STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

VERIFIED PETITION OF DUKE ENERGY INDIANA, INC. PURSUANT TO INDIANA CODE SECTIONS 8-1-8.4-1 ET SEQ., 8-1-2-19, AND 8-1-2-42(a) REQUESTING THE APPROVAL OF AND FOR (1) A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY FOR FEDERALLY MANDATED COMPLIANCE PROJECTS AND COSTS; (2) ESTIMATED COSTS OF ITS FEDERALLY MANDATED COMPLIANCE PROJECTS; (3) RECOVERY OF 80% OF FEDERALLY MANDATED COSTS ON A TIMELY BASIS THROUGH AN APPLICABLE RATE ADJUSTMENT MECHANISM; (4) DEFERRAL OF 20% OF FEDERALLY MANDATED COSTS ON AN INTERIM BASIS, WITH CARRYING COSTS, UNTIL THE APPLICABLE COSTS ARE REFLECTED IN PETITIONER'S BASE RETAIL ELECTRIC RATES; (5) ONGOING REVIEW OF THE FEDERALLY MANDATED COMPLIANCE PROJECTS; AND (6) CONFIDENTIAL TREATMENT OF CERTAIN INFORMATION RELATING TO PETITIONER'S FEDERALLY MANDATED COMPLIANCE PROJECTS.	)	**CAUSE NO. 44367**

OUCC PREFILED TESTIMONY

RONALD L. KEEN - PUBLIC'S EXHIBIT #1

STACIE R. GRUCA - PUBLIC'S EXHIBIT #2

ON BEHALF OF THE

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

November 5, 2013

Respectfully Submitted,

INDIANA OFFICE OF UTILITY CONSUMER

Tiffany T. Murray, Atty. No. 28916-49
Deputy Consumer Counselor

CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing ***Office of Utility Consumer Counselor Testimonies of Ronald L. Keen and Stacie R. Gruca*** has been served upon the following counsel of record in the captioned proceeding by electronic service and/or by depositing a copy of same in the United States mail, first class postage prepaid, on November 5, 2013.

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DIRECT TESTIMONY OF RONALD L. KEEN

CAUSE NO. 44367

DUKE ENERGY INDIANA (DUKE)

Q: Please state your name and your business address.

A: My name is Ronald L. Keen. My business address is 115 West Washington Street, Suite 1500 South, Indianapolis, Indiana 46204.

Q: By whom and in what capacity are you employed?

A: I am employed by the Indiana Office of Utility Consumer Counselor (OUCC) as a Senior Analyst within the Resource Planning and Communications Division (RPC).

Q: Please describe your educational background and experience.

A: I hold a Masters Degree in Aeronautical Science from Embry-Riddle Aeronautical University and have completed coursework toward a Masters in Political Science. I also hold a Bachelors Degree in Management from Texas State University at San Marcos.

Hired by the OUCC in December 2001, I have completed the regulatory studies program at Michigan State University sponsored by the National Association of Regulatory Utility Commissioners (NARUC), as well as several utility-related courses, seminars, and conferences focused on energy-generation and transmission related topics.

Prior to working at the OUCC, I retired from the United States Air Force after a distinguished career in which I gained extensive experience as an expert in project management, telecommunications, critical infrastructure protection, systems analysis and renewable energy generation systems.

After retiring from the Air Force, I briefly worked as a Project Manager for Aeronautical Radio, Incorporated (ARINC), developing training programs, policy, and operations concepts for the Department of Defense in advanced Satellite Communications Management Systems and general communications planning.

Q: Do you have any specific background or experience that is particularly germane to this docket?

A: Yes. I served for a number of years as an Intelligence Analyst working for agencies that ultimately reported to the National Security Agency (NSA). I have completed courses, seminars, and training and have an extensive background in threat assessment, contingency planning, terrorism/anti-terrorism, infrastructure protection and facility assessment. I have served in capacities in which I was directly responsible for the assessment of threats against and protection of multi-million dollar National Command Authority (NCA) assets critical to the protection and defense of the United States and continuation of the Federal government. I have completed training and was certified as a contingency/emergency operations/war planner through the Department of Defense and as a contingency planner through the Federal Emergency

Management Agency (FEMA). I currently serve as an ESF-12[1] for the Indiana Emergency Operations Center.

Q: Have you previously testified before the Indiana Utility Regulatory Commission (IURC or Commission) or other regulatory bodies?

A: Yes. I have testified in over one hundred dockets before the Indiana Utility Regulatory Commission (IURC or Commission) and before federal agencies, such as the Federal Energy Regulatory Commission (FERC) and the Federal Communications Commission (FCC), on a variety of issues in the telecommunications and energy arenas, including Critical Infrastructure Protection (CIP) issues.

Q: What have you done to identify and investigate issues presented in this case?

A: I reviewed the Petition and Direct Testimony, including exhibits, filed by Duke Energy Indiana (Duke or Petitioner) in this cause. I have participated in extensive formal and informal meetings with Petitioner and other OUCC staff. I have also discussed topics dealing with utility-level critical infrastructure protection with peers from other organizations and agencies, including but not limited to, the North American Electric Reliability Corporation (NERC), Federal Energy Regulatory Commission (FERC), Department of Homeland Security (DHS), Federal Emergency Management Agency (FEMA), and the Indiana Department of Homeland Security (IDHS).

