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**INDIANA UTILITY
REGULATORY COMMISSION**

I&M Exhibit: _____

Cause No. 45235

INDIANA MICHIGAN POWER COMPANY

PRE-FILED VERIFIED DIRECT TESTIMONY

OF

FRANZ D. MESSNER

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**PRE-FILED VERIFIED DIRECT TESTIMONY OF FRANZ D. MESSNER
ON BEHALF OF
INDIANA MICHIGAN POWER COMPANY**

1 **Q. Please state your name and business address.**

2 A. My name is Franz D. Messner. My business address is 1 Riverside Plaza,
3 Columbus, Ohio 43215.

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

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

10 **Q. Please briefly describe your educational background and business
11 experience.**

12 A. I earned a Bachelor of Science in Systems Engineering from the United States
13 Naval Academy in 1990. I earned a Master of Business Administration from the
14 Fisher College of Business at the Ohio State University in 1999. Prior to joining
15 AEP I served for approximately seven years as a U.S. Naval officer and
16 completed both chief engineer and submarine officer qualifications.

17 In June 1999, I was hired by AEPSC as an associate in a finance
18 associate development program. My primary roles have been in the areas of
19 financial analysis, budgeting, and forecasting. In July 2007, I was named
20 Manager in Corporate Planning and Budgeting and subsequently promoted to
21 Director in November 2009. In May 2016, I assumed my current position as
22 Managing Director of Corporate Finance.

1 **Q. What are your responsibilities?**

2 A. I am responsible for planning and executing the corporate finance programs of the
3 regulated AEP System operating companies, including I&M. My responsibilities
4 also include preparing recommendations for the payment of dividends by those
5 companies, maintaining capitalization targets, and managing the relationships of
6 AEP and its subsidiaries with the credit rating agencies.

7 **Q. Have you previously filed testimony before any regulatory commissions?**

8 A. Yes. I submitted testimony before the Indiana Utility Regulatory Commission in
9 Cause No. 44967 and before the Michigan Public Service Commission in Cause
10 No. U-18370 on behalf of Indiana Michigan Power Company.

11 **PURPOSE OF TESTIMONY**

12 **Q. What is the purpose of your testimony in this proceeding?**

13 A. The purpose of my testimony in this proceeding is to present and support the
14 capital structure and weighted average cost of capital for I&M. I also describe
15 the forecasted financing activity between December 31, 2018, the end of the
16 historical period, and December 31, 2020, the end of the forward-looking test
17 year (Test Year). Finally, I describe I&M's credit ratings and why regulatory
18 outcomes are important in the rating process.

19 **Q. Are you sponsoring any exhibits or workpapers in this proceeding?**

20 A. I am sponsoring the following exhibit and workpaper:

- 21
 - I&M Exhibit A-7: Projected Capital Structure and Weighted Average Cost
- 22 of Capital.

- 1 • WP-I&M-1-6: Historical Capital Structure and Weighted Average Cost of
2 Capital.

3 **Q. Were the exhibit and workpaper you are sponsoring prepared by you or**
4 **assembled under your direction?**

5 A. Yes.

6 **WEIGHTED AVERAGE COST OF CAPITAL**

7 **Q. Please describe I&M's capital structure and weighted average cost of**
8 **capital at the beginning and end of the Test Year as shown in Exhibit A-7.**

9 A. Exhibit A-7 depicts the calculation of the weighted average cost of capital for I&M
10 with both permanent capital and ratemaking adjustments including deferred taxes
11 and customer deposits. I&M's projected overall weighted average cost of capital,
12 inclusive of ratemaking adjustments, is 5.89% at the beginning of the Test Year
13 (December 31, 2019), and 5.91% at the end of the Test Year (December 31,
14 2020). In both cases, the Company utilizes a 10.5% cost of equity supported by
15 Company witness Hevert. Pages 1 and 3 of Exhibit A-7 (also shown in Figures
16 FDM-1 and FDM-2) show the computation of the weighted average cost of
17 capital for I&M at the beginning and end of the Test Year.

