-2-1 *et seq*. In this capacity, the Commission serves "primarily as a fact-finding body with the technical expertise to administer the regulatory scheme devised by the legislature … to insure that public utilities provide constant, reliable, and efficient service to the citizens of Indiana." *Northern Indiana Pub. Serv. Co. v. U.S. Steel Corp.* (*NIPSCO*), 907 N.E.2d 1012, 1015 (Ind. 2009) (citations omitted). When performing its ratemaking function, "the Commission balances the public's need for adequate, efficient, and reasonable service with the public utility's need for sufficient revenue to meet the cost of furnishing service and to earn a reasonable profit." *NIPSCO Industrial Group*, 100 N.E.3d at 238.

Utility rates are traditionally "adjusted through general ratemaking cases." *NIPSCO Industrial Group*, 100 N.E.3d at 238. A traditional ratemaking case is a "comprehensive" proceeding in which the Commission "examine[s] every aspect of the utility's operations and the economic environment in which the utility functions to ensure that the data [the Commission] has received are representative of operating conditions that will, or should, prevail in future years." *Id.* (quoting *United States Gypsum*, 735 N.E.2d at 798).

The Commission sets rates prospectively—a utility cannot use a new rate case to recover past losses, and consumers have no claim to a return of past profits and earnings that may appear excessive. *Pub. Serv. Comm'n v. City of Indianapolis*, 235 Ind. 70, 88, 113 N.E.2d 308, 315 (1956); *Indiana Gas Co., Inc. v. Office of Utility Consumer Counselor*, 575 N.E.2d 1044, 1052 (Ind. Ct. App. 1991). But in setting

those prospective rates, the Commission looks at the utility's *past* financials to determine the utility's future revenue requirement by selecting a "test year"—which is "normally the most recent annual period for which complete financial data are available"—and calculating the "revenues, expenses and investment during the test year." *City of Evansville v. Southern Indiana Gas & Elec. Co.*, 167 Ind. App. 472, 478, 339 N.E.2d 562, 568 (1975); *see also United States Gypsum*, 735 N.E.2d at 798; *In re Northern Indiana Pub. Serv. Co.*, 166 P.U.R.4th 213, 1995 WL 795042 (IURC Dec. 28, 1995). Indeed, "[u]nder traditional rate regulation, an energy utility must first make improvements to its infrastructure *before* it can recover their cost through regulatory-approved rate increases to customers" in a general ratemaking case. *NIPSCO Industrial Group*, 100 N.E.3d at 236 (emphasis added).

In a general retail rate case, the Commission evaluates all of a utility's expenses (i.e., operating costs) and (1) approves those expenses it finds reasonable, (2) determines the value of the utility's retail rate base, and (3) sets a fair rate of return on that rate base. II App. 29, 70, 133.

In reviewing and approving expenses, the Commission has "broad discretion to disallow for rate-making purposes any excessive or imprudent expenditures." *City of Evansville*, 167 Ind. App. at 479, 339 N.E.2d at 569 (citation omitted). So, for example, if the Commission determines that a utility has given its executives unreasonably high compensation packages, the Commission may disallow (and indeed has consistently disallowed) some of those expenses as excessive. I.C. § 8-1-

2-48; *see, e.g.*, *In re Petition of Citizens Water*, No. 44306, 2014 WL 1268669, at *48 (IURC Mar. 19, 2014).

In determining the value of the utility's retail rate base, the Commission determines the fair value of the utility's capital assets that are used and useful in the provision of electricity to the utility's customers. I.C. § 8-1-2-6(a); *Citizens Action Coalition of Indiana, Inc. v. Northern Indiana Pub. Serv. Co.*, 485 N.E.2d 610, 614 (Ind. 1985); *see also City of Evansville*, 167 Ind. App. at 479, 339 N.E.2d at 569 ("The 'rate base' consists of that utility property employed in providing the public with the service for which rates are charged and constitutes the investment upon which the 'return' is to be earned.").

And in setting a fair rate of return on that rate base, the Commission's ultimate goal is to settle on a rate that is "reasonable and just." I.C. § 8-1-2-4. A fair rate is one that "produce[s] a fair and nonconfiscatory return," that "will enable the company, under efficient management, to maintain its utility property and service to the public," and that will "provide a reasonable return upon the fair value of its used and useful property." *Pub. Serv. Comm'n of Indiana v. Indiana Bell Tel. Co.*, 235 Ind. 1, 15, 130 N.E.2d 467, 473 (1955); *see also L.S. Ayres & Co. v. Indianapolis Power & Light Co.*, 169 Ind. App. 652, 660, 351 N.E.2d 814, 821 (1976) ("The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties." (citation omitted)); *City of Evansville*, 167 Ind.

App. at 478, 339 N.E.2d at 568 ("The Commission's primary objective in every rate proceeding is to establish a level of rates and charges sufficient to permit the utility to meet its operating expenses plus a return on investment which will compensate its investors." (citations omitted)).

Based on these components, the Commission sets an authorized annual revenue requirement that will support both the utility's expenses and a fair rate of return on the rate base. *City of Evansville*, 167 Ind. App. at 478–82, 339 N.E.2d at 568–71; *see* II App. 133. Once the Commission sets the authorized annual revenue requirement, it then designs rates for each class of retail customer (residential, commercial, and industrial) that corresponds with the proportion of the authorized annual revenue requirement attributable to the respective class of customer. *See Bethlehem Steel Corp. v. Northern Indiana Pub. Serv. Co.*, 397 N.E.2d 623, 632 (Ind. Ct. App. 1979); II App. 139–44.

B. Duke's rate case

Duke is the largest electric utility in Indiana, and sells electricity to 840,000 customers in the central, north central, and southern parts of the State. II App. 28, 196; IURC 2019 Annual Report, www.in.gov/iurc/2981.htm. Duke has three general categories of customers: retail or end-use customers who purchase their electricity from Duke (and are further subdivided into residential, commercial, and industrial retail customers); wholesale customers who purchase electricity from Duke and resell it to their own end-use customers; and one high-pressure-steam customer that purchases steam from Duke. II App. 134.

