

ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

IN THE MATTER OF THE VERIFIED PETITION)
 OF INDIANA MICHIGAN POWER COMPANY) CAUSE NO. 44422
 FOR AUTHORITY TO ADJUST ITS RETAIL)
 ELECTRIC RATES THROUGH ITS CAPACITY)
 SETTLEMENT RIDER CONSISTENT WITH THE) APPROVED:
 COMMISSION'S ORDER IN CAUSE NO. 44075.)

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JUL 09 2014

ORDER OF THE COMMISSION

Presiding Officers:

David E. Ziegner, Commissioner

Jeffery A. Earl, Administrative Law Judge

On November 13, 2013, Indiana Michigan Power Company (“I&M”) filed its Verified Petition for a Capacity Settlement Rider Adjustment. Also on November 13, 2013, I&M filed the testimony and exhibits of the following:

- Marc E. Lewis, Vice President of Regulatory and External Affairs at I&M;
- Jeffrey L. Brubaker, Director of Regulatory Accounting Services at American Electric Power Service Corporation (“AEPSC”); and
- Nancy A. Heimberger, Senior Regulatory Consultant in Regulated Pricing and Analysis at AEPSC;

On January 14, 2014, the I&M Industrial Group (“Industrial Group”) filed a Petition to Intervene, which the Presiding Officers granted on January 22, 2014.

On February 17, 2014, the Indiana Office of Utility Consumer Counselor (“OUCC”) filed the testimony and exhibits of Michael D. Eckert, Senior Utility Analyst in the OUCC’s Electric Division.

Also on February 17, 2014, the Industrial Group filed the testimony and exhibits of Nicholas Phillips, Jr., Managing Principal of Brubaker & Associates, Inc.

On March 12, 2014, I&M filed the rebuttal testimony and exhibits of Mr. Brubaker and Paul Chodak III, President and Chief Operating Officer of I&M.

The Commission held an evidentiary hearing in this Cause at 1:00 p.m. on March 20, 2014, in Hearing Room 222, 101 West Washington Street, Indianapolis, Indiana. I&M, the OUCC, and the Industrial Group appeared and participated at the hearing. No members of the general public attended the hearing.

Based upon the applicable law and the evidence presented, the Commission finds:

1. **Notice and Jurisdiction.** Notice of the hearings in this Cause was given and published as required by law. I&M is a public utility as defined in Ind. Code § 8-1-2-1(a). In the February 13, 2013 Order in Cause No. 44075, the Commission approved an annual rate adjustment mechanism for I&M's recovery of capacity settlement payments and receipts. *Ind. Mich. Power Co.*, Cause No. 44075, 2013 Ind. PUC LEXIS 43 (IURC Feb. 13, 2013) ("44075 Order"). Under Ind. Code § 8-1-2-42, the Commission has jurisdiction over changes in I&M's schedules of rates and charges. Therefore, the Commission has jurisdiction over I&M and the subject matter of this Cause.

2. **I&M's Characteristics.** I&M, a wholly-owned subsidiary of American Electric Power ("AEP"), is a corporation organized and existing under the laws of the State of Indiana, with its principal office at One Summit Square, Fort Wayne, Indiana. I&M is a member of the East Zone of the AEP System. I&M is engaged in, among other things, rendering electric service in the States of Indiana and Michigan. In Indiana, I&M provides retail electric service to approximately 458,000 customers in the following counties: Adams, Allen, Blackford, DeKalb, Delaware, Elkhart, Grant, Hamilton, Henry, Howard, Huntington, Jay, LaPorte, Madison, Marshall, Miami, Noble, Randolph, St. Joseph, Steuben, Tipton, Wabash, Wells, and Whitley.

3. **Relief Requested.** In the 44075 Order, the Commission said:

I&M's capacity payments and receipts are governed by the formulas established in the [Federal Energy Regulatory Commission ("FERC")]-approved AEP Interconnection Agreement. The evidence establishes that the test-year level of capacity settlement receipts is not representative of I&M's ongoing capacity settlements due primarily to actual changes that have occurred in the amount of capacity owned by other members of the AEP Pool. . . .

