OFFICIAL
EXHIBITS

VERIFIED DIRECT TESTIMONY OF PAUL S. KELLY

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PETITIONER'S
EXHIBIT NO. 3
DATE 7-25-19 AT
REPORTER

Introduction and Purpose of Testimony

Q1. Please state your name, business address and title.

A1. My name is Paul Kelly. My business address is 150 W. Market Street, Suite 600, Indianapolis, IN 46204. I am Vice President of Major Accounts for Northern Indiana Public Service Company LLC ("NIPSCO" or the "Company").

Q2. Please briefly describe your educational and business experience.

A2. I am a graduate of Bob Jones University in Greenville, South Carolina, with a Bachelor of Science degree in Professional Accounting. I received my Juris Doctor from Valparaiso University School of Law in May, 2005. From January 2004 through June 2010, I provided business consulting services for NIPSCO and NiSource, Inc. ("NiSource"). In July 2010, I accepted a position with NIPSCO as Manager of Regulatory Strategic Analysis. I subsequently held the positions of Manager of Strategic Planning, Director of Regulatory Policy, and Director of Federal Regulatory Policy. I assumed my current position earlier this month.

Q3. Have you previously testified before this or any other regulatory commission?

A3. Yes, I have testified before this Commission and the Federal Energy Regulatory Commission across a range of topics.

Q4. What is the purpose of your testimony?

A4. The purpose of my testimony is to describe the changing energy marketplace and describe NIPSCO's proposed new industrial service structure.

<u>Changing Energy Marketplace</u>

Q5. Mr. Hooper describes this as a policy case dealing with the changing energy marketplace. Do you agree?

A5. Yes. The changing economic landscape includes the inefficiencies attributable to coal-fired generation and the availability of more economic alternatives within the MISO market for NIPSCO's customers. NIPSCO's large industrial customers utilize energy intensive processes and are sophisticated market participants, who participate in energy markets globally, and compete on the basis of price globally. NIPSCO believes that right now is the time to address the needs of its large industrial customers

for a market sensitive rate structure at the same time it addresses its on-going generation needs. As discussed in more detail by NIPSCO Witness Augustine, in NIPSCO's Integrated Resource Plan ("IRP"), analyses were performed for each of NIPSCO's coal-fired units that evaluated the ongoing operations versus retirement and replacement of the units with an alternative under various potential future states of the world. NIPSCO used a number of factors in analyzing the retirement timing of the coal units including economics, cost risk, reliability risk and impacts to NIPSCO's employees, and the local economy. NIPSCO's filing in this case requires its largest industrial customers to remain as NIPSCO's retail customers, while at the same time providing more market choices. It also is synchronized with the preferred plan presented in NIPSCO's IRP, which is being filed concurrently. An example of the changing landscape and resulting economics in the energy market is the March 29, 2018, Whiting Clean Energy, Inc. ("WCE") and BP Products North America ("BP") joint petition at the Commission docketed as Cause No. 45071, seeking treatment of WCE as a Qualified Facility ("QF") able to provide energy directly to BP. BP and WCE also requested that the Commission enter a finding that WCE and BP constitute a single industrial operation for which aggregated metering is

reasonable and appropriate, and asked the Commission to direct NIPSCO to provide as needed back-up, maintenance and temporary service to WCE as a QF. Finally, they requested that the Commission order NIPSCO to provide transmission service between WCE and BP.

Q6. What is the estimated impact of the loss of the Refinery load?

A6. Based on the existing Rate 733 tariff, the estimated margin losses are provided in the following table assuming the applicable BP load was aggregated with WCE as a QF during those periods without a historical demand ratchet in place for the preceding 11 months:

Estimated Annual Margin Losses from Aggregation of WCE and BP Refinery (in millions)		
2017	2018	2019
[redacted]		

Q7. Is there a potential for other industrial customers to also reduce their firm loads?

A7. Yes. It is both possible and probable. Some large customers, like BP, may utilize co-generation systems whether new or existing to reduce their firm requirements. In fact, NIPSCO is already aware that other large industrial customers are considering expansion of their cogeneration facilities. Others

may reduce those loads by shifting their industrial production to other locations outside Indiana that are more economic to operate.