In this case, the Commission held a lengthy evidentiary hearing and admitted testimony from 32 witnesses offered by Duke and 27 witnesses offered by other parties. II App. 26–27. The Commission ruled on a myriad of issues. II App. 20–22. From those issues, the appellants[1] appeal only three discrete items: (1) the allocation of rate base costs and expenses to retail customers; (2) the recovery of coal ash pond remediation costs as a regulatory asset, effectively placing the costs in rate base; and (3) the recovery of operational expenses attributable to operating the Edwardsport Generating Station's coal gasifier.

1. The separation study allocates Duke's rate base and expenses among Duke's retail customers, wholesale customers, and steam customer.

One of the many factors in a general retail rate case is the allocation of the utility's rate base and expenses between its retail, wholesale, and other (in this case, steam) customers. The rates for retail customers should only include those investments (rate base) and expenses that are attributable to providing service to those customers. *See* II App. 134–35; *cf. L.S. Ayres & Co.*, 169 Ind. App. at 698, 351 N.E.2d at 843 ("To establish only electrical rates for this hearing, the Petitioner had to separate steam plant from electrical plant.").

To allocate the costs, Duke performed a separation study to apportion Duke's assets, revenues, and expenses to the types of customers (retail, wholesale, or

[1] OUCC and Duke Industrial Group each filed appellant's briefs. The Sierra Club, CAC, EWG, and ICAA have joined Duke Industrial Group's brief.

steam) that benefit from the assets or that cause the cost.[2] 12 Conf. Exs. at 183. The separation study removes costs from Duke's retail customers when those costs are driven or caused instead by wholesale customers or Duke's steam customer. *Id.* As Duke's witness explained, after removing the costs driven by the wholesale and steam customers, the remaining assets, revenues, and expenses are related to the provision of retail electric service. *Id.*

The percentage of costs assigned to each type of customer in the separation study is determined in a multistep process. Each cost is first functionalized, to determine whether the cost is a production cost or a transmission cost, because the different types of costs are allocated by different methods. 12 Conf. Exs. at 189. The production and transmission costs are then classified according to whether they vary with the amount of energy produced or the level of energy need or demand. 12 Conf. Exs. at 190. The cost of fuel for a generator is an example of a cost that varies based on the amount of energy produced, and a transmission line is an example of a cost that varies based on the level of demand. *Id.* A generation asset has components of both depending on the specific cost. *Id.*

[2] The terms "jurisdictional" and "non-jurisdictional" are used in the context of a separation study in a general retail rate case to distinguish the level of the Commission's regulatory oversight regarding retail and wholesale customers. In retail rate cases, the retail customers are termed as "jurisdictional" (that is, relevant to that rate case) and wholesale and other customers are termed as "non-jurisdictional" (that is, outside of the retail rate case). Wholesale contracts are approved by the Federal Energy Regulatory Commission in proceedings separate from a general retail rate case. For clarity in this brief, customers will be referred to as "retail" and "wholesale," not as "jurisdictional" and "non-jurisdictional."

To determine the allocator—expressed as a percentage—for costs assigned to the three types of customers (i.e., retail, wholesale, or steam), Duke presented spreadsheets that calculated the percentage for the demand costs and the energy costs. 13 Conf. Exs. at 6–21. The demand allocator is determined by taking the relative share of demand at the peak load for each month over one year. 13 Conf. Exs. at 7. This is the 12 coincident peak method, or "12 CP." 12 Conf. Exs. at 186. The customer's average contribution to the 12 monthly peaks determines the allocation percentage, which is approximately 8% for the wholesale customers. 12 Exs. at 197; 13 Conf. Exs. at 7. For the costs that vary with energy use, Duke determined that allocator by the total energy usage by each customer as a percentage of the total energy over a one-year period. 13 Conf. Exs. at 9. The proportionate share yielded the allocation percentage for wholesale customers. *Id.*

The Industrial Group objected to Duke's determination of the customer's allocation with current data, instead recommending that the allocation be based on hypothetical usage by wholesale customers in an amount that was served by Duke in previous years. 17 Conf. Exs. at 181–82. The Industrial Group also recommended that Duke classify a five-year contract with a wholesale customer as long term and include it in the wholesale allocation instead of treating it as a short-term sale and therefore including it in the jurisdictional retail portion. *Id*. According to the Industrial Group, these changes are necessary because, in its view, Duke has acquired "excess capacity" for retail customers owing to the termination of some wholesale contracts. 17 Conf. Exs. at 180. The Industrial Group argued that anything over

Duke's forecasted load plus 15% for reserves is excess capacity that retail ratepayers should not have to pay for. *Id.* Its proposed "fix" was to impute back into the allocation historical wholesale load that no longer exists. II App. 134.

The Commission accepted Duke's separation study, finding that the study "as presented and supported is a reasonable allocation of costs among the various jurisdictions, both its wholesale and retail electric and steam jurisdictions." II App. 135. The Commission declined to "accept the Industrial Group's proposal to make adjustments for historical long-term wholesale sales that have terminated in a managed amount in recent years." *Id.* The Commission also found that, despite the termination of some wholesale contracts, the "level of sales allocated to wholesale in the jurisdictional separation study is approximately the same as it was in the Company's last rate case." *Id.* The Commission deemed these facts "persuasive" and determined that "imputing a historical level of sales, for the circumstances in this proceeding, is not needed." *Id.*

The Commission also concluded that the five-year contract should be considered as short term and included as a retail sale, not a long-term contract allocated to the wholesale customers. II App. 135. It determined that the contract should remain in the retail customers' allocation because this contract "differs markedly from traditional long-term wholesale native load contracts that are allocated to wholesale in the jurisdictional separation study process" because, "significantly," Duke does not "plan or build for this contract, in contrast to traditional wholesale native load customers." *Id.*

2. Coal ash pond remediation

Duke sought recovery of its past expenses associated with activities taken to comply with federal and state requirements applicable to coal ash[3] surface impoundments and other ash management areas. II App 67. The coal ash costs at issue were incurred in the years 2014–2018. 32 Exs. at 115. As with the Commission's order, this brief refers to these costs as the coal ash costs.

