

I&M Exhibit: _____

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INDIANA UTILITY
REGULATORY COMMISSION

Cause No. 45576

INDIANA MICHIGAN POWER COMPANY

PRE-FILED VERIFIED DIRECT TESTIMONY

OF

FRANZ D. MESSNER

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**DIRECT TESTIMONY OF FRANZ D. MESSNER
ON BEHALF OF
INDIANA MICHIGAN POWER COMPANY**

I. Introduction of Witness

1 **Q1. State your name and business address.**

2 My name is Franz D. Messner and my business address is 1 Riverside Plaza,
3 Columbus, OH 43215.

4 **Q2. By whom are you employed and in what capacity?**

5 I am employed by American Electric Power Service Corporation (AEPSC) as
6 Managing Director of Corporate Finance. AEPSC supplies engineering,
7 accounting, planning, advisory, and other services to the subsidiaries of the
8 American Electric Power (AEP) system, one of which is Indiana Michigan Power
9 Company (I&M or the Company).

10 **Q3. What are your responsibilities as Managing Director of Corporate**
11 **Finance?**

12 I am responsible for planning and executing the corporate finance programs of
13 the regulated AEP System operating companies, including I&M. My
14 responsibilities also include preparing recommendations for the payment of
15 dividends by those companies, maintaining capitalization targets, and managing
16 the relationships of AEP and its subsidiaries with the credit rating agencies.

17 **Q4. Describe your educational background and professional experience.**

18 I earned a Bachelor of Science in Systems Engineering from the United States
19 Naval Academy in 1990. I earned a Master of Business Administration from the
20 Fisher College of Business at the Ohio State University in 1999. Prior to joining

1 AEP, I served for seven years as a U.S. Naval officer and completed both chief
2 engineer and submarine officer qualifications.

3 In June 1999, I was hired by AEPSC as an associate in a finance associate
4 development program. My primary roles have been in the areas of financial
5 analysis, budgeting, and forecasting.

6 In July 2007, I was named Manager in Corporate Planning and Budgeting and
7 subsequently promoted to Director in November 2009. In May 2016, I assumed
8 my current position as Managing Director of Corporate Finance.

9 **Q5. Have you previously testified before any regulatory commissions?**

10 Yes. I submitted testimony before the Indiana Utility Regulatory Commission in
11 Cause No. 45235 and before the Michigan Public Service Commission in Cause
12 No. U-20359 on behalf of Indiana Michigan Power Company.

II. Purpose of Testimony

13 **Q6. What is the purpose of your testimony?**

14 The purpose of my testimony is to:

- 15 • Present and support the capital structure and weighted average cost of
16 capital for I&M.
- 17 • Describe the forecast financing activity between December 31, 2020, the
18 end of the Historical Period, and December 31, 2022, the end of the
19 forward-looking Test Year.
- 20 • Describe I&M's credit ratings and why regulatory outcomes are important
21 in the rating process.

1 **Q7. Are you sponsoring any exhibits?**

2 Yes, I am sponsoring I&M Exhibit A-7: Forecasted Capital Structure and
3 Weighted Average Cost of Capital.

4 **Q8. Are you sponsoring any workpapers?**

5 Yes, I am sponsoring WP-I&M-1-6: Historical Capital Structure and Weighted
6 Average Cost of Capital.

7 **Q9. Were the exhibits and workpapers prepared or assembled by you or under
8 your direction?**

9 Yes.

10 **Q10. Summarize your testimony.**

11 I&M is proposing a weighted average cost of capital (WACC) of 6.08%, which is
12 a reasonable value reflecting the forecast Test Year end 12/31/2022 capital
13 structure and a reasonable return on equity (ROE) as supported by Company
14 witnesses Thomas and Bulkley. I&M's overall proposal will help maintain solid
15 credit ratings and ready access to capital over the forecast period.

III. Weighted Average Cost of Capital

16 **Q11. Describe I&M's capital structure and WACC at the beginning and end of
17 the Test Year as shown in I&M Exhibit A-7.**

18 I&M Exhibit A-7 depicts the calculation of the weighted average cost of capital
19 for I&M with both permanent capital and ratemaking adjustments, which include
20 deferred taxes and customer deposits.

