

FILED
February 22, 2017
INDIANA UTILITY
REGULATORY COMMISSION

STATE OF INDIANA

Before the

INDIANA UTILITY REGULATORY COMMISSION

<p>IN THE MATTER OF THE PETITION of INDIANA MICHIGAN POWER COMPANY</p> <p>for all necessary authority in connection with a \$950,000,000 financing program involving the issuance of unsecured promissory notes of one or more new series and/or preferred stock.</p>	<p>:</p> <p>:</p> <p>:</p> <p>:</p> <p>:</p> <p>:</p> <p>:</p> <p>:</p> <p>:</p> <p>:</p>	<p>Cause No. 44904</p>
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PETITIONER’S SUBMISSION OF DIRECT TESTIMONY

The Petitioner, Indiana Michigan Power Company, submits the attached direct testimony of its witness, Franz D. Messner, in support of its petition. Mr. Messner’s testimony is identified as Petitioner’s Exhibit 1 and is accompanied by (i) pro forma accounting entries shown in Attachment 1 to Petitioner’s Exhibit 1 and (ii) the range and average credit spreads for BBB+ rated utilities over the last ten years in Attachment 2. In his testimony, Mr. Messner also incorporates by reference the petition filed to initiate this cause on February 7, 2017, which will be offered into evidence as Attachment 3 to Petitioner’s Exhibit 1.

Respectfully submitted,

INDIANA MICHIGAN POWER COMPANY

By: _____

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CERTIFICATE OF SERVICE

The undersigned, an attorney for Petitioner, certifies that on the 22nd day of February, 2017, a copy of the foregoing Notice was electronically served upon the Indiana Office of Utility Consumer Counselor, PNC Center, 115 W. Washington Street, Suite 1500 South, Indianapolis, IN 46204.



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November 2009. In May 2016, I assumed my current position as Managing Director of Corporate Finance. My responsibilities include development and implementation of the Company's long-term financing programs, including the issuance of senior notes, pollution control bonds, first mortgage bonds, preferred stock, trust preferred securities and various other financial instruments and hedging activities.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to describe the proposed 2017-2018 long term debt financing program of the Company, which, if approved by the Commission, will allow the Company to issue unsecured promissory notes (Notes) and preferred stock (New Preferred Stock) up to the aggregate principal amount of \$950,000,000.

Q. For what purposes will the Company be issuing these securities?

A. To refund directly or indirectly currently outstanding debt of the Company, for construction costs and for working capital purposes.

Q. Which of the Company's securities do you anticipate the Company refinancing?

A. Petitioner may purchase or redeem any series of New Preferred Stock or Notes or pollution control bonds where possible and advantageous for the Company to do so. Purchases will be made through a tender offer, negotiated transaction, redemption provision or on the open market. Any redemption will be made in accord with the terms of the securities to be redeemed.

Q. How will any such repurchases or redemption program be financed?

A. Repurchases and redemptions will be funded through the issuance of new debt, preferred stock or with cash.

Q. Are you familiar with the Company's Petition initiating this matter?

A. Yes. The Petition is incorporated by reference as Petitioner's Attachment 3 to my testimony.

Q. Are the facts stated in that Petition true and correct, to the best of your knowledge, information and belief?

A. Yes.

Q. Please identify Lonni L. Dieck and Thomas G. Berkemeyer, who executed the Company's petition.

A. Ms. Dieck is the Treasurer of the Company. Mr. Berkemeyer is an Assistant Secretary of the Company. Ms. Dieck and Mr. Berkemeyer executed the petition.

Q. In paragraphs 4 and 5 of its petition, the Company described its authorized and outstanding cumulative preferred stock, common stock and long-term debt as of September 30, 2016. Have there been any material changes in these figures since that date?

A. No.

Q. Please describe the anticipated new Notes.

A. The Notes may be issued in the form of Senior or Subordinated Notes or other types of promissory notes, including Notes to AEP. In the case of long-term borrowing from AEP, the interest rates and maturity dates of the borrowings will be designed to parallel the cost of capital of AEP. The Notes will mature in not more than 60 years and will be sold (i) by competitive bidding, (ii) in negotiated transactions with underwriters or agents or (iii) by direct placement with a commercial bank or other institutional investor or issued to AEP, as just described. Based on recent transactions, the yield to maturity of such Notes should not exceed by more than 5.0% the yield to maturity on United States Treasury bonds of comparable maturity at the time of pricing. We do not expect to exceed that difference. If we agree to a fluctuating rate of interest on Notes, it will not exceed 8% at the time of issuance. The Company may agree to specific redemption provisions, including redemption premiums, at the time of the pricing.