Duke initially sought a certificate of public convenience and necessity (CPCN) for the coal ash costs and a federally mandated tracker[4] under Indiana Code section 8-1-8.4-6 to recover the coal ash costs. 32 Ex. at 120–21. But on rebuttal Duke requested in the alternative the traditional ratemaking route to include in rate base a regulatory asset[5] consisting of its past coal ash basin planning, closure, and related expenses, and to recover those costs over 18 years. 40 Conf. Ex at 29.

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[3] Coal ash is "industrial waste" that is "created when coal is burned by power plants to produce electricity." Environmental Protection Agency, *Coal Ash (Coal Combustion Residuals, or CCR*), www.epa.gov/coalash.

[4] Trackers are costs that by statute may be recovered as they are incurred outside of the general rate case. *NIPSCO Industrial Group*, 100 N.E.3d at 238.

[5] A regulatory asset, or deferred accounting, is a financial vehicle to defer costs to a utility's balance sheet, and then include the asset as if in rate base, upon approval by the Commission in a later rate case. *See Duke Energy Indiana, Inc. v. Office of Utility Consumer Counselor*, 983 N.E.2d 160, 163 (Ind. Ct. App. 2012). Like any capital asset in rate base, the utility earns a rate of return on the asset and uniformly decreases the value over time. *City of Evansville*, 167 Ind. App. at 479–80, 339 N.E.2d at 569.

Duke presented evidence that the compliance activities giving rise to the coal ash costs were "necessary for continued operations" at three of its generating stations and that the coal ash costs "extended the useful life of existing energy facilities." 32 Exs. at 116. The coal ash costs through 2018 were to ensure compliance with federal requirements, specifically the Environmental Protection Agency's Coal Combustion Residuals rule, as well as the Indiana Department of Environmental Management's solid waste management rules. 32 Exs. at 120; *see* 40 C.F.R. §§ 257.50–257.107; 329 I.A.C. 10-9-1. The types of activities giving rise to the coal ash costs include geotechnical and site investigations, stability analyses, designing closure systems, excavation and dredging of some coal ash ponds, dewatering, grading, and placement of structural fill in some ponds. 32 Exs. at 115. Duke provided the total amount of the regulatory asset for recovery as $186.7 million in direct costs, with an additional $25 million in financing costs, for a total of $211.7 million. 39 Exs. at 92.

OUCC recommended that the Commission deny Duke's proposed recovery of the coal ash costs because, in OUCC's view, those costs, if they are to be recovered, must be recovered under the federally mandated tracker statute, I.C. § 8-1-8.4-6. 46 Exs. at 156, 164. The Industrial Group also opposed recovery of Duke's coal ash

costs for basically the same reason and cited a prior Commission order denying Duke's request to recover other past federally mandated costs.[6] 42 Exs. at 62–63.

The Commission approved Duke's request to treat the coal ash costs as a regulatory asset under traditional ratemaking, not as federally mandated costs under the federally mandated tracker statute, and, therefore, approved the regulatory asset for recovery over 18 years. II App. 67. The Commission explained that it "could not ignore" the historical importance of coal generation in Indiana, and that "ongoing environmental regulations drive costs associated with that history." *Id.* In approving the coal ash costs as a regulatory asset, the Commission found that the coal ash costs will provide "longstanding benefits in terms of compliance with federal and state laws" and "the ability to continue to use the generating stations." *Id.*

Although the Commission did not issue a CPCN for federally mandated costs under the federally mandated tracker statute, the Commission observed that if Duke would have sought preapproval, the coal ash costs would have been type of costs that are recoverable under the tracker statute. II App. 67. The Commission used that fact as "collateral support" for considering recovery under the traditional ratemaking method of a regulatory asset. *Id.*

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[6] In Cause No. 44367 FMCA 4, the Commission denied Duke's request to recover other past federally mandated costs under the federally mandated tracker statute because Duke had not sought pre-approval from the Commission for those costs. *Petition of Duke Energy Indiana, LLC*, No. 44367 FMCA 4, 2019 WL 6683737 (IURC Dec. 4, 2019). The Commission issued its decision in that case during the pendency of Duke's general base rate case.

In addition to the findings above, the Commission gave a thorough explanation that the ratemaking impact would not have changed even if it had not approved the coal ash costs as a regulatory asset. II App. 67. The coal ash costs would have been recoverable anyway under traditional ratemaking treatment as removal costs and built into rate base as such. *Id.*

3. Operation of Edwardsport on gasified coal

In addition to challenging the separation study and the recovery of coal ash costs—both of which concern the fair value of the assets appropriately included in the rate base—the Industrial Group also challenged the expenses incurred by Duke in operating it Edwardsport generation plant. Edwardsport is a dual-fuel, 618-megawatt generation facility that can operate either on gasified coal, which is a synthetic gas derived from coal, or on natural gas. *See* 42 Exs. at 23. Duke presented for approval its test year operating expenses for Edwardsport totaling $106 million, including basic generating station operations and maintenance outage costs. II App. 111; 42 Exs. at 33. These types of operational expenses, if approved by the Commission as prudent and reasonable, are included in rates at the level set in the test year.

The Industrial Group contended that Edwardsport should be run entirely on natural gas, shutting down the coal gasifier, and alleged a monetary savings of $81.6 million if Duke did so. 42 Exs. at 33–34, 49.