Q8. What would the effect of such a change be on NIPSCO's revenues and margins under its existing rate structure?

A8. Because large industrial sales constitute such a significant portion of NIPSCO's retail electric sales, NIPSCO would experience decreased revenues and operating margins far faster than could be offset by growth in other sectors. In the long run, such load loss would subject remaining customers and customer classes to increased costs.

Q9. Does NIPSCO have a proposal to mitigate this concern?

A9. Yes. After months of discussion with our largest industrial customers, NIPSCO is proposing a new Rate 831 market sensitive industrial service structure further discussed below. Over the years, NIPSCO has allowed its largest customers to incur more market risk in exchange for supporting less of NIPSCO's production costs. In Cause No. 43969, NIPSCO expanded its long-standing use of interruptible service to be of use in the evolving MISO market. In Cause No. 43969, seven customer premises took service subject to Rider 675, and NIPSCO's capacity requirements in the MISO market

were reduced by approximately 377 MWs. In Cause No. 44688, NIPSCO expanded the availability of the interruptible rate at the request of its industrial customers, and its interruptible customers allowed NIPSCO to reduce its capacity requirements by approximately 530 MWs, which ultimately led to the earlier closure of Bailly Units 7 and 8. This interruptible/curtailable design, the reductions in NIPSCO's industrial load, and the current electric generation economic landscape lead NIPSCO and its industrial customers to believe that the time has come to allow further access into the energy marketplace while retaining NIPSCO's provision of retail service and providing protections for its remaining firm customers.

Overview of Proposed New Rate 831 Market Sensitive Industrial Service Structure

Q10. What is a utility's service structure?

A10. A service structure includes all provisions within a utility's tariff for providing utility service. A tariff may include customer, demand and energy charges, and various service characteristics, to implement rates and service options to serve various customer classes with differentiated characteristics. For example, two customers that use the same amount of

energy each month may have different costs of service if they require the energy at different voltage levels or use the energy at different times of the day. In this case, the utility may separate these two customers into different rate classes so that the customer whose energy consumption characteristics cause the utility to incur less expense does not unreasonably subsidize the customer whose consumption characteristics cause the utility to incur more expense.

Q11. Please summarize NIPSCO's new market sensitive large industrial Rate 831 proposal.

A11. As further described by NIPSCO Witnesses Campbell and Westerhausen, Rate 831 will replace Rates 732, 733, and 734 and Rider 775 for NIPSCO's largest industrial customers. The availability requirements for Rate 831 are: (1) any transmission or sub-transmission voltage-connected customer with a load of at least 10 MWs, (2) interval data recorder ("IDR") metering, and (3) a five year contract. Three Tiers of service are offered under the rate, and the customer will be given the opportunity to be served under Tier 1 with either, or both, of the other two, Tiers 2 and 3. I further outline each of the rate Tiers below.

Tier 1

Under Rate 831, a customer is required to take a minimum of 10 MWs of Tier 1 firm service. The Tier 1 rates were designed based on approximately 184 MWs (measured at the meter) being subscribed from NIPSCO's five largest industrial customers (approximately 190 MW measured at the generator bus bar). Tier 1 is billed as a fixed demand charge for production and customer related charges and is considered first through the meter for purposes of energy except when the customer is taking back up or maintenance services defined in the tariff. Tier 1 is also subject to all applicable Riders as listed on Appendix A of the tariff filed in this proceeding. Tier 1 will be billed as first through the meter up to the applicable amount of Tier 1 contract demand. A customer is required to provide five years of notice to increase the Tier 1 contract demand and must execute a new five year contract for the increased service.