Figure FDM-1
Projected Weighted Average Cost of Capital at the Beginning of the Test Year,
December 31, 2019
(Exhibit A-7, Pg. 1)

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	2,928,301,261	43.55%	4.53%	1.97%
3	Common Equity	2,481,087,345	36.90%	10.50%	3.87%
4	Customer Deposits	37,972,608	0.56%	2.00%	0.01%
5	ADFIT ¹	1,251,804,495	18.62%	0.00%	0.00%
6	ADITC ²	<u>24,174,484</u>	<u>0.36%</u>	7.27%	<u>0.03%</u>
7					
8	Total	<u>6,723,340,193</u>	100.00%		<u>5.89%</u>
9					
10					
11					
12	<u>Cost of Investor Supplied Capital</u>				
13	Long-Term Debt	2,928,301,261	54.13%	4.53%	2.45%
14	Common Equity	<u>2,481,087,345</u>	<u>45.87%</u>	10.50%	<u>4.82%</u>
15	Total	5,409,388,606	100.00%		7.27%

¹Accumulated Deferred Federal Income Taxes

²Accumulated Deferred Job Development Investment Tax Credits

Figure FDM-2
Projected Weighted Average Cost of Capital at the End of the Test Year,
December 31, 2020
(Exhibit A-7, Pg. 3)

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	2,926,531,185	42.69%	4.54%	1.94%
3	Common Equity	2,574,496,077	37.55%	10.50%	3.94%
4	Customer Deposits	37,972,608	0.55%	2.00%	0.01%
5	ADFIT ¹	1,297,621,545	18.93%	0.00%	0.00%
6	ADITC ²	<u>18,960,268</u>	<u>0.28%</u>	7.33%	<u>0.02%</u>
7					
8	Total	<u>6,855,581,684</u>	100.00%		<u>5.91%</u>
9					
10					
11					
12	<u>Cost of Investor Supplied Capital</u>				
13	Long-Term Debt	2,926,531,185	53.20%	4.54%	2.42%
14	Common Equity	<u>2,574,496,077</u>	<u>46.80%</u>	10.50%	<u>4.91%</u>
15	Total	5,501,027,263	100.00%		7.33%

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, 2019 (Figure
5 FDM-1) and December 31, 2020 (Figure FDM-2). Column (c) identifies each
6 component's percentage of I&M's total capital, and Column (d) identifies the cost
7 rates associated with each component. Column (e) shows the weighted average
8 cost of capital by component.

9 **Q. How are the December 31, 2019 and December 31, 2020 weighted cost of**
10 **capital computations used in this proceeding?**

11 A. The December 31, 2019 weighted cost of capital is used in determining the
12 Phase-in Rate Adjustment as supported and described by Company witness
13 Duncan. The December 31, 2020 weighted cost of capital is used in determining
14 I&M's proposed base rates.

15 **Q. Please describe I&M's Test Year cost of long-term debt as shown in Exhibit**
16 **A-7.**

17 A. The projected cost rates for long-term debt at the beginning of the Test Year
18 (December 31, 2019) and end of the Test Year (December 31, 2020) shown on
19 pages 1 and 3 of Exhibit A-7 are 4.53% and 4.54% respectively. The calculation
20 of these projected costs is shown on pages 2 and 4 of Exhibit A-7 and is
21 inclusive of all costs associated with long-term debt issuances.

1 **Q. What is the source of the other cost rates in Exhibit A-7?**

2 A. The 10.50% cost of equity was provided to me by Company witness Hevert. A
3 2.0% cost rate was applied to the balance of customer deposits consistent with
4 the Stipulation and Settlement Agreement approved in Cause No. 44967. A
5 0.0% cost rate was assigned to accumulated deferred federal income taxes. The
6 cost rate assigned to accumulated deferred job development investment tax
7 credits is the weighted average cost rate of investor supplied capital. The Test
8 Year cost of capital calculation is consistent with the methodology used to
9 calculate the weighted average cost of capital in the Commission's order in I&M's
10 last basic rate proceeding, Cause No. 44967.

11 **Q. How did the Company project the common equity balances in Exhibit A-7?**

12 A. I&M's projected common equity balances – \$2,481,087,345 at December 31,
13 2019 and \$2,574,496,077 at December 31, 2020 – were derived from the
14 Company's forecast for 2019-2020 supported by Company witness Heimberger.