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[1] Within the Indiana Emergency Operations Center (EOC), the Emergency Support Functions (ESFs) provide the structure for coordinating inter-agency support in response to an incident. The Incident Command System (ICS) provides for the flexibility to allow ESFs through the EOC to assign resources according to their capabilities, taskings, and requirements to augment and support the other sections of the EOC in order to respond to incidents in a more collaborative and cross-cutting manner. The Emergency Support Function (ESF)-12 position is specifically responsible for energy industry utility coordination, energy infrastructure assessment, repair, and restoration and energy forecast information during an emergency or disaster.

Q: What is the purpose of your testimony?

A: I first will address, in general terms, Duke's request for cost recovery for its CIP project. Secondly, I will recommend an industry-wide reporting concept. Lastly, I will recommend the IURC approve the proposed Duke CIP request subject to the changes and recommendations offered in testimony by OUCC witnesses.

Q: Who will be testifying on behalf of the OUCC?

A: In addition to myself, Ms. Stacie Gruca will testify about financial issues, including but not limited to, Duke's proposed Federally Mandated Cost Rate Adjustment (FMCRA) Mechanism.

Q: Can you describe the CIP Compliance Project as proposed by Duke?

A: No. The details of this project are confidential and cannot be discussed in this testimony since they are directly related to the safety and security of Duke's critical cyber assets. Discussing the specific details of the CIP Compliance Project would provide significant and valuable information to entities that may be antagonistic to, among others, Duke, the State of Indiana, or the United States.

Q: Can you offer an overarching view of the OUCC position with regard to CIP?

A: Yes. The OUCC has concerns regarding the vulnerability of the nation's utility infrastructure and understands the gravity of the threat posed against that infrastructure. We believe it is imperative that each sector of Indiana's utility industry work closely with the IURC, OUCC, and other governmental agencies to develop cohesive strategies to secure utility infrastructure, provide reliable service, and mitigate or defeat existing and future threats. The OUCC believes that because compliance with NERC CIP standards is a compromise in most cases, a utility can be compliant, but may not be secure. Likewise, a utility can be secure, but may not be compliant.

Q: Have you examined the NERC CIP Standards referenced in this Cause?

A: Yes. I have completed an analysis of the NERC Critical Infrastructure Protection Reliability Standards-Version 4 (NERC CIP v4)[2] as approved by FERC and referenced in this Cause. I have also completed an analysis of the NERC Critical Infrastructure Protection Reliability Standards-Version 5 (NERC CIP v5 or v5), currently under consideration for approval by FERC. Duke's team is primarily concerned with NERC CIP v4 and has focused their efforts on those federal requirements that bind applicable utilities to take certain actions at this time. However, the OUCC believes, as the agency stated in IURC Cause No. 44340, that the IURC must also understand the potential implications of NERC CIP v5 and its pending approval by FERC. The OUCC believes it would also be advantageous for the IURC to examine the issues being postured for NERC Critical Infrastructure Protection Reliability Standards-Version 6 (NERC CIP v6 or v6).

Q: Which version of the NERC CIP are Duke and the other utilities held accountable to as of today?

A: Currently, the industry is subject to NERC Critical Infrastructure Protection Reliability Standards-Version 3 (NERC CIP v3 or v3). Because no order has been issued by FERC regarding NERC CIP v5, the utility industry must continue

[2] The Critical Infrastructure Protection Standards are comprised of eight primary standards which include 41 requirements and 164 sub-requirements for mandatory compliance for all major electric companies in the North American power grid.

work to become compliant with NERC CIP v4 not later than October 1, 2014. Both FERC and NERC have indicated an intent to retire v4 altogether in favor of the v5.[3]

Q: What does the evolving regulatory landscape mean for ratepayers?

A: From a ratepayer perspective, utility rates could include recovery of utility expenditures -- for compliance activities associated with v4 <u>and</u> associated with the shift to v5. The uncertainty with what is required to be compliant and what is needed to be secure creates the very real possibility that ratepayers will be paying for stranded or abandoned work necessitated by evolving federal requirements and paradigm shifts. Consequently, expenditures directly and indirectly related to CIP must be examined in detail to ensure that the costs passed on to consumers as a result of shifting from one NERC CIP version to the next subsequent version are prudent, justified, and pertinent.

Q: Have you examined the Duke CIP program proposed in this Cause?

A: Yes.

Q: Can you summarize your findings?

A: Yes. Working closely with Duke staff, the OUCC team conducted a thorough examination of the Duke proposal. However, due to the sensitive nature of this subject matter, I will not elaborate on Duke's data or the conclusions derived from that analysis. The OUCC is convinced that Duke's proposed measures comply with federal CIP compliance guidance, are both prudent and justified,

[3] Federal Energy Regulatory Commission; Docket No. RM13-5-000; Notice of Proposed Rulemaking - Version 5 Critical Infrastructure Protection Reliability Standards; Issued April 18, 2013.

and will protect Duke infrastructure assets against the wide variety of natural disasters, accidents, and incidents.