On this issue, the Commission rejected the Industrial Group's proposal to effectively convert Edwardsport to solely a gas plant. II App. 95–96. The Commission

relied on evidence showing—and affirmatively found—that the decision to do so would have "permanent repercussions." II App. 95–96. The Commission emphasized the importance of maintaining a "diverse generation portfolio" and found that Edwardsport, as Duke's "youngest and most advanced coal-fired unit," will continue to operate as "older coal fired unit[s] are largely replaced by noncoal fired units." II App. 96.

The Commission additionally found that a conversion to only natural gas would be "operationally difficult," "time consuming," and "costly." *Id*. Likewise, if Duke closed the coal gasifier, the company would lose the highly trained workforce. *Id*. And the Commission cast doubt on the potential for savings from fuel, as the contract for coal would mean Duke would have an "oversupply of coal" if it stopped operating the gasifier for any length of time. *Id*.

The Commission, therefore, denied the Industrial Group's recommendation that only costs associated with hypothetically running Edwardsport as a gas unit should be included in rates, finding instead "that continued operations primarily on coal is reasonable for Edwardsport." II App. 97.

SUMMARY OF THE ARGUMENT

The General Assembly has delegated to the Commission the legislative function of ratemaking for most utilities, including Duke. The Commission has the statutory authority and the unique technical expertise to analyze and evaluate the evidence presented to it and to make findings and determinations based on that evidence. The Indiana Supreme Court has determined that, when the Commission

makes such ratemaking decisions within its technical expertise, the courts should grant the Commission great deference. The three issues in this appeal are solidly within the Commission's ratemaking and technical expertise and thus are entitled to a high level of deference.

On the cost allocation issue, the Commission made a factual finding that Duke's separation study was reasonable because the retail customers were allocated approximately the same level of costs as in the previous rate case, signifying that the amount of capacity allocated to retail customers is the same amount of capacity built for them and used by them. Nothing in the allocation changed in this rate case, and so there was no reason to impute a different level of hypothetical wholesale contracts in the allocation. Retail customers are still paying for approximately the same percentage of Duke's system as they historically have. Even if customers presently have a slight amount of "excess capacity," the extra capacity is part of the reserve margin needed to serve those customers and is still used and useful to retail customers.

On the coal ash costs issue, approval of the coals ash pond remediation as a regulatory asset to be included in rate base was also a factual, rate-setting determination within the Commission's special expertise. The Commission approved the regulatory asset because the coal ash costs were a necessary aspect for operation of Duke's coal plants. There is no requirement that Duke must proceed to recover costs under the federally mandated tracker statute instead of as a traditional rate base asset, as Duke alternatively requested in rebuttal in this proceeding. Because Duke

did not seek preapproval of the costs, it took the risk that the Commission would not ultimately approve the costs as reasonable, which is the way traditional rate setting has worked for the last century. That traditional ratemaking process—where the utility makes capital expenditures at its discretion and later seeks approval and rate base treatment of those expenditures in a rate case—is still allowable even in light of other trackers that possibly could be used by utilities as an alternative method. Moreover, recovery of the coal ash costs as a regulatory asset has the same rate impact as designating the costs as removal costs, and absent the Commission's approval of the regulatory asset, the costs would otherwise have been recoverable in rate base as a cost of removal.

Regarding the Edwardsport operating costs, the Commission made specific findings about why it authorized the expenses of running Edwardsport on gasified coal instead of converting it to a natural gas plant. It found that the conversion to run on natural gas only would have permanent repercussion for the dual fuel plant. It would be operationally difficult to convert, time consuming, and costly to switch in response to short term gas prices. The Commission also found that Duke would lose the highly trained work force that operates the gasifier. Finally, it specifically found that, based on Duke's coal contract, Duke would still purchase coal, whether used or not, resulting in an oversupply of coal. These specific findings are sufficient to support the Commission's approval of the Edwardsport operating costs.

The Court should defer to the Commission's findings, all of which were made within its statutory authority and technical expertise, and uphold the Commission's order.

ARGUMENT

The General Assembly created the Commission as a fact-finding body with the technical expertise to regulate utilities in Indiana. *Northern Indiana Pub. Serv. Co. v. U.S. Steel Corp.* (*NIPSCO*), 907 N.E.2d 1012, 1015 (Ind. 2009); *IPL Industrial Group v. Indianapolis Power & Light Co.*, __ N.E.3d __, 2020 WL 6479600, at *2 (Ind. Ct. App. Nov. 4, 2020). Owing to its function and specialized expertise, an order from the Commission "is presumed valid unless the contrary is clearly apparent." *Citizens Action Coalition of Indiana, Inc. v. Northern Indiana Pub. Serv. Co.*, 485 N.E.2d 610, 612 (Ind. 1985); *see also Citizens Action Coalition of Indiana, Inc. v. Northern Indiana Pub. Serv. Co.*, 76 N.E.3d 144, 151 (Ind. Ct. App. 2017).

This Court reviews Commission orders using a multi-tiered standard. *NIPSCO*, 907 N.E.2d at 1016; *Citizens Action Coalition of Indiana, Inc. v. Indianapolis Power & Light Co.*, 74 N.E.3d 554, 562 (Ind. Ct. App. 2017). First, the Court determines whether the Commission's findings of basic fact are supported by substantial evidence. *NIPSCO*, 907 N.E.2d at 1016. Second, the Court determines whether the Commission's order contains "specific findings on all the factual determinations material to its ultimate conclusions" and whether the Commission's conclusions of ultimate fact are reasonable. *Id.* (citation omitted).