15 **Q. How did the Company determine the balances of customer deposits in
16 Exhibit A-7?**

17 A. The balances in customer deposits in Exhibit A-7 were derived from the
18 Company forecast for 2019-2020 supported by Company witness Heimberger.

19 **Q. How did the Company determine the balances of accumulated deferred
20 income taxes (ADFIT) and accumulated deferred job development
21 investment tax credits (ADITC) in Exhibit A-7?**

22 A. The data used to determine the balances of ADFIT and ADITC in Exhibit A-7
23 were derived from the Company forecast for 2019-2020 supported by Company

1 witness Heimberger. The balances of ADFIT and ADITC were calculated and
2 provided by Company witness Kelly and include Rate Base Adjustment 6 (RB-6)
3 as described and supported by Company witness Williamson.

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

6 A. The historical calculation in WP-I&M-1-6 is based on actual data reflected in the
7 Company 10-K. The calculation was prepared in the same manner as the Test
8 Year calculation in Exhibit A-7 and is used to answer certain minimum standard
9 filing requirement schedules.

10 **FINANCING ACTIVITY**

11 **Q. Please describe refinancing activity associated with the \$475,000,000**
12 **Series I bonds agreed to in the Stipulation and Settlement Agreement**
13 **approved in Cause No. 44967?**

14 A. As part of the Stipulation and Settlement Agreement approved in Cause No.
15 44967 the cost of capital was adjusted, "...to reflect refinancing of the \$475
16 million in Series I Bonds (with a March 2019 maturity) at an estimated rate of
17 4.7% on or before July 1, 2018, and amortization of an estimated \$15 million
18 make whole call premium over the life of the replacement debt." The original
19 coupon on the Series I bonds was 7.0%. In August 2018 the \$475,000,000
20 Series N bonds were issued at a rate of 4.25% and the Series I bonds were
21 subsequently repaid including a make whole of approximately \$10,300,000. The
22 net result of this refinancing, inclusive of make whole and issuance costs, is a
23 lower cost of long-term debt associated with the \$475,000,000.

1 **Q. Please describe I&M's financing activity between December 31, 2018, the**
2 **end of the historical period, and December 31, 2020, the end of Test Year.**

3 A. In October 2019, the \$25,000,000 City of Lawrenceburg Series 2008 I Pollution
4 Control Bonds mature. In addition, the Company intends to issue \$300,000,000
5 of new long-term debt in November 2019 to supplement the needs of its ongoing
6 capital investment program.

7 **CREDIT RATINGS**

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

9 A. 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 corporations
14 or utilities.

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

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

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

2 A. 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 stresses the inherent benefits
5 and risks associated with having a diversified family of operating companies
6 across AEP's eleven-state service territory.

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

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

11 A. 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 **Q. Please discuss I&M's position with the credit rating agencies.**

17 A. I&M's senior unsecured ratings are A- at S&P and A3 at Moody's. As shown in
18 the Company's response to Minimum Standard Filing Requirement 170 IAC 1-5-
19 13(a)(10), on February 2, 2017, S&P upgraded I&M and all other AEP operating
20 companies to A- from BBB+. On February 13, 2018, S&P reaffirmed the rating of
21 A- (stable). On April 26, 2018, Moody's upgraded I&M's credit rating to A3
22 (stable) from Baa1 (positive). On April 27, 2018, Moody's published an updated
23 credit opinion in which they recognized the above average regulatory

1 environments in the two state jurisdictions the Company operates in that offer a
2 transparent suite of recovery mechanisms as well as the Federal Energy
3 Regulatory Commission (FERC). The stable outlook recognizes the credit
4 supportive regulatory environments.

5 **Q. Is regulatory treatment important to the rating agencies?**

6 A. A significant portion of the Company's credit rating is based on qualitative factors
7 related to regulatory environment. Rating agencies closely follow regulatory
8 outcomes for a utility. Consistent and appropriate regulatory treatment is a credit
9 positive and supports the Company's credit ratings which in turn affords the
10 Company better access to capital markets to better source capital at lower cost.

11 **Q. Does this complete your pre-filed verified direct testimony?**

12 A. Yes.

VERIFICATION

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

Date: 5/8/2019



Franz D. Messner