Tier 2

Tier 2 is a non-firm curtailable service. NIPSCO will register as a Load Modifying Resource ("LMR") at MISO that portion of a customer's Tier 2 contract demand for which capacity is not procured through MISO's PRA or contracted through a third party. Under Tier 2, the customer will take

all Energy at the MISO Day-Ahead LMP at the applicable Company Load Zone. Tier 2 is subject only to the non-production Riders applicable to non-firm service (currently the energy portion of NIPSCO's RTO tracker, and any NERC/CIP components of NIPSCO's FMCA tracker). Tier 2 will be billed as second through the meter up to the amount of Tier 2 contract demand after calculating the amount of Tier 1 energy.

Tier 3

Tier 3 is also a non-firm curtailable service. NIPSCO will register as a LMR at MISO that portion of a customer's Tier 3 contract demand for which capacity is not procured through MISO's PRA or contracted through a third party, but NIPSCO will only register a single LMR for any non-firm load if a customer chooses to take both Tier 2 and 3 service. NIPSCO, as the MISO Market Participant, will register participating customers as an Asset Owner at MISO, which will allow the customer access to the MISO Market Portal to carry out MISO Asset Owner functions. Tier 3 is subject to any NERC/CIP components of NIPSCO's FMCA tracker but not the components of the RTO Tracker that Tier 2 will be responsible for given that Tier 3 customers will be invoiced for those charges directly from MISO as an Asset Owner. If, under the MISO Asset Owner framework, a customer

has not arranged for any third party energy with NIPSCO as the contracting Market Participant, the customer will take all energy under this Tier 3 service at the market price (LMP at the applicable Company Load Zone plus all applicable MISO charges / transmission charges). All settlements associated with the customer's Asset Owner energy offers and demand bids will be passed through to the Tier 3 customer. All three tiers will pay volumetric transmission charges for all energy delivered to their premises with a discount available for adjacent customer-owned premises that contain co-generation facilities capable of outputting energy to NIPSCO's system. Tier 3 will be billed as last through the meter.

Q12. Is NIPSCO offering the ability for Rate 831 customers to aggregate multiple premises under this rate?

A12. Yes. Under the proposed rate, if multiple premises are held under common ownership and at the same qualifying service voltage, NIPSCO will allow customers to aggregate those loads with IDR metering as a single service. Each IDR meter qualifying for aggregation under the rate will be included in the customer's contract to avoid confusion on which meters will or will not be included within the aggregation calculations.

Q13. Why is NIPSCO requiring a five year contract as a requirement for service under Rate 831?

A13. NIPSCO is requiring a five year contract to balance the needs of all stakeholders in launching the proposed service structure. NIPSCO and its other customers need these Rate 831 customers to continue to contribute to the fixed costs of production long enough to achieve an orderly transition to NIPSCO's preferred plan in the IRP submitted concurrently. Without a five year contract, these customers could have an incentive to reduce their contract demands to a level that would immediately require NIPSCO to file another rate case to reallocate the undercollected revenue to remaining classes. Also, without the five year notice provision to increase the firm Tier 1 contract demand, NIPSCO could be forced to procure uneconomic capacity to meet the increased need due to the inability to properly evaluate and potentially construct required capacity resources. This is especially problematic given the lead times to navigate the MISO interconnection queue and construct various generation technologies all of which also have long useful lives. Considering these issues, the five-year contract period provides a reasonable level of certainty for NIPSCO and all of its customers

in moving to a structure that provides more market choices for the Rate 831 customers in exchange for that commitment.

Q14. Is NIPSCO proposing a discounted transmission rate for the gross Energy transferred from a premise with behind the meter generation to an adjacent premise held under common ownership or by affiliates (as defined in Indiana Code 23-1-43-1)?

A14. Yes. NIPSCO is offering an alternative transmission charge solely to customers that are held under common ownership or affiliates, which are located on adjacent premises which have cogeneration facilities that can produce power at one premise and transfer that power across NIPSCO's transmission system to an adjacent premise owned by the customer or its affiliate. Because such customers will need to use only a small portion of the NIPSCO transmission system to transmit power from one of its premises to an adjacent industrial premise, NIPSCO is proposing to provide a 70 percent discount on the transmission charge for power that is transmitted between the two adjacent, affiliated premises. While discounted, the rate will result in some transmission revenue from these

customers that would not occur if they built their own lines between their premises.