Q: Does the OUCC have any recommendations regarding on-going reporting of CIP compliance?

A: Yes. We believe that the Commission should consider developing a reporting methodology for utilities to keep state government (the IURC, OUCC and potentially other state agencies) apprised of utility's compliance with CIP requirements.

Q: Do you see an issue with public utility commissions like the IURC maintaining detailed information regarding utility infrastructure relative to any type of reporting mechanism?

A: Yes. The continued maintenance of sensitive information about utility infrastructure by not only the IURC, but other agencies such as the Indiana Department of Environmental Management (IDEM), and Department of Natural Resources (DNR), and even the OUCC, offers open source or publicly available intelligence to entities that may be adversarial to those utilities, the State of Indiana, and the United States.

Q: Given the sensitivity of this information, how do you believe the IURC can safeguard this information while monitoring the progress of CIP programs at the utility level?

A: I believe it is necessary for the IURC, OUCC, and other state agencies that maintain publicly available information on utility infrastructure within Indiana's borders to become more aware as to how information can offer operational, structural, or other significant intrinsic information to adversarial entities. These state agencies must understand both the adversarial value of information and the methods that must be undertaken to begin protecting existing data and safeguarding new information as it is received. This is to not to say that public access to records and the transparency of the administrative process should be undermined. The OUCC believes it is possible for the IURC and others to monitor the progress of CIP-related programs and projects without requiring extensive reporting or maintaining detailed data.

Q: Does the OUCC have a CIP compliance reporting concept to recommend?

A: Yes.

Q: Please describe the OUCC's CIP compliance reporting recommendation.

A: Reflecting on the testimony provided in IURC Cause No. 44340, the OUCC continues to recommend that utilities provide reports to the IURC regarding CIP-related programs and projects. The OUCC testimony in this Cause is a maturation of the concept the agency proposed in Cause No. 44340. If developed properly, the OUCC's CIP compliance reporting concept could be a template for all utilities dealing with CIP-related issues, absent any industry-specific issues.

Regardless of the specific report details, the OUCC believes three overarching tenets should govern the development process of a CIP reporting methodology. The final methodology must: (1) simplify the regulatory process dealing with the monitoring of CIP assets and projects by state agencies, (2) ease regulatory uncertainty with regard to the federal CIP monitoring and reporting process, and (3) impose little to no additional regulatory burden on the utilities themselves when factored into normal utility actions relative to CIP compliance activities.

Q: Why is the OUCC recommending only a concept rather than a detailed and specific set of requirements?

A: The active participation of the IURC and other interested entities is key to the success of a comprehensive and effective reporting and monitoring program. While the expertise of the Duke team (as well as teams from other utilities) will be invaluable in developing the details, neither Duke nor the OUCC can anticipate specific needs of the IURC or other agencies that could potentially find this tool useful. Once a final, non-appealable order has been issued in this Cause, the OUCC anticipates parties could begin the process of developing the concept into a fully-functional set of reporting requirements that could be used as a template for all jurisdictional utilities engaged in CIP compliance.

Q: What is the OUCC's vision for the "compliance" portion of its proposed reporting concept?

A: The OUCC understands that utilities must address not only NERC CIP standards, but other standards, best practices, voluntary compliance, etc. pertaining to CIP facilities originating from other agencies and sources as well (NIST SP800-53,[4] ISO 27001,[5] NERC CIP, ISA 99,[6] COBIT,[7] etc.). The parties would develop an annual

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[4] National Institute of Standards and Technology (NIST) Special Publication (SP) 800-53, "Recommended Security Controls for Federal Information Systems and Organizations," catalogs security controls for all U.S. federal information systems except those related to national security. It is published by the NIST, which is a non-regulatory agency of the United States Department of Commerce.

[5] ISO/IEC 27001:2005 – Information technology – Security techniques – Information security management systems – Requirements, is an information security management system (ISMS) standard published by the International Organization for Standardization (ISO) and the International Electrotechnical Commission (IEC). ISO/IEC 27001:2005 formally specifies a management system intended to bring information security under explicit management control.

certification to certify that, to the best of the utility's ability and with consideration given to its ongoing activities, the utility is (a) in compliance with all applicable federal and state CIP-related rules, regulations and requirements; (b) that the utility has accomplished all necessary threat analysis and vulnerability studies with regard to their facilities; and (c) that the utility will make itself available, under proper safeguards and with security in place, to answer questions regarding CIP activities and the threat to or vulnerability of its assets.

The OUCC acknowledges that the language used in this certification must provide safeguards to the utility from liability and must acknowledge the on-going efforts by the utility on a daily basis to remain in compliance with existing rules, regulations, and requirements while working to be compliant with new directives as they are finalized.

Q: How is this certification form helpful to the Commission?

A: Because the Commission has responsibility to ensure that utility service to Indiana residents remains safe and reliable, this certification provides a verification to the Commission that the utility is, to the best of its knowledge and

[6] ISA/IEC-62443 is a series of standards, technical reports, and related information defining procedures to implement electronically secure Industrial Automation and Control Systems (IACS). The guidance applies to end-users (i.e. asset owner), system integrators, security practitioners, and control systems manufacturers responsible for manufacturing, designing, implementing, or managing industrial automation and control systems. The documents were originally referred to as ANSI/ISA-99 or the ISA99 standards – they were created by the International Society for Automation (ISA) and publicly released as American National Standards Institute (ANSI) documents. In 2010, the system was renumbered and became the ANSI/ISA-62443 series – a change intended to align the ISA and ANSI document numbering with International Electrotechnical Commission (IEC) standards.