In order to address the variability in the capacity settlement payments, we adopt I&M's proposal to periodically adjust I&M's rates to match the projected credits received or payments made with actual levels pursuant to Ind. Code § 8-1-2-42(a). . . . The initial level of revenues for the capacity settlement should be set at \$38.5 million. . . . The Capacity Tracker factors shall be established annually based upon a projection of capacity payments/receipts to be tracked and will include a reconciliation of actual capacity payments/receipts for the prior year

2013 Ind. PUC LEXIS 43, at *173-74.

The initial zero Capacity Settlement Rider ("CSR") factors were established as part of I&M's compliance filing pursuant to the 44075 Order. In accordance with the timing reflected in the 44075 Order, I&M seeks to reconcile actual capacity equalization settlement payments/receipts against the level of capacity settlement revenue embedded as a credit to I&M's basic rates for the period February 28, 2013 through October 31, 2013 ("2013 Period 1"), and to also reflect in the CSR factors a projection of capacity settlement payments/receipts for a forecast bridge period of November and December 2013 ("2013 Bridge Period" and collectively with the first period identified above "the 2013 Under-Recovery") and a forecast period of January 1, 2014 through December 31, 2014 ("2014 Period"). I&M seeks to make the new CSR factors requested herein effective for all bills rendered for electric services beginning with I&M's March 2014 billing cycle (February 28, 2014) or the first full billing cycle following a Commission order in this Cause.

4. I&M Direct Evidence. Mr. Lewis described the AEP Pool Agreement, which includes I&M, Appalachian Power Company (“APCo”), Kentucky Power Company (“KYCo”), and Ohio Power Company (“OPCo”). The AEP Pool Agreement defines the rights and obligations of the four companies and sets out the methodology for allocating their responsibilities. Specific to this case, the agreement provides a capacity settlement that equalizes reserve margins by assigning responsibility to each member for its member load ratio share of the total system capacity. To the extent that a member’s capacity is less than its system responsibility, that company must pay a capacity charge to the surplus companies. If a member has surplus, its surplus capacity is multiplied by its capacity rate to derive its capacity receipts. If a member is deficient, its deficient capacity is multiplied by the weighted capacity rate of the surplus members to derive the capacity payments it must make.

Mr. Lewis described the CSR, provided an overview of the AEP Pool Agreement, discussed the main provisions of the AEP Pool Agreement associated with capacity settlement, explained how capacity settlement payments/receipts are calculated under the AEP Pool Agreement, and discussed the level of capacity settlement receipts the initial CSR factors were designed to recover. Mr. Lewis also described the periods which make up this CSR reconciliation filing. He discussed the forecasted capacity settlement payments/receipts for the 2013 Bridge Period and associated under-recovery during that time. Mr. Lewis explained that as a result of the corporate separation of AEP System Pool Member OPCo’s generation and marketing businesses from its transmission and distribution businesses, AEP gave notice to dissolve the AEP Pool Agreement effective January 1, 2014. As a result, the AEP Pool Agreement is not in effect during the 2014 Period.

Mr. Lewis and Mr. Brubaker explained that for the 2013 Period 1, I&M under-recovered \$18,318,938 (Indiana retail jurisdictional) for the capacity settlement receipts/payments as shown on Pet. Revised Exhibit JLB-1; Pet. Ex. MEL, at 6; Pet. Ex. JLB-S, at 2-3. Mr. Lewis added that for purposes of the CSR, I&M is expected to under-recover its capacity receipts during the 2013 Bridge Period by approximately \$3,652,326 as shown on Pet. Ex. MEL, at 8, Table 1. Mr. Lewis stated that as a result of the dissolution of the AEP Pool Agreement on January 1, 2014, I&M’s total Company capacity payments/receipts for the 2014 Period will be zero. He also explained that it remains necessary for I&M to continue performing under/over accounting for the CSR so that the actual zero costs are reconciled with the \$24.9 million credit embedded in basic rates as provided in the 44075 Order. He testified that the projected capacity settlement payments and receipts are reasonable and explained how the CSR factor was calculated.