Any Notes may mature as soon as one year, but more likely will be of a longer term. They will likely be issued under an Indenture, to be supplemented and amended by one or more Supplemental Indentures or other similar documentation. A copy of the anticipated form of Indenture and a description of the terms of a new Company Note were filed by the Company as Exhibits B and C to the Petition.

Q. Do you view the interest rate expectations as conservative and appropriate?

A. Yes. In the event of a distressed market environment similar to what the market experienced in January of 2009 when I&M had to access the debt capital markets, the global credit crisis caused underlying credit spreads to increase to historic levels. For example, I&M's 2009 fixed rate debt issuance had a 475 basis point credit spread, as compared to the most recent I&M fixed rate debt issuances in March of 2013 and 2016, which had credit spreads of 120 and 195 basis points, respectively. It is for this reason we have asked for the flexibility to anticipate the potential for a volatile and distressed market environment at the time the new debt issuances occur. Furthermore, Attachment 2 illustrates the range and average credit spreads for BBB+ rated utilities over the last ten years. Over the last ten years the maximum credit spread for a 10-year (or greater) debt issuer with a similar credit profile as I&M has been 541 basis points, which is just above the 500 basis point maximum the Company has asked for in this application. In addition, Attachment 2 demonstrates that our planning process must recognize that absent the Federal Reserve policies that have held interest rates low, variable rates over the last 10 years have been much higher and more volatile.

Q. Are the interest rate expectations consistent with those submitted in previous financing petitions?

A. Yes, those expectations were as follows: Cause No. 43707, October 1, 2009 Order, p. 2: Fixed – 7.5%, Floating – 10%; Cause No. 44116, May 2, 2012 Order, p. 2: Fixed – 6.0%,

Floating – 8.0%; Cause No. 44426, March 26, 2014 Order, p. 2: Fixed – 5%, Floating – 8%; Cause No. 44679, December 9, 2015 Order, p. 2: Fixed – 5%, Floating – 8%. Thus, the current interest rate expectations are consistent with the Company’s previous petitions, Cause Nos. 44426 and 44679 and lower than the Company’s previous petitions in Cause Nos. 43707 and 44116.

Q. Did the interest rate expectations in Cause Nos. 43707, 44116, 44426 and 44679 turn out to be conservative?

A. Yes. All debt issuances during the 2009-2016 timeframe covered by the previous four proceedings were below the expected rates.

Q. In your opinion, are I&M customers adequately protected in the event of fluctuating interest rates?

A. Yes. For the upcoming financing period, the Company has included an upper bound expectation for the credit spreads for fixed rate debt issuances and variable benchmark interest rates as a protection to our customers in order to issue debt both competitively and prudently. I cannot predict what the market is willing to pay for I&M’s underlying credit risk or what benchmark interest rates will be in the future. Thus, it is important for our customers that the Company retains the flexibility to issue new debt or refinance existing debt in both fixed and variable rate form. Furthermore, the ability for the Company to enter into interest rate risk management agreements provides our customers further protection from volatile interest rate environments.

Q. In connection with the sale of any unsecured Notes, will Petitioner agree to any restrictive covenants?

A. Yes. The Company may agree to restrictive covenants which would prohibit it from, among other things: (i) creating or permitting to exist any liens on its property, with certain stated exceptions; (ii) creating indebtedness except as specified therein; (iii) failing to maintain a specified financial condition; (iv) entering into certain mergers, consolidations and

dispositions of assets; and (v) permitting certain events as to occur in connection with pension plans. Also, Petitioner may permit the holder of the Notes to require Petitioner to prepay them after certain specified events, including an ownership change.

Q. On what basis will the Company decide to issue Senior or Subordinated Notes or other promissory notes or New Preferred Stock?

A. The Company will decide to issue Senior or Subordinated Notes or other promissory notes or New Preferred Stock on the basis of market conditions, principally the lowest cost and best terms available, in the Company's judgment, at the time, and consistent with maintaining a sound capital structure. However, it is in the public interest to afford Petitioner the necessary flexibility to adjust its financing program to developments in the markets for medium and long-term debt securities when and as they occur in order to obtain the best reasonably available price, interest rate and terms for its Notes and New Preferred Stock. Therefore, Petitioner requests that it be given the flexibility to decide at future dates whether there will be one or more series and on the maturity of each series of the Notes. Any specific redemption provisions will be determined at the time of pricing of each series of Notes. Any New Preferred Stock will be issued in lieu of a portion of the Notes otherwise issuable.