[7] Control Objectives for Information and Related Technology (COBIT) is a framework created by the Information Systems Audit and Control Association (ISACA) for information technology (IT) management and IT governance. It is a supporting toolset allowing managers to bridge the gap between control requirements, technical issues and business risks. The process focus of COBIT subdivides IT into four domains: Plan and Organize; Acquire and Implement; Deliver and Support; and Monitor and Evaluate.

ability, in compliance with all applicable CIP rules, regulations, and requirements. Consequently, the Commission and other state agencies will have assurance that utilities are taking necessary steps to protect infrastructure in Indiana without the need for the Commission to manage each program/project operational milestone.

Q: Is what you propose in this proceeding different from what the OUCC proposed in Cause No. 44340?

A: No. In Cause No. 44340, the OUCC offered the idea of a checklist developed by the IURC and parties to govern what the certification statement proposed in that Cause would cover. Upon realizing that inclusion of specific example material created more confusion than clarification, we simplified our proposed reporting concept to a more generic description.

Q: Please describe the final aspect of the OUCC's proposed reporting concept.

A: The OUCC proposes the final aspect of its proposed CIP compliance reporting concept would be the development of a reporting mechanism on a semi-annual basis to describe the status of CIP assets undergoing modification as a result of CIP-related requirements to the IURC and other relevant state agencies. However, and without exception, this provision of information about any asset cannot include any type of data that could be deemed valuable to adversarial entities. The reporting could be accomplished in conjunction with semi-annual CIP tracker reporting. This CIP asset report would only be applicable to specific assets for as long as that asset is undergoing some change and/or modification associated with CIP tracker cost recovery.

Q: How is this type of reporting helpful to the IURC and other parties if it provides no actual detail regarding each project?

A: The OUCC believes that, as CIP-related projects are undertaken, the IURC and interested parties may have a valid interest in ensuring that the assets and/or facilities are not at any level of increased risk and/or vulnerability. Though increased risk associated with a CIP project would be rare, given that the CIP projects have been granted specialized cost recovery and are being conducted in order to secure the state's utility infrastructure, a report to the Commission with this information would be valuable and necessary.

Q: Doesn't the proposed report provide some degree of actionable intelligence to adversarial entities?

A: No. Under the OUCC's proposal, the utility will identify an asset or facility using a generic designator such as (a), (b), (c), (d), etc. Using this type of generic nomenclature should provide no intrinsic value to an individual seeking actionable intelligence, as long as all documentation contained in the official publicly-accessible files contains no associated information that could provide correlatable intelligence. If necessary, the IURC and/or interested parties can work with the utility in a properly secured environment to discuss details regarding any concerns that may exist.

Q: What does the OUCC recommend regarding Petitioner's request?

A: Subject to the revisions proposed by Ms. Gruca and the recommendations regarding the reporting concept contained within this testimony, the OUCC recommends the IURC approve Duke's petition.

Q: Does this conclude your testimony?

A: Yes.

AFFIRMATION

I affirm, under the penalties for perjury, that the foregoing representations are true.

By: Ronald L. Keen
Indiana Office of
Utility Consumer Counselor

November 5, 2013
Date

DIRECT TESTIMONY OF STACIE R. GRUCA
CAUSE NO. 44367
DUKE ENERGY INDIANA, INC.

Q: Please state your name and business address.

A: My name is Stacie R. Gruca, and my business address is 115 West Washington St., Suite 1500 South, Indianapolis, Indiana 46204.

Q: By whom are you employed and in what capacity?

A: I am employed by the Indiana Office of Utility Consumer Counselor (OUCC) as a Senior Utility Analyst in the Electric Division.

Q: Please summarize your professional background and experience.

A: I graduated from Indiana University, Indianapolis, with a Bachelor of Science degree in Business, majoring in Accounting, Finance, and International Studies. I joined the OUCC in 2003. Since then, I have attended seminars on demand side management and energy efficiency issues. I attended "Practical Skills for the Changing Electric and Gas Industries," sponsored by the National Association of Regulatory Utility Commissioners (NARUC) and the New Mexico State University Center for Public Utilities, in Albuquerque, New Mexico. I also attended the 2003 Annual Regulatory Studies Program sponsored by NARUC and the Institute of Public Utilities at Michigan State University in East Lansing, Michigan, and the 37th Annual Eastern NARUC Utility Rate School sponsored by NARUC and the Institute of Public Utilities at Michigan State University in Clearwater, Florida. I have attended various Market Subcommittee, Market Settlements Work Group, and Revenue Sufficiency Guarantee (RSG) Task Force meetings of the Midcontinent Independent System Operator, Inc. (MISO).

Q: Please describe your duties and responsibilities at the OUCC.

A: I review Indiana electric utilities' requests for regulatory relief filed with the Indiana Utility Regulatory Commission (hereafter Commission or IURC). I also prepare and present testimony based on the results of my analysis and make recommendations to the Commission on behalf of Indiana electric utility consumers.