The Court must afford great deference to the Commission on matters within its expertise, though the Court "may examine the logic of inferences drawn and any rule of law that may drive the result." *Id.* The Commission's orders are also "subject to review as contrary to law, but this review is limited to whether the Commission stayed within its jurisdiction and conformed to the statutory standards and legal principles involved in producing its decision, ruling, or order." *Id.*

Each of the three issues raised by the Industrial Group and OUCC is subject to and survives deferential review because they involve the Commission's reasonable determinations of ultimate fact. First, the Commission reasonably determined that Duke's separation study properly allocated costs among its retail, wholesale, and steam customers. Second, the Commission reasonably determined that Duke's coal ash costs is a regulatory asset that should be included in its rate base. Third, the Commission reasonably determined that Duke's expenses for operating the Edwardsport plant are reasonable. The appellants seek to avoid deferential review by injecting legal issues into their arguments, but as explained below their efforts are wide of the mark.

I.
The Commission properly accepted Duke's separation study as reasonable, while dismissing the Industrial Group's request to impute hypothetical wholesale contracts in the allocation.

In accepting Duke's separation study, the Commission determined that the study was a reasonable approach to allocating costs among its different categories of customer because the allocation had not changed in any significant manner from Duke's previous rate case in 2004. This determination falls squarely at the core of

the Commission's ratemaking function. *See Citizens Action Coalition of Indiana, Inc. v. Duke Energy, Indiana, Inc.,* 15 N.E.3d 1030, 1038 (Ind. Ct. App. 2014) ("The allowance of costs is inherent in the ratemaking process and we accord deference to the Commission"). And because this is a question of ultimate fact, this Court's review is limited to assessing the reasonableness of the Commission's acceptance of Duke's separation study over the Industrial Group's invitation to redo the separation study with hypothetical wholesale contracts. Contrary to the Industrial Group's assertion, the Commission's acceptance of Duke's separation study does not run afoul of the used and useful standard because the capacity allocated to retail customers was built for use by those customers and is used and useful by those customers, either directly or as part of the capacity reserve margin utilities must maintain.

A. The Commission in its judgement properly determined that ratepayers only pay for capacity built for them and used by them.

It is reasonable for the Commission to allocate costs to a utility's retail customers when those costs were incurred to provide service and ensure supply to those customers. The Commission's finding that Duke's separation study is reasonable stems from the fact that the retail jurisdiction customers have been allocated approximately the same level of sales as in the previous rate case. II App. 135. This means that retail customers have not been saddled with costs from Duke's provision of service to wholesale customers in the way the Industrial Group argues. Industrial Group Br. 21.

Under Duke's separation study, retail customers are being allocated costs for capacity that was built to provide service to them. Those customers are paying for

the same percentage of Duke's system as they have for decades. The consistency of the allocation over time refutes the idea that there has somehow been an unfair redistribution of costs to retail customers due to the termination of a small amount—a "managed" amount as the Commission found—of wholesale contracts. Electric demand and supply for different customers is not constant. Duke lost some long-term wholesale contracts, entered into others, gained additional retail customers, built new generation capacity, and saw shifting load patterns (i.e., customers used electricity differently at different times). But with all the changes, in this rate case retail customers are still allocated the approximate same percentage of the system as they historically have been. Thus, the Commission found that continued allocation in Duke's separation study reasonable.

Indeed, Duke's separation study showed that retail customers were actually allocated a *lower* percentage of the production costs—costs that vary based on demand—than they were in the previous rate case. II App. 135. In this regard, retail customers are paying for a *smaller* share of these production costs, and wholesale customers are paying for a *larger* share. *Id*. The Industrial Group does not mention this point, presumably because it cuts against its argument that wholesale capacity is being unfairly piled on retail customers.

By the same token, the Industrial Group refrains from arguing what specific amount of capacity it believes is "excess." It does not specify the "proper" amount of capacity Duke should have, or provide any specific amount of capacity costs that were improperly shifted.

The fact that available capacity exceeds retail load does not mean that the utility has unreasonable "excess" capacity above and beyond what is needed to service the retail customers. *See In re Investigation Into Allegations of Unreasonable Excess Generating Capacity*, No. 37458, 1984 WL 994833, at *2 (Ind. Pub. Serv. Comm'n June 8, 1984). Capacity and load are rarely, if ever, precisely matched. Even if one *could* forecast the precise peak load a utility will see in any given year—which in and of itself is virtually impossible—the installed capacity to meet that peak load would be "lumpy" over time, for the capacity would not change in proportion with the change in load. The reason: Capacity additions are made in relatively large segments because it is typically more economical per megawatt to build one large generation facility instead of many small ones. This "lumpiness" means that a utility at any given point never precisely matches its load with needed capacity. *See id*. Utilities target an "excess" capacity called a reserve margin—capacity that is used to continue service to customers in the event of load exceeding forecast or a generation station outage—but for the same reasons, the amount of the reserve margin varies over time as well.

What is more important is that the capacity that is allocated to retail customers was implicitly constructed and intended for the retail customers' use. Duke's capacity built after passage of Indiana Code chapter 8-1-8.5 in 1983 was pre-approved by the Commission as reasonably necessary under that statute. Capacity preceding that statute has already been included in Duke's rate base and attributable to retail customers from rate cases after the construction of each generating station. All this

is to say that a consistent allocation of capacity over time indicates that the retail customers are paying for the same percent of Duke's capacity either approved by the Commission for retail customers or previously included in Duke's rate base with the same percent allocated to retail customers. That led the Commission to approve the same approximate allocation as reasonable here. II App. 135. And the Industrial Group has never identified any *significant* change in circumstances to justify departing from this long-established cost allocation.

Similarly, the Commission reasonably rejected the Industrial Group's proposal to classify the five-year contract as wholesale for purposes of the separation study. The Commission based its rejection of that proposal on the finding that Duke does not "plan or build for this contract." II App. 135. This capacity was instead planned and built for retail customers, and that contract creates value for retail customers by "creating sales revenues that would otherwise not exist"—that revenue goes toward Duke's annual revenue requirement, thereby reducing the amount that Duke recovers from retail customers. *Id*. The Commission did not act unreasonably in refusing to allocate the contract to wholesale customers because the contract "differs markedly" from traditional wholesale contracts. *Id*.