Q. Will the Company enter into any interest rate management techniques in connection with the issuance of the Notes?

A. Possibly. In order to reduce and manage interest costs, the Company may enter into interest rate hedging transactions and anticipatory interest rate hedging transactions with respect to anticipated debt offerings and enter into related interest hedging agreements. Such techniques and agreements include, but are not limited to "interest rate swaps," "caps," "collars," "floors," "options," or hedging products such as "forwards" or "futures" or similar products, the purpose of which is to manage and minimize interest costs.

Petitioner expects to enter into any such agreements with counterparties that are highly rated financial institutions.

Q. Is Petitioner requesting the authority to enter into such interest rate hedging agreements?

A. Yes. Petitioner must be able, and requests authority, to execute interest rate hedging agreements when the opportunity arises to obtain the most competitive pricing.

Q. Does the Company intend to redeem any outstanding senior unsecured notes during the financing period?

A. The Company will continue to evaluate prudent liability management opportunities, the purpose of which is to manage and reduce interest costs to our customers.

Q. How will the Company account for any premiums paid to redeem the outstanding bonds and New Preferred Stock?

A. Redemption premiums for bonds being redeemed should be amortized over the term of the refunding bonds. The Company will utilize deferred tax accounting for the premium expense in order to properly match the amortization of the expense and the related tax effect. In the event of a refinancing or refunding of New Preferred Stock, the Company proposes to account for any premiums paid to redeem stock as a stock reacquisition cost, to be deferred and amortized to Account 439, Adjustments to Retained Earnings, on a straight-line basis over the life of the new securities.

Q. Will the Company provide some form of credit enhancement in connection with the issuance of the Notes?

A. If it is deemed advisable, Petitioner may provide some form of credit enhancement such as a letter of credit, surety bond or other insurance. The Company may pay a fee in connection therewith. Petitioner requests authority to enter into such credit enhancement if the Company determines that it is appropriate.

- Q. What is Petitioner's Attachment 1?
- A. Petitioner's Attachment 1 shows pro forma accounting entries that reflect the proposed transactions, on the assumption the \$950,000,000 of debt securities will be used to refund outstanding long-term and short-term debt. The interest rates used for the proposed securities are estimated, based on current market conditions. They are, of course, subject to change by the time the securities are sold.
- Q. Do you consider the terms and composition of this financing program in the Company's and the public's best interest?
- A. Yes. The proposed financings are reasonably necessary in the operation and management of Petitioner's business in order that Petitioner may provide adequate service and facilities. The capital structure of Petitioner after giving effect to the proposed financings will be reasonable and in the public interest. Moreover, the total amount of the proposed financings, together with Petitioner's outstanding stock, notes maturing more than 12 months from the date thereof, and other evidences of Petitioner's indebtedness will not be in excess of the fair value of Petitioner's utility property.
- Q. Please discuss the actual utilization of the financing authority granted by the Commission in Cause No. 44679.
- A. By an order issued December 9, 2015, the Commission granted I&M authority to issue up to \$750 million of unsecured promissory notes during the 2016-2017 financing period. During this financing period, I&M issued \$400 million of unsecured long-term debt securities.
- Q. Please briefly explain why the Company is requesting additional financing authority.
- A. I&M submitted its 2016-2017 financing authority application on September 18, 2015 based on the Company's forecasted capital plan and the potential of exercising liability management opportunities. However, during the course of the authorized financing

period the Company's forecast of planned capital expenditures increased. In addition, on January 24, 2017, Bloomberg announced key changes to requirements for inclusion of bonds into its U.S. Aggregate Index (formerly the Barclays Aggregate Bond Index). Effective April 1, 2017, the change increases the minimum amount outstanding requirement to \$300 million from \$250 million. In primary capital markets, in which I&M is a participant, the "sub-index eligible" premium that was previously associated with deals smaller than \$250 million will now likely be required for all deals less than \$300 million. With the requested additional financing authority, I&M will be able to effectively and efficiently fund its capital program in addition to meeting the liquidity needs of capital market investors.

Q. Are the foregoing facts and representations to which you have testified in this testimony true to the best of your knowledge, information and belief?

A. Yes.

Q. Does this conclude your testimony?

A. Yes.

VERIFICATION

I verify under the penalties of perjury that the foregoing representations are true and correct to the best of my information, knowledge and belief.

Signed: 

Franz D. Messner

Dated: February 22, 2017