I. Introduction

Q: What is the purpose of your testimony?

A: I will present a review of my analysis and recommend that the Commission approve, with modifications, Duke Energy Indiana, Inc.'s (hereafter Duke Energy Indiana, DEI, or Petitioner) proposed Standard Contract Rider No. 72 - Federally Mandated Cost Rate Adjustment (hereafter FMCRA or Rider 72). In particular, I will address DEI's proposed Rider 72 tariff language, capital structure, ratemaking treatment of federally mandated project costs, estimated operation and maintenance (O&M) expense, and depreciation.

Q: Have you previously testified before the Indiana Utility Regulatory Commission?

A: Yes, I have.

Q: Please describe the examination and analysis you conducted in order to prepare your testimony and schedules in this Cause.

A: I reviewed Petitioner's Verified Petition, prefiled testimony, exhibits, work papers, and confidential information. I also reviewed Petitioner's responses to the OUCC's data requests, and participated in discussions with DEI staff.

II. FMCRA Tariff Language

Q: Please describe DEI's proposed Rider 72.

A: Pursuant to Indiana Code § 8-1-8.4-7, DEI is requesting authority to implement a new annual Standard Contract Rider No. 72 – FMCRA in its electric tariff. The FMCRA will allow DEI recovery of 80% of the retail jurisdictional share of costs associated with its requested Certificate of Public Convenience and Necessity (CPCN) for its NERC Compliance Phase I projects to comply with Critical Infrastructure Protection (CIP) Version 4 (CIP Compliance Project).

Q: Does the OUCC have concerns with DEI implementing an annual FMCRA Mechanism?

A: No. The OUCC does not oppose the implementation of an annual adjustment mechanism to recover 80% of the retail jurisdiction share of approved federally mandated costs through Petitioner's new Rider 72 requested under Ind. Code § 8-1-8.4.

Q: Does the OUCC have concerns with DEI's proposed FMCRA Rider 72 tariff?

A: Yes. Original Sheet No. 72 for DEI's Standard Contract Rider No. 72 - Federally Mandated Cost Rate Adjustment Applicable to Retail Rate Groups, states:

> The applicable charges for electric service to the Company's retail electric customers shall be increased or decreased for the change in costs associated with the Company's compliance with federally mandated requirements for electric utilities.[1]

The OUCC recommends narrowing the scope of this language to avoid inclusion of federally mandated costs that have not received Commission approval. Changing the tariff language as shown below will accomplish this:

[1] Petitioner's Exhibit E-1.

> The applicable charges for electric service to the Company's retail electric customers shall be increased or decreased for the change in costs associated **with a Commission-approved Certificate of Public Convenience and Necessity (CPCN) pursuant to Ind. Code § 8-1-8.4 et. seq. and incurred in connection** with the Company's compliance with federally mandated requirements for electric utilities. **(emphasis added)**

III. Capital Structure

Q: What capital structure does DEI propose to use in the development of its Rider 72?

A: DEI proposes to use its most current return on common equity approved by the Commission in its most recent general retail rate case, currently 10.5%.[2] While the return on equity would remain the same, DEI proposes to update its capital structure along with the debt costs in each Rider 72 filing.

Q: Does the OUCC agree that DEI's use of an updated capital structure is an appropriate basis for development of Rider 72?

A: Yes. DEI's use of an updated capital structure follows the Commission's current construction work in progress (CWIP) ratemaking practices in DEI's Environmental Cost Recovery (ECR) and Integrated Coal Gasification Combined Cycle Generating Facility (IGCC) proceedings, as referenced in 170 IAC 4-6-1 et. seq. The use of a current capital structure is appropriate for federally mandated project cost recovery calculations.

[2] IURC Cause No. 42359, Final Order dated May 18, 2004.

IV. Ratemaking Treatment

Q: Please describe Duke Energy Indiana's proposed treatment of the 80% tracked costs to be included in Rider 72.

A: DEI proposes to recover costs including capital, allowance for funds used during construction (AFUDC), operating, maintenance, depreciation, tax, and financing costs through its Rider 72.

Petitioner proposes to implement CWIP ratemaking treatment for qualifying capital investments. DEI proposes to accrue AFUDC[3] on its investment for all federally mandated capital projects until such costs are given CWIP ratemaking treatment and included for recovery under Rider 72 or are otherwise included in retail base rates or until projects are placed in service. Once federally mandated projects are placed in service, DEI proposes to accrue post-in-service carrying costs based on its weighted average cost of capital (WACC) until project costs are included for recovery in retail rates through Rider 72.

As indicated in DEI's testimony, a portion of the federally mandated project costs will be allocated to wholesale customers. A wholesale percentage will be determined for any jointly owned facilities including the Transmission and Local Facilities Agreement. DEI adjusted its total company transmission investment based on a joint ownership percentage of 14.686%.[4]

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[3] Duke Energy Indiana was granted permission from the Federal Energy Regulatory Commission (FERC) on August 12, 1996, to determine its AFUDC rate on a monthly basis rather than the annual calculation specified by the Uniform System of Accounts instructions.