Because the Commission's acceptance of the separation study was reasonable, the Court need not go any further. *Cf. Jay Classroom Teachers Association v. Jay School Corp*. 55 N.E.3d 813, 816 (Ind. 2016) (explaining that if an agency's interpretation of a statute it is charged with enforcing is reasonable, "we stop our analysis and need not move forward with any other proposed interpretation").

B. Approving Duke's separation study as reasonable did not violate the used and useful standard.

1. The Commission's acceptance of Duke's separation study does not violate the used and useful standard because the capacity underlying the allocated costs is used and useful for the provision of electricity to retail customers.

In performing its ratemaking function, the Commission "shall value all property of every public utility actually used and useful for the convenience of the public at its fair value." I.C. § 8-1-2-6. The used and useful standard requires "(1) that the utility plant be actually devoted to providing utility service, and (2) that the plant's utilization be reasonably necessary to the provision of utility service." *City of Evansville v. Southern Indiana Gas & Elec. Co.*, 167 Ind. App. 472, 516, 339 N.E.2d 562, 589 (1975). In other words, this standard requires that a utility's rate base only include plant or equipment "employed in providing the public with the service for which rates are charged." *Citizens Action Coalition v. Northern Indiana Public Service Co.*, 485 NE 2d 610, 614 (Ind. 1985). Likewise, any allowable operating expense must have a connection to the utility service rendered before it can be recovered through retail rates. *Id*.

Applying this standard, the Supreme Court held in *Citizens Action Coalition* that a utility could *not* include in its rate base a nuclear generation plant that was cancelled before it was put into service. *Id.* at 614. That plant, explained the Court, "never became 'used and useful' property as I.C. § 8-1-2-1 contemplates," and so the Court concluded that the "characterization of the cancelled Bailly N–1 project as an

extraordinary cost of service loss was incorrect and the order allowing amortization was contrary to law." *Id*.

Similarly, a utility may not include in its retail rate base capacity that was built and earmarked for wholesale customers. *See L. S. Ayres & Co. v. Indianapolis Power & Light Co.*, 169 Ind. App. 652, 681–85, 351 N.E.2d 814, 833–35 (1976). In *L.S. Ayres*, the question was whether all of the Petersburg Two generating plant was reasonably necessary to retail customers when that capacity had been previously sold to another utility. Explaining that the used and useful standard required "the plant included in the rate base be reasonably necessary to the efficient and reliable provision of utility service to the public," *id.* at 681, 351 N.E.2d at 833, the Court remanded the case to the Commission for specific findings on whether the entire capacity of the plant was used and useful for retail customers, *id.* at 683–85, 351 N.E.2d at 834–35.

The Commission did not contravene these principles when it accepted Duke's separation study. *Citizens Action Coalition* is inapposite. Whereas that case involved a cancelled nuclear plant that never produced energy, this case involves generation capacity that *does* produce energy and either directly serves retail customers' needs or is part of the retail customers' reserve margin. And *L.S. Ayres* is of limited value because it predates the certificate of public convenience and necessity (CPCN) statute, *see* I.C. § 8-1-8.5-2, under which utilities must obtain pre-approval of capacity additions *before* construction. Because there was no such pre-approval in *L.S. Ayres*, the court questioned whether the capacity originally built for another

purpose (another utility) could be used and useful for retail customers. But in the case at hand, Duke's capacity has already been pre-approved by the Commission as reasonably necessary for retail customers, or the capacity, if in existence before 1983, has been previously included in rate base in prior rate cases as used and useful to the retail customers. So unlike in *L.S. Ayres*, Duke's capacity allocated to retail customers has never been earmarked solely for non-retail customers and has already been previously approved by the Commission for use by retail customers. Importantly, by law, Duke is entitled to "recover through rates the actual costs the utility has incurred in reliance on a certificate" issued under the CPCN statute. I.C. § 8-1-8.5-6.5. The Commission thus could not exclude those costs from Duke's rate base without modifying Duke's previously approved certificates.[7] *See* I.C. § 8-1-8.5-5.5.

2. Nor did the Commission take an inconsistent position by accepting Duke's separation study, even though it previously denied another utility's separation study in a different case involving different circumstances. *See Indiana Michigan Power Co.*, 2020 WL 1656243 (IURC Mar. 11, 2020).

The facts and circumstances in *Indiana Michigan* differed in several material respects. There, the utility attempted to allocate what were previously wholesale

[7] Notably, the alleged "excess" capacity that Duke owns, even if not needed at the moment to serve Duke's customers, is still used and useful to those customers because Duke's sells "excess" capacity, if economical, in the wholesale power markets. II App. 153. When Duke does so, any profit on the "excess" capacity above and beyond what is included in base rates, is shared through a tracker with Duke's ratepayers on a 50/50 basis. *Id*. In this way, ratepayers share in the economic value of capacity assigned to them as it is sold in the market.

costs to its retail customers after a group of municipal wholesale customers terminated their contract with the utility. The utility had constructed that capacity to serve wholesale customers, and that capacity had served them for more than 50 years. The Commission denied the utility's proposal to allocate what until then had always been wholesale capacity to its retail customers. That capacity, said the Commission, "represent[ed] a wholesale contractual load for whom I&M ha[d] planned and incurred costs for many years." 2020 WL 1656243 at *89. Moreover, I&M's separation study significantly *increased* the allocation to retail customers from the historical level in the previous rate case, signifying "in effect, I&M now looks to recover [wholesale] related costs from its other customers, including Indiana retail customers." *Id*. On top of that, the Commission found that I&M's management had failed to act with prudent foresight: "We cannot find support for the lack of management foresight in allowing a wholesale contract misalignment of load and resources as warranting what is, effectively, shifting I&M's risk to Indiana captive retail customers." *Id.* at *90.