Q15. Does NIPSCO expect all of its existing Rate 732, 733, and 734 customers to migrate to Rate 831?

A15. No. NIPSCO currently has 15 customers (23 premises) taking service under Rates 732, 733, and 734, and only five customers (9 premises) have also taken service under Rider 775. Of those 15 customers, 4 have less than 10 MWs of demand at a single premise. NIPSCO expects all five of its largest industrial customers (14 premises) to take service under Rate 831. The remaining 10 customers are expected to take service under NIPSCO's new Rate 830 including the 4 below 10 MWs which will be grandfathered onto the rate.

Q16. How will the proposed industrial service structure affect the assignment of cost responsibility to NIPSCO's other customers?

A16. Transitioning NIPSCO's industrial load to the proposed market-sensitive rate structure requires better cost recovery alignment. It will result in a near term shifting of some fixed costs currently being recovered from the

industrial customers to other customers, but will establish a more sustainable rate platform going forward.

Q17. What happens if the five large industrial customers take more or less than the 184 MWs used to allocate production costs?

A17. NIPSCO is proposing a two-phase rate design approach with the following characteristics to mitigate that risk if necessary.

Phase 1 Filed Rates: the as-filed rates for Rate 831 were designed with the allocated cost of service study allocating 184.556 MWs (measured at the customer meter) of NIPSCO's fixed production cost to Rate 831's Tier 1 service for the 5 largest industrial customers (or 189.794 MWs measured at the generator bus bar). This level of firm demand was based upon numerous conversations with NIPSCO's five largest customers. NIPSCO is proposing that customers will choose Tier 1, 2 and 3 contract levels within 30 days following the final order from the Commission in this rate proceeding. NIPSCO will also adjust the RTO Tracker allocations based upon the customer's choices regarding Tiers 1, 2 and 3. Any revenue shortfall resulting from an unsubscribed portion of the 184.556 MWs will require a second phase true up.

Phase 2 Rates True-Up: If, after the final order, the total amount of Tier 1 firm service chosen by the five largest industrial customers is different than 184.556 MWs, final rates will be set in the Phase 2 rates to collect the appropriate revenue. NIPSCO will also adjust the RTO Tracker allocations based upon the customer's choices regarding Tiers 1, 2 and 3.

Q18. Please briefly describe NIPSCO's new Rate 830.

A18. Recognizing that not all of NIPSCO's largest industrial customers would be interested in the market sensitive service under Rate 831, NIPSCO has designed Rate 830 to provide an industrial service that is very similar to the current Rate 732, with a few exceptions as explained by NIPSCO Witness Campbell. Between Rate 830 and 831, NIPSCO's largest industrial service customers will be able to select a service option that meets their needs for firm service and their tolerance for different levels of market risk.

Q19. Is NIPSCO's proposed new industrial service structure in the public interest as required for an alternative regulatory plan as set forth in Indiana Code Chapter 8-1-2.5?

A19. Yes, I believe it is. Indiana Code § 8-1-2.5-6 states in pertinent part:

Sec. 6. (a) Notwithstanding any other law or rule adopted by the commission, except those cited, or rules adopted that pertain to those cited, in section 11 of this chapter, in approving retail energy services or establishing just and reasonable rates and charges, or both for an energy utility electing to become subject to this section, the commission may do the following:

(1) Adopt alternative regulatory practices, procedures, and mechanisms, and establish rates and charges that:

(A) are in the public interest as determined by consideration of the factors described in section 5 of this chapter; and

(B) enhance or maintain the value of the energy utility's retail energy services or property;

including practices, procedures, and mechanisms focusing on the price, quality, reliability, and efficiency of service provided by the energy utility.

Indiana Code 8-1-2.5-5(b) states in pertinent part

(b) In determining whether the public interest will be served, the commission shall consider the following:

(1) Whether technological or operating conditions, competitive forces, or the extent of regulation by other state or federal regulatory bodies render the exercise, in whole or in part, of jurisdiction by the commission unnecessary or wasteful.