Mr. Brubaker further discussed the under-recovery of capacity settlement payments/receipts for 2013 Period 1. Ms. Heimberger supported the proposed CSR factors, including among other things, jurisdictional allocations, rate design, and the average residential bill impact.

5. OUCC’s Evidence. Mr. Eckert discussed the 44-7 Order and the relief sought by I&M. He also stated his view that dissolution of the AEP System Pool contributes substantially to the large proposed rate increase through the CSR. Mr. Eckert explained that the OUCC is concerned about what he considered a large rate increase in this proceeding because it follows a 16.25% rate increase reflected in the Commission’s 2013 Residential Bill Survey comparison of July 1, 2012 bills to July 1, 2013 bills. He recommended the Commission spread the 2013 Under-Recovery over a three-year period.

6. Industrial Group's Evidence. Mr. Phillips discussed how the CSR filing relates to I&M's last rate case, and described I&M's request. He also commented on the AEP Pool Agreement that was terminated effective January 1, 2014. There is a Bridge Agreement for a short period because of legacy contracts and joint purchase and sales agreements that will not expire until after January 1, 2014. There is also a new Power Coordination Agreement in progress among I&M, KYCo, and APCo with the AEPSC acting as agent. Mr. Phillips said he understands that the new agreement will not mitigate risk or provide for the sharing of capacity and energy at average cost as was the case in the now terminated AEP Pool Agreement. He opined that costs and risks will likely increase to I&M Indiana retail ratepayers because of the termination of the AEP Pool Agreement and because I&M is now acting as a standalone utility with less capacity and less ability to purchase power at average cost from other AEP utilities than it had in the past.

Mr. Phillips also noted I&M's announcement of its decision to retire Tanners Creek Unit 4 and I&M information indicating that the unit could be converted from coal to gas for \$65 million. While he raised questions about this decision, he testified that sufficient information concerning Tanners Creek Unit 4 has not been presented by I&M for him to make a determination whether the unit should be refueled instead of closed. Mr. Phillips asserted that retiring Tanners Creek Unit 4 would reduce I&M's reserve capacity and this raised concerns in the event of an outage at the Cook or Rockport Plant. After Tanners Creek is completely closed, I&M will be operating with two stations, Cook and Rockport, each with extremely large units. If there is a Cook or Rockport outage, I&M would be required to buy purchased power at market prices. I&M currently has no gas-fired capacity. With some probability of much higher market prices in the future (partially due to the shutdown of a large number of coal units), Indiana ratepayers are at a much greater risk of cost increases for replacement power than in the past.

Mr. Phillips noted that I&M has not sought Commission approval regarding the retirement in 2015 of Tanners Creek Unit 4 and added that costs associated with this facility were included in I&M's current base rates approved in the 44075 Order. In his view, least-cost planning and the provision of reliable electric service should dictate that a procedure be established to address this matter with involvement by concerned parties. Mr. Phillips also stated that customers are concerned with both current cost increases and potential future cost increases. In light of these changes, Mr. Phillips believes that the Commission should also review reliability including frequency of curtailment or interruptions for certain customers.

With regard to the current requested rate increase, Mr. Phillips testified that a reasonable approach to mitigate the impact to customers is to spread the collection of the 2013 Under-Recovery over a three-year period, but collect the on-going amount of \$24.8 million since it will be approximately the same annual amount until I&M files a base rate case.