The facts here differ thrice over: First, the allocation to retail customers did not increase but stayed the same as (and in fact slightly decreased from) the previous rate case. Second, nothing in the record shows that capacity which was planned and built to serve the wholesale customers is now being assigned to retail customers—rather, the allocated capacity was built and planned for retail customers. Third, there is no evidence suggesting Duke's management had lack of foresight in misaligning retail capacity with load—to the contrary, the Commission found

Duke's wholesale contracts have terminated in a "managed" amount. II App. 135. Thus, the two cases are easily distinguishable by the different findings in each order. The Commission did not depart from past practice in this case.

II.
Approval of Duke's coal ash pond remediation costs as a regulatory asset was a reasonable factual determination by the Commission, did not modify rates retroactively, and was not otherwise reversible error.

The Commission reasonably determined that Duke could recover its coal ash costs in its rates. The legislature has afforded the Commission broad discretion to determine the assets included in a utility's rate base. *See* I.C. § 8-1-2-6(a); *Citizens Action Coalition of Indiana, Inc. v. Northern Indiana Pub. Serv. Co.*, 485 N.E.2d 610, 614 (Ind. 1985); *see also City of Evansville v. Southern Indiana Gas & Elec. Co.*, 167 Ind. App. 472, 479, 339 N.E.2d 562, 569 (1975) ("The 'rate base' consists of that utility property employed in providing the public with the service for which rates are charged and constitutes the investment upon which the 'return' is to be earned."). Here, the Commission determined that the coal ash costs were reasonable and prudent because they "will provide longstanding benefits, in terms of compliance with such federal and state mandates, improved environmental footprints, and the ability to continue to use utility properties." II App. 67.

Neither OUCC nor the Industrial Group challenges the reasonableness of the Commission's determination in that regard. Instead, they argue that the Commission committed legal error by (A) engaging in retroactive ratemaking and (B) allowing Duke to recover these costs in its base rate instead of seeking pre-approval under the federally mandated tracker statute. Both arguments are misguided.

A. The bar on retroactive ratemaking prohibits changes to historical rates, not recovery of previously incurred capital costs.

Duke sought to recover its past coal ash remediation costs as a regulatory asset, and the Commission approved Duke's request. II App. 67. Duke will, therefore, recover a rate of return on the regulatory asset and uniformly decrease the regulatory asset. As with any capital asset included in Duke's rate base, the return on and of the regulatory asset will be include in rates implemented after this rate case.

In a traditional rate case, the Commission sets rates based on the test year that will go into effect after the Commission's order; and those rates will continue to apply regardless of whether later years exactly match the test year. *See City of Evansville*, 167 Ind. App. at 478–82, 339 N.E.2d at 568–71. The general prohibition on retroactive ratemaking bars modifying rates to make up for divergences between the test year and what actually occurs in subsequent years. *Pub. Serv. Comm'n v. City of Indianapolis*, 235 Ind. 70, 88, 113 N.E.2d 308, 315 (1956) ("Past losses of a utility cannot be recovered from consumers nor can consumers claim a return of profits and earnings which may appear excessive."); *see also Indiana Gas Co., Inc. v. Office of Utility Consumer Counselor*, 575 N.E.2d 1044, 1052 (Ind. Ct. App. 1991). The general bar on retroactive ratemaking also prohibits modifying rates that were previously set in the past, after those rates have already been collected or billed. *Indiana Tel. Corp. v. Pub. Serv. Comm'n*, 131 Ind. App. 314, 340, 171 N.E.2d 111, 124 (1960) ("The statute provides the commission with the power to fix rates *for the future* … but we look in vain to find statutory authority for the commission to fix rates for the past.").

In approving the regulatory asset, the Commission neither allowed Duke to recoup past income losses nor modified previously established rates. The Commission set rates that would take effect *after* the issuance of its order. II App. 192–93. Those rates of course include, as part of Duke's rate base, assets constructed in the past with costs in the past because those assets must be used and useful before being included in rate base. *See NIPSCO Industrial Group v. Northern Indiana Pub. Serv. Co.*, 100 N.E.3d 234, 236 (Ind. 2018) ("Under traditional rate regulation, an energy utility must first make improvements to its infrastructure before it can recover their cost through regulator-approved rate increases to customers. The process for recouping these costs, sometimes not until years after they were incurred, is an expensive, onerous ratemaking case, which involves a comprehensive review of the utility's entire business operations.").

If including recovery of and on rate-based capital assets ran afoul of retroactive ratemaking principles, no rate base assets could ever be included in rate base. Inclusion of assets previously constructed in rate base is not a violation of retroactive ratemaking because no previous losses are recovered and no previous rates are modified. In this case, the Commission appropriately followed traditional ratemaking principles in determining that the coal ash cost regulatory asset (and other capital assets not at issue here) were "reasonably necessary." *City of Evansville*, 167 Ind. App. at 516, 339 N.E.2d at 589.

B. The federally mandated tracker statute is optional and thus does not prohibit federally mandated costs from being treated as a regulatory asset recoverable in a general rate case.

To be sure, Duke had another option to recover its coal ash costs outside of its general base rate case. Under the federally mandated tracker statute, a utility that obtains pre-approval from the Commission may recoup a portion of certain federally mandated costs *as they incur them* without having to wait for its next general rate case. I.C. §§ 8-1-8.4-6, -7(c); *cf. IPL Industrial Group v. Indianapolis Power & Light Co.*, __ N.E.3d __, 2020 WL 6479600, at *1 (Ind. Ct. App. Nov. 4, 2020) (discussing analogous TDSIC mechanism). But to obtain that benefit, the statute requires that the utility obtain a certificate of public convenience and necessity (CPCN) from the Commission *before* incurring the costs. *See* I.C. § 8-1-8.4-6(a); *see also* I.C. § 8-1-8.4-6(b) ("The commission shall issue a [CPCN] … if the commission finds that *the proposed compliance project will* allow the energy utility to comply … with one (1) or more federally mandated requirements." (emphasis added)); *Petition of Duke Energy Indiana, LLC*, No. 44367 FMCA 4, 2019 WL 6683737 (IURC Dec. 4, 2019).