(2) Whether the commission's declining to exercise, in whole or in part, its jurisdiction will be beneficial for the energy utility, the energy utility's customers, or the state.

> (3) Whether the commission's declining to exercise, in whole or in part, its jurisdiction will promote energy utility efficiency.
>
> (4) Whether the exercise of commission jurisdiction inhibits an energy utility from competing with other providers of functionally similar energy services or equipment.

Rate 831 will only be offered to energy intensive, highly sophisticated customers that compete directly or indirectly in a global market. Traditional retail service at fixed rates as determined by the Commission is no longer necessary for the large industrials loads capable of being served through curtailable services with products from the FERC regulated MISO capacity and energy marketplace. I believe that the Commission's approval of this innovative service structure is beneficial to NIPSCO's industrial customers, its remaining firm customers and to NIPSCO. NIPSCO is currently implementing the preferred plan from its IRP for best serving our customers with generation capacity. To the extent that its future generating needs can be reduced, all customers will benefit. I also believe that approval of this new service structure will provide more accurate price signals, in that the customers will be paying the market rate for energy, and will be economically incented to adjust their consumption based on the market price signal.

Q20. What could this proposed market sensitive industrial service structure mean for the local economy within northern Indiana?

A20. I believe this proposed service structure is critical for retaining the level of industrial production from NIPSCO's largest customers. I also believe it is crucial for NIPSCO's other 468,000+ customers that these Rate 831 customers continue to make a contribution to NIPSCO's fixed production costs through their retail electric utility service. NIPSCO has directly observed the loss of load when customers relocate production out of northern Indiana to other facilities that they own across the US and the world. NIPSCO has also experienced the near total loss of major industrial customers due to the inability of the customer to maintain economic viability. If a major employer closes its doors or even reduces the number of operating shifts in our service territory, it will negatively impact the broader economic stability of the region as well as hinder NIPSCO's ability to provide reasonably adequate service at just and reasonable rates. Those job losses can create a ripple effect that eventually impacts local governments and commercial businesses. In short, this proposed structure will best position these large industrial customers to remain cost competitive within their global markets while also contributing to

NIPSCO's fixed production costs to serve. With those customers remaining and potentially expanding their industrial production in the region, this service structure could also mean the difference between a growing local economy in northern Indiana or one that is losing jobs and seeing reductions in its skilled labor force and property tax base.

Conclusion

Q21. Please summarize your testimony.

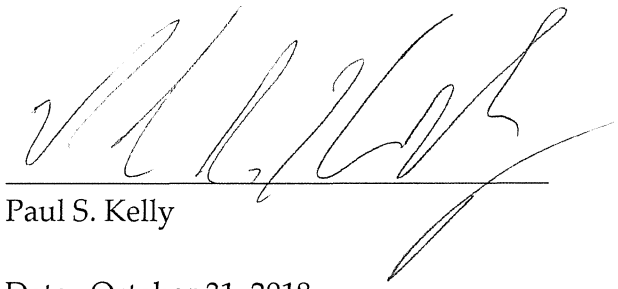
A21. NIPSCO is unique in that its large industrial customers have historically accounted for more than fifty percent of its energy sales. As those customers compete globally, they are demanding electric rates that more accurately reflect the marginal cost of energy production. As NIPSCO considers retirement of its coal-fired generation and its replacement alternatives, it presents a unique opportunity to address NIPSCO's industrial customers' needs, while offering protection to its remaining customers that they will not be responsible for replacement generation cost to serve industrial load that is more volatile, and more able to leave the system with stranded cost. NIPSCO's proposed industrial service structure balances the interests of all stakeholders and positions NIPSCO to provide safe and reliable service at just and reasonable rates.

Q22. Does this conclude your prefiled direct testimony?

A22. Yes.

VERIFICATION

I, Paul S. Kelly, Vice President of Major Accounts of Northern Indiana Public Service Company LLC, affirm under penalties of perjury that the foregoing representations are true and correct to the best of my knowledge, information and belief.



Paul S. Kelly

Date: October 31, 2018