7. I&M Rebuttal. Mr. Chodak explained that the units at the Tanners Creek Plant are not equipped with post-combustion Air Pollution Control Devices specifically designed to minimize emissions of SO₂ or to remove hazardous air pollutants. I&M must strike a strategic balance between spending on capital projects and the affordability of its service. I&M has developed a strategic plan to help guide its business decisions now and over the next several years and I&M is using that plan, in conjunction with I&M's integrated resource planning, to find the proper balance point and select the actions I&M needs to take to meet the coming challenges, including the decision to close the Tanners Creek Plant.

Mr. Chodak explained that I&M is making significant investments at its Rockport Plant to comply with existing and emerging environmental regulations because the size and the age of the Rockport Plant make economic sense for I&M and its customers. The Tanners Creek Plant, however, is quite different from the Rockport Plant because the units are relatively small and are much older. I&M was faced with making significant investments to prolong the units' lives, refueling the units with a fuel other than coal, or closing the units. For Tanners Creek Units 1, 2, and 3, the decision was fairly clear that the right choice was to close the units because further investment was not economically warranted. At the time of Cause No. 44075, the future of Tanners Creek 4 was still in doubt as I&M was analyzing the costs and benefits of refueling that unit to operate on natural gas.

Mr. Chodak explained that after considering the costs of refueling, the current demand for electricity, the capacity markets in which I&M operates, and the existing and potential federal environmental mandates, I&M made the decision to close Tanners Creek 4 as of June 1, 2015. I&M based this decision on an analysis of resource needs and environmental compliance costs as part of I&M's disciplined approach to capital investment. Due to relatively flat electricity demand and I&M's ability to meet the needs of its customers without Tanners Creek 4, I&M determined that the cost of refueling Tanners Creek 4 is not a reasonable investment. Mr. Chodak presented I&M's 2013 Integrated Resource Plan ("IRP") Summary, which contains an analysis supporting the closure of the Tanners Creek Plant on June 1, 2015.

Mr. Chodak explained that I&M will work with its employees and the community to mitigate the impact of the closing and transition employees to other I&M or AEP generating plants, if possible. He added that I&M's long-term planning has evaluated the impact of these early plant closings on I&M's system and on the PJM Interconnection Regional Transmission Operator and will be working to avoid any disruption of service due to the loss of these units. He stated that I&M's long-term plan includes evaluating all alternatives to replacing the Tanners Creek capacity as needed, such as new generating assets, purchases from the wholesale market, renewable energy, and energy efficiency.

Mr. Chodak explained that I&M's decision to close Tanners Creek 4 is irrelevant to the "increased risk" Mr. Phillips discusses because nothing about the cost to purchase power to serve I&M customers is changed by retiring Tanners Creek 4. Mr. Chodak added that all things considered, the closing of Tanners Creek 4 is the best decision for I&M and its customers based on the known and foreseeable information available. In response to Mr. Phillips's testimony regarding the impact of the Tanners Creek 4 decision on I&M's capacity, Mr. Chodak pointed to the demonstration in I&M's 2013 IRP that I&M has sufficient capacity to serve its internal load through 2028, although it may have to make short-term purchases in 2015 and 2016 as the Dry Sorbent Injection ("DSI") technology is integrated into the operations at the Rockport Plant.

Mr. Chodak also responded to Mr. Phillips's concern about the probability of much higher market prices in the future. I&M recognizes that a significant amount of coal capacity will be closed in 2015 due to EPA rules. Closing these coal units certainly raises very serious questions about the availability of power and the impact on reliability. I&M and AEP are working hard on the policies and regulations creating the risks and on the operational changes needed to manage the risks. I&M is undertaking these actions so that I&M is prepared and so that customers are unaffected.

Mr. Chodak explained that particularly now that I&M is more of a stand-alone company following the termination of the AEP Pool Agreement, the large base load units at Cook and Rockport must run reliably to minimize the times when I&M will inevitably call upon market resources to serve its customers. This is why the Life Cycle Management project at the Cook Plant and the DSI project at the Rockport Plant are critically important to I&M and its customers. In addition, I&M has a goal to diversify its fleet over time and change the current portfolio by adding other generation resources, such as natural gas. I&M will do so as part of a cost-effective plan developed in accordance with the IRP process.