[4] Petitioner's Exhibit E, Direct Testimony of Kent K. Freeman, Page 7, lines 15-21 and Page 8, lines 1-2.

DEI split out (80/20) its federally mandated project construction costs for native load prior to making any additional calculations. DEI calculates a return on its 80% capital investment utilizing its most recent Commission-approved WACC of 6.77%[5] until such amounts are fully depreciated in the FMCRA Mechanism or reflected in base rates. The 80% return on investment is grossed up for taxes resulting in the revenue requirement - return on investment. The revenue requirement – return on investment is added to 80% O&M expense and depreciation expense to derive a total revenue requirement. This total revenue requirement is then adjusted based on the percentage allocated to retail customers[6] resulting in the total retail revenue requirement tracked through DEI's proposed Rider 72.

Q: Does the OUCC have concerns with DEI's proposal to apply post-in-service WACC to the federally mandated construction project cost?

A: Yes. The OUCC believes Petitioner should use the AFUDC rate in calculating post-in-service carrying costs. In a construction tracker, there can be a delay from the time a construction project is complete and placed into service and when the project costs are recovered in the tracker. A utility may seek special authorization from the Commission to accrue post-in-service carrying costs during this narrow window of time. When a construction project is completed and placed into service, accrual of AFUDC ceases. If approved by the Commission, post-in-service AFUDC/carrying charges (along with deferred depreciation) can be applied to improve the utility's financial position from the time the project is

[5] Approved by the Commission in Cause No. 42061 ECR-21.
[6] Duke determined a retail/wholesale split based on the Separation Study included in Cause No. 42359 and approved by the Commission on May 18, 2004.

placed into service until the project is reflected in rates. If Petitioner's request to apply post-in-service carrying charges on 80% of the construction costs net of depreciation is approved, then the AFUDC rate is the proper carrying charge rate to apply post-in-service.

Q: Does the OUCC believe that both debt and equity should be included in the calculation of post-in-service AFUDC?

A: No. Only the debt portion of AFUDC is allowed in post-in-service accounting, pursuant to FASB 71 (now Accounting Standards Code, ASC 980-340-25.1), which allows only expenses to be capitalized post-in-service.[7] The equity portion does not get charged to an expense account and therefore is normally not included in the calculation of post-in-service AFUDC. The Commission has approved post-in-service AFUDC, including debt only, in cases including, but not limited to, Indiana-American Water Co. Cause Nos. 40701 and 41244. In considering the appropriate relief, the Commission may include the equity component in the post-in-service AFUDC if it believes serious financial hardship may occur without such relief. DEI has made no showing of such hardship in this case. Petitioner's Exhibit E-4, Page 1 of 3, shows Petitioner's proposed FMCRA Mechanism includes estimated capital expenditures of approximately $805,000 and estimated O&M costs of approximately $8,000 for its NERC Compliance Phase I projects to comply with CIP Version 4.[8]

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[7] With respect to post-in-service AFUDC, the only cost that would otherwise be charged to expense is interest expense related to the debt portion of the post-in-service debt cost in the AFUDC calculation.

[8] The OUCC is aware that it did not raise the issue of using only the debt portion of the AFUDC rate in its calculation of post-in-service AFUDC/carrying charges in a previous CIP Compliance Project tracker case, but that oversight in no way limits the merits of the OUCC's argument presented here. Limiting post-in-service AFUDC to debt only is still the most appropriate treatment for post-in-service AFUDC/carrying charges on a construction project.

Q: Why should post-in-service carrying charges be calculated using a utility's most current AFUDC rate, including debt only, as opposed to its WACC?

A: Ind. Code § 8-1-8.4-7(c)(1) does not specify how post-in-service carrying charges should be treated for ratemaking purposes. Ind. Code § 8-1-8.4-7(c)(1) provides:

> Eighty percent (80%) of the approved federally mandated costs shall be recovered by the energy utility through a periodic retail rate adjustment mechanism that allows the timely recovery of the approved federally mandated costs.

"Federally mandated costs" are described in Ind. Code § 8-1-8.4-4 as: "…costs that an energy utility incurs in connection with a compliance project, including capital, operating, maintenance, depreciation, tax, or financing costs." Financing costs are also referred to as carrying costs or post-in-service carrying costs. The statute provides no direction as to what rate financing costs are to be based on (i.e., AFUDC, WACC, etc.). The AFUDC rate includes many of the same components as WACC; however, the AFUDC rate is more appropriately designed for construction projects because, unlike WACC, it includes short-term debt.

Q: Is the OUCC proposing that Duke Energy Indiana use the debt portion only of its most current AFUDC rate to calculate post-in-service carrying costs in this case?

A: Yes. For the reasons outlined above, the OUCC supports the use of the AFUDC rate (debt portion only) when determining post-in-service carrying costs on a construction project. Not only is AFUDC (debt portion only) the most appropriate rate to apply to a construction project; in this case, it is also lower than Petitioner's WACC rate.

Q: Does the OUCC have an alternate proposal in the event the Commission approves using DEI's most current AFUDC rate inclusive of both debt and equity in the calculation of post-in-service carrying charges?