1 I&M's forecast overall weighted average cost of capital, inclusive of ratemaking
 2 adjustments, is 6.07% at the beginning of the Test Year (December 31, 2021),
 3 and 6.08% at the end of the Test Year (December 31, 2022). In both cases, the
 4 Company utilizes a 10.00% ROE supported by Company witnesses Thomas
 5 and Bulkley.

6 Pages 1 and 3 of I&M Exhibit A-7 (also shown in Figures FDM-1 and FDM-2)
 7 show the computation of the weighted average cost of capital for I&M at the
 8 beginning and end of the Test Year.

Figure FDM-1. Forecast WACC at the beginning of the Test Year, 12/31/2021

| Line No. | (a) Description | (b) Total Company Capitalization | (c) Percent of Total | (d) % Cost Rate | (e) % Weighted Average Cost Rate |
|----------|--|--|----------------------------|--------------------------|--|
| 1 | | \$ | | | |
| 2 | Long-Term Debt | 2,822,302,210 | 42.41% | 4.44% | 1.88% |
| 3 | Common Equity | 2,762,126,699 | 41.51% | 10.00% | 4.15% |
| 4 | Customer Deposits | 41,698,455 | 0.63% | 2.00% | 0.01% |
| 5 | ADFIT ¹ | 1,010,598,387 | 15.19% | 0.00% | 0.00% |
| 6 | ADITC ² | <u>17,469,705</u> | <u>0.26%</u> | 7.19% | <u>0.02%</u> |
| 7 | | | | | |
| 8 | Total | <u>6,654,195,455</u> | 100.00% | | <u>6.07%</u> |
| 9 | | | | | |
| 10 | | | | | |
| 11 | | | | | |
| 12 | <u>Cost of Investor Supplied Capital</u> | | | | |
| 13 | Long-Term Debt | 2,822,302,210 | 50.54% | 4.44% | 2.24% |
| 14 | Common Equity | <u>2,762,126,699</u> | <u>49.46%</u> | 10.00% | <u>4.95%</u> |
| 15 | Total | 5,584,428,909 | 100.00% | | 7.19% |

¹Accumulated Deferred Federal Income Taxes

²Accumulated Deferred Job Development Investment Tax Credits

Figure FDM-2. Forecasted Weighted Average Cost of Capital at the End of the Test Year, 12/31/2022

| Line No. | (a) Description | (b) Total Company Capitalization | (c) Percent of Total | (d) % Cost Rate | (e) % Weighted Average Cost Rate |
|----------|--|-------------------------------------|-------------------------|--------------------|-------------------------------------|
| 1 | | \$ | | | |
| 2 | Long-Term Debt | 2,820,079,888 | 40.86% | 4.44% | 1.81% |
| 3 | Common Equity | 2,927,644,814 | 42.42% | 10.00% | 4.24% |
| 4 | Customer Deposits | 41,698,455 | 0.60% | 2.00% | 0.01% |
| 5 | ADFIT ¹ | 1,098,242,295 | 15.91% | 0.00% | 0.00% |
| 6 | ADITC ² | <u>13,678,705</u> | <u>0.20%</u> | 7.27% | <u>0.01%</u> |
| 7 | | | | | |
| 8 | Total | <u>6,901,344,157</u> | 100.00% | | <u>6.08%</u> |
| 9 | | | | | |
| 10 | | | | | |
| 11 | | | | | |
| 12 | <u>Cost of Investor Supplied Capital</u> | | | | |
| 13 | Long-Term Debt | 2,820,079,888 | 49.06% | 4.44% | 2.18% |
| 14 | Common Equity | <u>2,927,644,814</u> | <u>50.94%</u> | 10.00% | <u>5.09%</u> |
| 15 | Total | 5,747,724,702 | 100.00% | | 7.27% |

¹Accumulated Deferred Federal Income Taxes

²Accumulated Deferred Job Development Investment Tax Credits

1 Column (a) shows the components of capital, including long-term debt, common
2 equity, customer deposits, accumulated deferred federal income taxes (ADFIT),
3 and accumulated deferred job development investment tax credits (ADITC).

4 Column (b) shows the capitalization by component at December 31, 2021
5 (Figure FDM-1) and December 31, 2022 (Figure FDM-2). Column (c) identifies
6 each component's percentage of I&M's total capital, and Column (d) identifies
7 the cost rates associated with each component. Column (e) shows the weighted
8 average cost of capital by component.

9 **Q12. How are the December 31, 2021 and December 31, 2022 weighted average**
10 **cost of capital computations used in this proceeding?**

11 The December 31, 2021 weighted average cost of capital is used in determining
12 the Phase-in Rate Adjustment as supported and described by Company witness
13 Duncan. The December 31, 2022 weighted average cost of capital is used in
14 determining I&M's proposed base rates.

1 **Q13. Describe I&M's Test Year cost of long-term debt shown in I&M Exhibit A-7.**

2 The forecasted cost rates for long-term debt at the beginning of the Test Year
3 (December 31, 2021) and end of the Test Year (December 31, 2022) shown on
4 pages 1 and 3 of I&M Exhibit A-7 are 4.44%.

5 The calculation of these forecasted costs is shown on pages 2 and 4 of I&M
6 Exhibit A-7 and is inclusive of all costs associated with long-term debt
7 issuances.

8 **Q14. What is the source of the other cost rates in I&M Exhibit A-7?**

9 The 10.00% ROE was provided to me by Company witnesses Thomas and
10 Bulkley. A 2.0% cost rate was applied to the balance of customer deposits
11 consistent with the Settlement Agreement approved in Cause No. 44967 and
12 the cost of capital reflected in the March 11, 2020 Order in Cause No. 45235
13 (Cause No. 45235 Order), the Company's last basic rate proceeding.

14 A 0.0% cost rate was assigned to accumulated deferred federal income taxes.
15 The cost rate assigned to accumulated deferred job development investment tax
16 credits is the weighted average cost rate of investor-supplied capital. The Test
17 Year cost of capital calculation is consistent with the methodology used to
18 calculate the weighted average cost of capital in Cause No. 45235.

19 **Q15. What are I&M's forecasted common equity balances in I&M Exhibit A-7?**

20 I&M's forecasted common equity balances in I&M Exhibit A-7 are
21 \$2,762,126,699 at December 31, 2021 and \$2,927,644,814 at December 31,
22 2022. These were derived from the Company's forecast for 2021-2022
23 supported by Company witness Heimberger.

24 **Q16. What are I&M's forecasted customer deposit balances in I&M Exhibit A-7?**

25 I&M's forecasted customer deposit balances in I&M Exhibit A-7 are \$41,698,455
26 at both December 31, 2021 and December 31, 2022. These were derived from

1 the Company forecast for 2021-2022 supported by Company witness
2 Heimberger.

3 **Q17. What are I&M's forecasted balances of accumulated deferred income taxes**
4 **(ADFIT) and accumulated deferred job development investment tax credits**
5 **(ADITC) in I&M Exhibit A-7?**

6 I&M's forecasted balances of ADFIT and ADITC in I&M Exhibit A-7 are
7 \$1,010,598,387 and \$17,469,705 at December 31, 2021 and \$1,098,242,295
8 and \$13,678,705 at December 31, 2022. These were derived from the
9 Company forecast for 2021-2022 supported by Company witness Heimberger.
10 The balances of ADFIT and ADITC were calculated and provided by Company
11 witness Criss.

12 **Q18. How were the historical capital structure and weighted average cost of**
13 **capital determined in workpaper WP-I&M-1-6?**

14 The historical calculation in WP-I&M-1-6 is based on actual data as of
15 12/31/2020. The calculation was prepared in the same manner as the Test Year
16 calculation in I&M Exhibit A-7 and is used to answer certain minimum standard
17 filing requirement schedules.

IV. Financing Activity

18 **Q19. Describe I&M's financing activity that was forecast for the period between**
19 **December 31, 2020, the end of the Historical Period, and December 31,**
20 **2022, the end of Test Year.**

21 The Company forecast a \$450,000,000 issuance of new long-term debt to offset
22 the existing \$200,000,000 local bank term loan facility that matured in May 2021
23 and to supplement the needs of its ongoing capital investment program.

1 The forecast reflects a cost rate of 3.75% based on prevailing treasury market
2 conditions and credit spread information provided by banks used in issuing long-
3 term debt.

4 The Company forecasted remarketing the currently outstanding \$40,000,000
5 City of Rockport Series D pollution control revenue bonds. The forecast reflects
6 a cost rate of 1.5% based on prevailing market conditions and pricing
7 information provided by banks used in issuing long-term debt.

V. Credit Ratings

8 **Q20. What are credit ratings and what is an investment grade rating?**

9 Credit ratings are opinions on a company's ability to repay its debt and other
10 obligations in full and on time. The credit ratings facilitate the process of issuing
11 bonds by providing a widely recognized measure of relative credit risk. Investors
12 may also use ratings as a screening device to determine investments. For
13 example, an investor may choose only to invest in investment grade
14 corporations or utilities.

15 The credit ratings scale ranges from the highest ratings of 'AAA' for Standard
16 and Poor's (S&P) which is the highest rating and generally associated with U.S.
17 and similar government securities and a handful of corporations to the lowest
18 rating of 'D' which indicates that the entity has defaulted on its payments. Moody
19 Investor Service's (Moody's) scale is from the highest credit rating of Aaa to a
20 lowest credit rating of C.

21 Investment grade ratings are those instruments or corporations that are rated
22 from AAA/Aaa to BBB/Baa respectively by S&P/Moody's. Any ratings below
23 investment grade are considered by investors to be either speculative, with less
24 likelihood of repayment, or already in default.

1 **Q21. Generally describe the methodology of each rating agency.**

2 S&P evaluates the credit of each operating company utilizing a family approach,
3 factoring in the ratings of all AEP system subsidiaries. S&P's family approach to
4 bond ratings for individual operating companies emphasizes the inherent
5 benefits and risks associated with having a diversified family of operating
6 companies across AEP's eleven-state service territory.

7 Moody's and Fitch rate each operating company individually based on the merits
8 of the company's underlying operations and credit profile but recognize that
9 each is part of a larger holding company.

10 **Q22. Why are credit ratings important to I&M?**

11 A higher credit rating results in lower cost of debt and better access to capital in
12 times of financial volatility. The credit rating is the primary criteria by which fixed
13 income investors evaluate debt investments. Additionally, fixed income investors
14 are limited in the amount of non-investment grade securities that they can
15 purchase, so it is important for a utility to maintain investment grade ratings.

16 **Q23. Please discuss I&M's position with the credit rating agencies.**

17 I&M's senior unsecured ratings are A- at S&P, A3 at Moody's and BBB+ at
18 Fitch. As shown in the Company's response to Minimum Standard Filing
19 Requirement 170 IAC 1-5-13(a)(10), on April 28, 2021, S&P reaffirmed I&M's
20 credit rating of A- and revised their outlook to negative from stable.

21 On April 22, 2021, Moody's reaffirmed I&M's credit rating of A3 (stable)
22 recognizing the above average regulatory environments in the two state
23 jurisdictions the Company operates in that offer a transparent suite of recovery
24 mechanisms. On April 8, 2021, Fitch reaffirmed I&M's credit rating of BBB+
25 (stable) and considers the regulatory regime in Indiana and Michigan to be
26 supportive.

1 **Q24. Is regulatory treatment important to the rating agencies?**

2 Yes, a portion of the Company's credit rating is based on qualitative factors
3 related to regulatory environment. Rating agencies closely follow regulatory
4 outcomes for a utility. Consistent and appropriate regulatory treatment is a credit
5 positive and supports the Company's credit ratings which in turn affords the
6 Company better access to capital markets to better source capital at lower cost.


7 **Q25. Does this conclude your pre-filed verified direct testimony?**

8 Yes.

VERIFICATION

I, Franz D. Messner, Managing Director Corporate Finance AEPSC, affirm under penalties of perjury that the foregoing representations are true and correct to the best of my knowledge, information, and belief.

Date: 6/28/2021



Franz D. Messner