Finally, Mr. Chodak disagreed that approval of the request in this case rises to the level of rate shock and added that while I&M is mindful of the impact of its request on customers' bills, it also recognizes the importance to customers and shareholders of matching the timing of the incurrence of a cost with the recovery of that cost.

Mr. Brubaker testified that the 2013 Under-Recovery amount is \$21,971,264 and explained that Mr. Eckert's slightly higher amount did not reflect Mr. Brubaker's supplemental testimony. Mr. Chodak explained why he disagreed with the proposal to delay for three years the recovery of \$21.9 million of capacity payments under-recovered in 2013. He testified that such recovery was the reason why the CSR was established in 44075, that there is no dispute that I&M's calculation of the CSR factors is correct, and that I&M is entitled to the cost recovery. In his view, I&M has complied with the 44075 Order, the proposal to recover the costs over three years extends too long and does not reflect the time value of money cost to I&M of delaying the cost recovery. He stated that had the proposal suggested the recovery of the \$21.9 million over a period of two years, instead of three years, and allowed I&M to record and recover its carrying costs on the un-recovered balance (as calculated by I&M rebuttal witness Brubaker), that might have been a different matter, but that is not the proposal under consideration in his rebuttal.

8. Commission Discussion and Findings. I&M's capacity settlement payments and receipts are governed by the formulas established in the FERC-approved AEP Pool Agreement. These costs are recognizable for ratemaking purposes. In the 44075 Order, the Commission found that the evidence establishes that the test-year level of capacity settlement receipts (\$60.7 million) is not representative of I&M's ongoing capacity settlements due primarily to actual changes that have occurred in the amount of capacity owned by other members of the AEP Pool. 44075 Order, 2013 Ind. PUC LEXIS 43, at *173. In order to address the variability in the capacity settlement payments, the Commission established an annual CSR to periodically adjust I&M's rates to match the projected credits received or payments made with actual levels pursuant to Ind. Code § 8-1-2-42(a), stating:

We find such an adjustment mechanism appropriate in light of the materiality of the settlement capacity receipts and payments and the significant and unpredictable changes in the capacity settlements. The level of revenue recognized by I&M fell by nearly 50% during the twelve months following the test year. The initial level of revenues for the capacity settlement should be set at \$38.5 million. This reflects the actual settlement receipts/payments of \$30.8 million for the twelve months ended March 2012 and Ms. McLravy's normalization of this amount. The Capacity Tracker factors shall be established annually based upon a projection of capacity payments/receipts to be tracked and will include a reconciliation of actual capacity payments/receipts for the prior year as proposed by Mr. Krawec. I&M shall file

compliance tariffs reflecting this initial tracker recovery. Within nine months after the implementation of the initial capacity tracker, I&M shall file a petition and supporting testimony and exhibits for approval to implement the first annual adjustment to the Capacity Tracker. As proposed by Mr. Krawec, the initial factor will be reconciled and a new factor will be proposed based upon a forecast of capacity payments/receipts during the period that the factor will be in effect adjusted for the amount of the reconciliation.

Id., at *174-75.

Embedding \$38.5 million (total company) had the effect of lowering the revenue requirement used to set I&M's rates subject to an annual adjustment to reconcile the actual capacity payments/receipts for the prior year against the amount included as a credit in basic rates and to reflect a projection of capacity payments/receipts. By establishing the CSR in Cause No. 44075, the Commission ensured that customers either receive the benefit of every dollar I&M receives from the capacity settlement or pay rates for electric service that reflect only what I&M pays when it is in a capacity deficit position.

In this case, the sole dispute regarding I&M's proposed CSR factors is whether the recovery through rates of the 2013 Under-Recovery should be spread over a three-year period as proposed by the OUCC and the Industrial Group or collected in a single year as proposed by I&M. There is no dispute that the 2014 Period costs should be recovered on an annual basis.