The fact that Duke had but did not use this special tracker to recoup its coal ash costs earlier did not preclude it from waiting until its next general rate case. Nothing in the federally mandated tracker statute makes it a mandatory process. Rather, like other trackers, that statute simply allows a utility to expedite its ability to recover some of its federally mandated costs, without having to wait for a general rate adjustment. *See NIPSCO Industrial Group*, 100 N.E.3d at 238 ("Over the years, the legislature has supplemented traditional ratemaking with various

'tracker' procedures that allow utilities to ask the Commission to adjust their rates to reflect various costs without having to undergo a full ratemaking case.").

The tracker process, of course, differs from traditional ratemaking treatment, where the utility incurs the costs and then afterward requests approval from the Commission, thereby taking all of the risk that the Commission will determine that the asset was not needed, too expensive, or otherwise unnecessary. *Id.* at 236. If the Commission approves the request as it did with Duke, then those costs are recovered through future rates (i.e., after the Commission's order approving the request).

No law specifies the type of assets that may be approved by the Commission as a regulatory asset, other than that they must be used and useful for utility service. I.C. § 8-1-2-6. In light of this, the Commission turned to the guidelines in the federally mandated tracker as "collateral support" to aid its judgement in whether to approve the regulatory asset under traditional ratemaking principles. II App. 67. This did not mean the Commission applied the statutory requirements, or that it granted a CPCN, only that it used the federally mandated tracker statute "off-label" to assist in its analysis.

Under traditional remaking, the Commission approved the coal ash cost regulatory asset as it had other similar types of costs in other proceedings. II App. 67. It made specific findings about the importance of coal historically in providing energy to Indiana, and the long standing benefits of the coal ash costs, including that they were necessary for continued operation of some of the coal plants. *Id.* The Com-

mission also specifically found that the coal ash costs improved Duke's environmental footprint, and it specifically credited Duke's testimony supporting the reasonableness of the coal ash costs. *Id.* With these facts based on the record, approving the regulatory assets was reasonable, included specific findings, and did not require preapproval under the federally mandated statute.

III.
The Commission made specific findings of fact and reasonably determined that Duke's expenses in operating Edwardsport's gasifier are reasonable.

The Commission reasonably determined that Duke's operating expenses for the Edwardsport's gasifier are reasonable and supported its determination of ultimate fact on this score with specific findings. The Commission has "broad discretion" in determining the reasonableness of a utility's expenses. *City of Evansville v. Southern Indiana Gas & Elec. Co.*, 167 Ind. App. 472, 479, 339 N.E.2d 562, 569 (1975) (citation omitted); *see also Citizens Action Coalition of Indiana, Inc. v. Northern Indiana Pub. Serv. Co.*, 485 N.E.2d 610, 614 (Ind. 1985) ("Any allowable operating expense must have a connection to the service rendered before it can be recovered through retail rates."). Here, the Commission reasonably concluded that Duke could include its expenses for operating Edwardsport's gasifier in its base rate.

The Commission's determination in allowing the costs to operate Edwardsport with its coal gasifer in the test year were specific and itemized. The Commission found that converting Edwardsport to a gas unit only would have "permanent repercussions, and would put the future use of the plant as a dual-fueled syn-

gas/natural gas plant at risk." II App. 115. The Commission also found that operating only on natural gas "would be operationally difficult, time consuming, and costly to switch fuels in response to short-term natural gas price signals in an attempt to capture benefits for customers." *Id.* The Commission noted other downsides, including "among other things, the Company would lose the highly trained and qualified workforce, which [Duke's witness] stated would be devastating to the future of restarting the plant on coal." *Id.* Each of these is a specific finding based on the evidence and cut against the Industrial Group's proposal for the operation of the Edwardsport plant on natural gas only.

The Commission went on to find that if the gasifier were shut down, Duke would be "oversupplied with coal if it were to switch to natural gas for any length of time" because of the existing coal contract. *Id.* And based on the foregoing specific finding the Commission made its ultimate conclusion approving the cost of Edwardsport to run on coal: "We have found continued operations primarily on coal is reasonable for Edwardsport and as such, we find it reasonable to set a level of O&M in base rates based on such operation."

Moreover, the Commission specifically pointed out the importance of generation resource diversity, and determined that Edwardsport, as Duke's youngest and most advanced coal-fired unit could continue to operate on coal for years to come as older coal units are retired or replaced. *Id.* As Duke and other Indiana utilities "re-

tire thousand of megawatts of coal-fired baseload generation, the remaining base-load units [like Edwardsport] … may become critical from a grid reliability perspective." *Id*. These conclusions were eminently reasonable.

It is true that the Industrial Group presented testimony that, in its witness's opinion, these qualitative benefits of reversibility and diversity of fuel were not valuable enough to justify including them in the base-rate determination. But that is simply one witness' opinion, and the Commission did not credit that opinion. *Id*. In reviewing this issue, the Court looks only to the evidence most favorable to the Commission's determination and assesses whether the Commission made sufficient and specific findings of fact. *Northern Indiana Pub. Serv. Co. v. U.S. Steel Corp.* (*NIPSCO*), 907 N.E.2d 1012, 1016 (Ind. 2009). Here, the Commission made the necessary specific findings and reasonably determined that Duke should be allowed to recover its expenses for operating the Edwardsport gasifier in its base rate.

CONCLUSION

For the foregoing reasons, the Court should affirm the Commission's order.

Respectfully submitted,

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WORD COUNT CERTIFICATE

I verify that this Brief of Appellee contains no more than 14,000 words, not including those portions excluded by Indiana Appellate Rule 44(C).

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CERTIFICATE OF SERVICE

I certify that on December 14, 2020, I electronically filed the foregoing document using the Indiana E-filing System. I also certify that on December 14, 2020, I served the foregoing document on the following contacts through E-Service using the IEFS:

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