A: Yes. Should the Commission not approve the use of DEI's most current AFUDC rate including debt only, the OUCC alternatively recommends the lower of the updated WACC rate or the most current AFUDC rate be used in the calculation of post-in-service carrying costs. In this case, the lower of the two would be DEI's WACC rate.

DEI's AFUDC rate inclusive of both debt and equity is <u>7.75%</u> (2.39% is debt portion only[9]) as of June 2013 and DEI's most recent Commission-approved WACC rate is <u>6.77%</u> as of December 31, 2012. Typically, there is not such a great disparity between the WACC rate and the AFUDC rate. Petitioner's variance is due to the minimal amount of short-term debt included in the computation of its AFUDC rate. This alternate position is supported due to the unusual gap between Petitioner's WACC rate and AFUDC rate in this proceeding and the need to minimize the cost burden to ratepayers.

Q: Please describe DEI's proposed treatment of the 20% deferred costs.

A: In accordance with Ind. Code § 8-1-8.4-7, DEI proposes to accrue post-in-service carrying costs (based on its WACC rate) on the 20% of the retail jurisdictional portion of the federally mandated construction project costs, including accrual on previously computed post-in-service WACC. Additionally, Petitioner proposes to accrue post-in-service WACC on its O&M expenses, property tax expense, and

[9] AFUDC Rate short-term debt of 0.001% plus long-term debt of 2.391% for a total 2.392% AFUDC rate (debt portion only)

depreciation expense from the in-service date until such costs are fully reflected in DEI's retail base rates after a general rate case.

Q: Does the OUCC have concerns with DEI's treatment of 20% deferred federally mandated costs?

A: Yes. The OUCC has concerns with Petitioner's proposal to: (1) use the WACC rate in calculating the accrual of post-in-service carrying costs on the 20% deferred federally mandated construction project costs; and (2) apply carrying costs on deferred depreciation, O&M, and property tax expense.

Q: Please describe the OUCC's concerns with the WACC rate applied to the 20% of federally mandated construction project costs placed in-service until the costs are recovered in retail rates.

A: For the same reasons previously indicated in my testimony, if approved by the Commission, post-in-service AFUDC should be calculated on the 20% deferred construction project costs (including accrual on previously computed post-in-service AFUDC) net of depreciation based on DEI's most current AFUDC rate (debt portion only) from the time projects are placed in-service until the project costs are recovered in retail rates. Ind. Code § 8-1-8.4-7(c)(2) refers to post-in-service carrying costs based on the overall cost of capital most recently approved by the Commission with respect to the 20% deferred federally mandated costs. However, the utilization of post-in-service AFUDC not only follows the Commission's standard practice for recovery of construction project costs, but also benefits the utility from a financial reporting perspective because the accrual on capital costs reduces interest expense. The use of AFUDC is most appropriate because the AFUDC rate includes many of the same components of WACC, yet takes into consideration short-term debt balances that are pertinent to construction costs. Post-in-service AFUDC (debt portion only) is also consistent with FASB 71 (now Accounting Standards Code, ASC 980-340-25.1), which allows only expenses to be capitalized post-in-service.

Alternatively, should the Commission deny the application of post-in-service AFUDC, debt portion only (currently at 2.39%), the OUCC recommends Petitioner use the lower of its WACC rate or AFDUC rate to calculate post-in-service carrying costs. This is an appropriate alternative due to the disparity between DEI's WACC rate and its AFUDC rate.

Q: Please describe the OUCC's concerns with Duke Energy Indiana's application of carrying charges to deferred depreciation, O&M, and property tax expenses.

A: The 20% deferred depreciation, O&M, and property expenses should be deferred <u>without</u> carrying charges until DEI's next rate case. Ind. Code § 8-1-8.4-7(c)(2) provides:

> Twenty percent (20%) of the approved federally mandated costs, including depreciation, allowance for funds used during construction, and post-in-service carrying costs, based on the overall cost of capital most recently approved by the commission, shall be deferred and recovered by the energy utility as part of the next general rate case filed by the energy utility with the commission.

This section of the statute does not specifically allow carrying charges to be applied to deferred depreciation, O&M, or property tax expenses. From a financial reporting perspective, Petitioner already benefits from the deferral of depreciation because the deferral delays depreciation expense from hitting the income statement. DEI has not presented evidence that suggests further specialized treatment of deferred depreciation, O&M, and property tax expenses is warranted in this case.

V. Estimated O&M

Q: Does the OUCC have concerns with DEI's proposed estimated O&M costs?

A: No. DEI estimates a total of $7,500 in contract labor O&M and $7,500 in internal labor O&M for 2014. Petitioner indicated that it is not requesting cost recovery of internal labor O&M for CIP Version 4 compliance as part of this Cause.[10] Based on communications with DEI, it is my understanding that the difference in the $100,000 estimated O&M costs included in its Petition[11] and the $7,500 estimated contract labor costs is due to the recent FERC Order postponing the enforcement date for CIP Version 4 from April 1, 2014 to October 1, 2014. DEI filed its Petition in this Cause prior to the FERC Order providing postponement. Due to the postponement, Petitioner was able to delay training needs at this time and its associated O&M amount was reduced from $100,000 to $7,500. The $7,500 O&M costs (rounded up to $8,000) were included in the estimated revenue requirement for the proposed Rider 72 in Petitioner's Exhibit E-4, Page 1 of 3. Final cost estimates of the projects could change; however, Petitioner indicated it will update the Commission in its periodic filings.