Mr. Eckert asserts that delaying the recovery of the 2013 Under-Recovery for three years is justified due to the role played by AEP's dissolution of the Pool. We disagree. The record establishes that the 2013 Under-Recovery stems from I&M's position in the Pool and the calculation of the Member Load Ratio ("MLR") in accordance with the AEP Pool Agreement. As shown on Pet. Revised Ex. JLB-1, I&M was in a capacity-deficient position during the 2013 Period 1 reconciliation months of February 2013 through July 2013. This resulted in I&M making capacity payments to the other AEP Pool Members during those months. Starting in August 2013, I&M's capacity deficient position in the AEP Power Pool changed to a capacity surplus position as a result of a reduction in I&M's MLR. I&M remained in a capacity surplus position for October 2013, the end of 2013 Period 1. The record reflects that I&M expects to remain in a capacity surplus position for the 2013 Bridge Period. Accordingly, the record establishes that the 2013 Under-Recovery occurred prior to the termination of the AEP Pool Agreement. Therefore we decline to delay the annual cost recovery authorized by the 44075 Order based on the termination of the AEP Pool Agreement.

We find it would be unreasonable to delay the recovery of the 2013 Under-Recovery as proposed by the OUCC and the Industrial Group witnesses. Approval of I&M's request implements the 44075 Order. The Commission established the CSR for I&M to track and reconcile actual capacity equalization settlement payments/receipts against the level of capacity settlement revenue embedded as a credit to I&M's customers' basic rates in Cause No. 44075. The record reflects that I&M's calculation of the CSR factors is correct and there is no dispute that I&M is entitled to recover the 2013 Under-Recovery through the CSR.

The rate impact under I&M's proposal is 4.7%. We find this does not rise to the level of rate shock. Adhering to the annual reconciliation process authorized in the 44075 Order provides a

better matching of the timing of the incurrence of the cost with the recovery of that cost.

Mr. Phillips's concerns, including his discussion of I&M's post-pool operation, its decision to close Tanners Creek 4 in 2015, and future capacity market price increases, do not involve the period associated with the 2013 Under-Recovery. Instead, Mr. Phillips's testimony addresses matters generally outside the scope of this docket. I&M's 2013 IRP shows that I&M has sufficient capacity to serve its internal load through 2028, although it may have to make short-term purchases in 2015 and 2016 as the DSI technology is integrated into the operations at the Rockport Plant. The record also shows that I&M has and continues to take prudent steps to support the reliability of the Cook and Rockport units and thus minimize the times when I&M will inevitably call upon market resources to serve its customers. Accordingly, we find the concerns raised by Mr. Phillips do not warrant a departure from the annual cost recovery authorized by the 44075 Order or other Commission action.

Therefore, we find the reconciliation should be implemented on an annual basis consistent with the 44075 Order, and we approve I&M's proposed CSR factors. Because implementing the rate in the middle of a billing cycle may create an inequity to customers billed at differing points in the cycle, I&M shall apply the approved factors beginning with the August billing cycle.

IT IS THEREFORE ORDERED BY THE INDIANA UTILITY REGULATORY COMMISSION that:

1. Indiana Michigan Power Company is authorized to implement its requested Capacity Settlement Rider factors.
2. Indiana Michigan Power Company shall place into effect the Capacity Settlement Rider factors approved in this Order applicable to bills rendered on or after the first billing cycle of August 2014 upon filing with the Electricity Division of this Commission, First Revised Tariff Sheet No. 36, as shown in Petitioner's Exhibit NAH-4.
3. This Order shall be effective on and after the date of its approval.

STEPHAN, MAYS, WEBER, AND ZIEGNER CONCUR:

APPROVED: JUL 09 2014

I hereby certify that the above is a true and correct copy of the Order as approved.



Shala M. Coe
Acting Secretary to the Commission