As indicated previously in my testimony, the OUCC is concerned with DEI's proposal to apply carrying charges on the deferred portion of O&M expense.

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[10] Petitioner's Exhibit D, Direct Testimony of Mark G. Powell, Page 4, lines 7-13 and Petitioner's Exhibit D-1.

[11] Cause No. 44367, Verified Petition, Page 4.

VI. Depreciation Rate

Q: Does the OUCC have concerns with DEI's proposed depreciation rates?

A: No. DEI used five year depreciation lives for its rate impact analysis. In response to OUCC Data Request No. 1.6, DEI stated:

> Once the projects are completed the Asset Accounting Department will determine the proper FERC account for each project and the Commission approved depreciation rate for that account will be utilized. Because of the minimal rate impact of the projects, the Company believes that a five year life is appropriate for rate analysis purposes and if the actual lives are longer, it would only reduce the near term rate impacts.

Five year depreciation lives for physical enhancements such as installation of badge readers, upgrading door locks, and securing physical openings appear to be consistent with the Internal Revenue Service (IRS) guidelines for similar items. Five year depreciation lives for electronic security enhancements, such as the installation of network routers, switches, etc., to form the electronic security perimeter and protecting certain electronic access ports is sound. Petitioner's depreciation lives are reasonable given likely technological advances and resulting obsolescence of component equipment, possible changes in compliance/security strategy, and replacement or upgrades to computer software.

As indicated previously in my testimony, the OUCC is concerned with DEI's proposal to apply carrying charges on the deferred portion of depreciation expense.

VII. Additional Concerns

Q: Does the OUCC have any other concerns to bring to the Commission's attention?

A: Yes. The nature of this proceeding is entirely different from other CPCN proceedings due to the security issues involved. DEI's CIP Compliance Project information requires highly confidential treatment. As described by OUCC witness Keen, changes to federal CIP guidelines and requirements are forthcoming that may require changes within an adjustment mechanism. The lifespan of CIP Compliance Project-related construction and equipment is much shorter than construction and equipment requested in most other CPCN proceedings. Given these confidentiality issues, the OUCC recommends working with DEI staff at the time its initial Rider 72 is filed establishing rates, including a discussion to develop a standard audit package, similar to what has been done in other tracker proceedings that may include additional supporting information and/or work papers.

Second, the OUCC recommends Petitioner use the same Cause No. and extension in each of its subsequent filings (i.e. Cause No. XXXXX FMCRA-X). This will provide consistency for Duke's future FMCRA tracker filings.

VIII. Recommendations

Q: What does the OUCC recommend the Commission do with regard to Duke Energy Indiana's requests in this CIP proceeding?

A: The OUCC recommends the Commission:

1) Approve the OUCC's proposed changes to the Rider 72 tariff language.

2) Approve Duke Energy Indiana's use of an updated capital structure in each FMCRA annual filing.
3) Approve the OUCC's recommended ratemaking treatment of federally mandated construction project costs described herein. For the 80% tracked portion, the OUCC specifically recommends calculating post-in-service AFUDC (debt portion only) when the CIP Compliance Project is completed and placed into service. In the alternative, the lower of post-in-service WACC or post-in-service AFUDC should be applied to 80% of the construction costs based on Duke Energy Indiana's updated WACC rate or current AFUDC rate until it receives ratemaking treatment in Rider 72.
4) Approve the OUCC's recommended ratemaking treatment of federally mandated construction project costs described herein. For the 20% deferred construction costs, the OUCC specifically recommends calculating post-in-service AFUDC (debt portion only) when the CIP Compliance Project is completed and placed into service. In the alternative, the lower of post-in-service WACC or post-in-service AFUDC should be applied to the 20% deferred construction costs including previously accrued post-in-service carrying costs (based on Duke Energy Indiana's updated WACC rate or current AFUDC rate) until deferred costs are recovered in Petitioner's next general base rate case.
5) Deny Petitioner's request to apply post-in-service carrying costs on deferred depreciation, property tax, and O&M expenses.
6) Approve Duke Energy Indiana's proposed estimated O&M costs of $7,500.

7) Approve Duke Energy Indiana's proposed depreciation rates based on the 5-year useful lives.

8) Require Duke Energy Indiana to provide the OUCC (in addition to the Commission) its Compliance Filing that includes Duke Energy Indiana's first set of Rider 72 factors.

9) Require Duke Energy Indiana to participate in discussions with the OUCC to develop a standard audit package for Rider 72.

10) Require Duke Energy Indiana to utilize the same Cause No. and extension in each of its subsequent filings under the proposed Federally Mandated Costs Rate Adjustment Mechanism (i.e. Cause No. XXXXX FMCRA-X).

Q: Does this conclude your testimony?

A: Yes, it does.

AFFIRMATION

I affirm, under the penalties for perjury, that the foregoing representations are true.

Stacie R. Gruca

By: Stacie R. Gruca
Indiana Office of
Utility Consumer Counselor

11/5/2013
Date: