ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

IN THE MATTER OF THE APPLICATION OF INDIANA MICHIGAN POWER COMPANY FOR AUTHORIZATION OF A NEW FUEL ADJUSTMENT CHARGE FOR ELECTRIC SERVICE APPLICABLE FOR THE BILLING MONTHS OF APRIL 2010 THROUGH SEPTEMBER 2010 AND FOR APPROVAL OF RATEMAKING TREATMENT FOR COST OF WIND POWER PURCHASES PURSUANT TO CAUSE NOS. 43328 AND 43750	)	**CAUSE NO. 38702 FAC 64** **APPROVED:** MAR 24 2010

BY THE COMMISSION:
David E. Ziegner, Commissioner
Loraine L. Seyfried, Administrative Law Judge

On January 21, 2010, Indiana Michigan Power Company ("I&M" or "Applicant") filed with the Indiana Utility Regulatory Commission ("Commission") its Verified Application For a New Fuel Adjustment Charge for electric service to be applicable during the April 2010 through September 2010 billing months, pursuant to the provisions of Ind. Code § 8-1-2-42, and for approval of I&M's ratemaking treatment of wind power purchase costs. I&M filed its direct testimony and exhibits on January 21, 2010.

On February 2, 2010, Steel Dynamics, Inc. ("SDI"), an industrial customer located in the electric service territory of I&M, filed its Petition to Intervene. Also, on February 2, 2010, the I&M-Industrial Group ("Industrial Group"), an ad hoc group of industrial customers located in the electric service territory of I&M, filed its Petition to Intervene.[1] Both petitions to intervene were granted by docket entries dated February 11, 2010.

On February 10, 2010, the Indiana Office of Utility Consumer Counselor ("OUCC") filed the testimony of Michael D. Eckert and on February 12, 2010 filed its report and the testimony of Gregory T. Guerrettaz in this Cause. By docket entry dated February 24, 2010, the Commission requested additional information, which information was provided by the parties by March 3, 2010. By docket entry dated March 3, 2010, the Commission requested additional information, which information was provided by I&M on March 4, 2010. On March 4, 2010, I&M filed supplemental testimony and exhibits which modified its proposed factor.

Pursuant to notice given and published as required by law, proof of which was incorporated into the record of this Cause by reference and placed in the official files of the Commission, a public hearing was held on March 5, 2010, at 9:30 A.M. in Room 224, National City Center, 101 W.

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[1] The I&M-Industrial Group included Air Products & Chemicals, Inc., Arcelor Mittal USA, Hartford City Paper, LLC, Marathon Petroleum Company, LLC, Praxair, Inc. and The Linde Group.

Washington Street, Indianapolis, Indiana. The Applicant, OUCC, and the Industrial Group participated in the hearing. No members of the general public appeared. At the hearing, Applicant's direct testimony and exhibits as well as the OUCC's direct testimony and exhibits were admitted into evidence. All parties waived cross-examination.

The Commission, based upon the applicable law and the evidence of record, now finds as follows:

1. **Notice and Jurisdiction.** Proper notice of the public hearing in this Cause was published as provided by law. I&M is a public electric generating utility within the meaning of the Public Service Commission Act, as amended. I&M is an Indiana corporation engaged in rendering electric public utility service in the State of Indiana and the Commission has jurisdiction over the parties and the subject matter of this proceeding.

2. **Applicant's Request.** In its Verified Application, Applicant seeks Commission approval to implement its proposed fuel adjustment charge during the billing months of April 2010 through September 2010 pursuant to Ind. Code § 8-1-2-42 and I&M's ratemaking treatment of wind power purchase costs. I&M also requests authority to implement a coal hedging program as a result of changing fundamentals in the coal market. Applicant's application originally included its canister costs for storage of spent nuclear fuel. Applicant subsequently agreed to modify its proposal to exclude these costs without prejudice to Applicant's right to pursue the issue in a future proceeding. Therefore we need not address this issue further herein. I&M's application continues the semi-annual filing process in place since 1999. Applicant also requests the Commission to find that the applicable provisions of Ind. Code § 8-1-2-42 are satisfied.

3. **Report on FAC62 S1 Subdocket.** In Cause No. 38702 FAC62, a subdocket was established to provide a forum for certain issues to be addressed if necessary. In FAC62, the parties agreed to engage in informal resolution of the issues deferred to Cause No. FAC62 S1. At the hearing, I&M informed the Commission of its continued willingness to work with the parties and the Commission to resolve issues deferred to the subdocket.

4. **Source of Fuel.** Applicant must comply with the statutory requirements of Ind. Code § 8-1-2-42(d)(1) by making every reasonable effort to acquire fuel and generate or purchase power, or both, so as to provide electricity to its retail customers at the lowest fuel cost reasonably possible. Applicant's evidence represents that it has made every reasonable effort to obtain available fuel or power as economically as possible. Based on the evidence presented and subject to further review of the matters pending in Cause No. 38702 FAC62 S1, the Commission finds that Applicant is endeavoring to acquire fuel for its internal generation or purchase power so as to provide electricity at the lowest fuel cost reasonably possible.

5. **Operating Expenses.** Ind. Code § 8-1-2-42(d)(2) requires the Commission to find that increases in a utility's fuel cost have not been offset by decreases in other expenses. Applicant's non-fuel operating expenses for the twelve month period ended November 30, 2009 in the amount of $748,164,000, as reflected on Applicant's Exhibit 1-F, Schedule 1, Column 11, Line 30, are in excess of the corresponding amount determined in Applicant's last base rate order (Cause No. 43306) of $734,525,000, by an amount of $13,639,000. Applicant's filing demonstrates that I&M is in compliance with the expense test and we so find.

6. **Return Earned.** As explained in the testimony of I&M Witness Krawec, the Order in Cause No. 43306 directed I&M to phase-in its authorized net electric operating income based on the effective days of I&M's rates in Cause Nos. 39314 and 43306. Applicant's Exhibit 7 at 4. Pursuant to the Order in Cause No. 43306, I&M is authorized to earn electric operating income of $154,587,000. According to Applicant's Exhibit 1-F, for the twelve months ended November 30, 2009, I&M earned an actual net operating income of $169,206,000. Therefore, during the twelve month period ending November 30, 2009, I&M earned in excess of the stipulated return for this proceeding. Accordingly, pursuant to Ind. Code § 8-1-2-42.3, the Commission must determine the amount, if any, of the return to be refunded through the variance in this Cause by comparing I&M's actual return earned during the relevant period, to I&M's authorized return during that same period. A refund is only appropriate if the sum of the differentials during the "relevant period" is greater than zero. As shown on Exhibit 1-F, Schedule 4, the sum of differentials for the relevant period is less than zero. Therefore, we find that no refund is required at this time.

By way of explanation, I&M Witness Krawec testified that during the twelve month period ended November 30, 2009, a forced outage at I&M's Donald C. Cook Nuclear Plant, Unit 1 ("Cook Plant Unit 1") occurred as discussed by Witness Hruby. Applicant's Exhibit 7 at 4. Witness Krawec also explained that as a result of this outage I&M is incurring and will continue to incur expenses related to the outage. I&M maintained property damage and accidental outage insurance policies with Nuclear Electric Insurance Limited ("NEIL") for such incidents. I&M has also received property and accidental outage policy payments during the twelve months ended November 30, 2009. As explained by Witness Krawec, the accidental outage policy payments are time based and not directly related to any specific expense. The total outage related expenses are not expected to be known until well after the outage has concluded. Therefore, the policy payments at a given point in time may exceed the currently known outage related expenses, which is the current situation. *Id.* Witness Krawec explained that as a result, I&M's per books net electric operating income exceeds the authorized net electric operating income for the twelve months ended November 30, 2009. *Id.*

Witness Krawec also noted that the Order in Cause No. 38702 FAC62 requires I&M to file a report with the Commission providing a final accounting of the funds received and funds spent from the insurance policies and a report detailing the costs covered by the vendor warranties and guarantees following the conclusion of the outage. *Id.* at 5. He noted that I&M intended to file an initial report in February 2010. We take administrative notice that I&M filed an initial interim report with the Commission on February 26, 2010 in Cause No. 38702 FAC62 S1 and informed the Commission that I&M will submit updated reports contemporaneous with each subsequent FAC until such time as a final report can be submitted.

7. **Estimating Techniques.** I&M's weighted average fuel cost estimating error during the months of the reconciliation period of June 2009 through November 2009 was an over estimation of 12.56%. The evidence presented indicates the decrease in coal costs due to market conditions was the major contributor to the estimation variances. The Commission notes that the monthly estimation errors depicted on Exhibit 1-D line 27 for the initial four months of the reconciliation period are markedly higher than the errors in the final two months. We further note that the forecast for the initial four months were made in FAC62 while the final two months were made in FAC63, and that a full 6 months separated these filings. We believe the relatively high amount of the estimation error results at least in part from the Applicant's choice to make its FAC filings on a 6-

month rather than 3-month cycle. The Commission will continue to monitor the estimation performance of the Applicant in light of this management choice and to evaluate whether such estimating is reasonable.

I&M projected its fuel costs for the billing months of April 2010 through September 2010. I&M's filing represents that the estimates of I&M's prospective average fuel costs for the projected period are reasonable after taking into consideration the difference between I&M's projected and actual fuel cost for the reconciliation period of June 2009 through November 2009.

Therefore, based on the evidence, and subject to further review of the matters remaining pending in Cause No. 38702 FAC62 S1, we find that Applicant's estimating techniques are reasonably accurate.

8. Fuel Cost Adjustment Charges. Applicant's Revised Exhibit 1-C sets forth I&M's actual incurred fuel costs for the reconciliation period. I&M's fuel costs for the reconciliation period were over-recovered in the amount of $24,904,428 based upon projected fuel costs for those months previously approved by the Commission.

Applicant's total estimated cost of fuel for the billing months of April 2010 through September 2010 is $212,770,770 and its total estimated sales are 11,834,288 MWh. I&M's estimated cost of fuel, as indicated on Applicant's Revised Exhibit 1-B, Schedule 1, line 27, is therefore 17.979 mills per kWh. In accordance with the Order in Cause No. 38702 FAC63, Applicant's proposed factor also includes the remaining half of the variance from the reconciliation period in Cause No. 38702 FAC63. The evidence of record indicates that I&M reconciled the actual fuel costs and revenues for the reconciliation period of June 2009 through November 2009. Reconciliation of actual fuel costs and revenues results in an over-collected total variance of $24,904,428. Combining the variance factors with the estimated per kWh cost of fuel, subtracting the base cost of fuel and adjusting for Indiana Utilities Receipts Tax, results in a proposed total fuel factor of 3.763 mills per kWh for the billing months of April 2010 through September 2010.

The OUCC recommended I&M's proposed fuel adjustment charge be approved and be made interim subject to refund pending further review of evidence related to the Cook Plant Unit 1 outage. Public's Exhibit 2 at 7. The OUCC also recommended that I&M file a report with the Commission and the OUCC providing a final accounting of the funds received and funds spent from the insurance policies and a report detailing the costs covered by the vendor warranties and guarantees. *Id.* Because these reporting requirements were accepted by the Commission's Order in Cause No. 38702 FAC62 further action is not necessary at this time. Additionally, the OUCC recommended that I&M should meet with the OUCC and interested stakeholders to explain its interim accounting report related to Cook Plant Unit 1 outage. At the hearing, I&M informed the Commission that it had invited the parties to meet after the outage ended and expressed its willingness to work with the parties and the Commission to discuss the interim accounting report.

In accordance with the basing point approved by the Commission in Cause No. 43306, we find Applicant should be authorized to apply a fuel cost adjustment of 3.763 mills per kWh to Applicant's Indiana retail tariffs for the billing months of April 2010 through September 2010.

Therefore, we find that the fuel adjustment charge for the billing months of April 2010

through September 2010 is 3.763 mills per kWh on an interim basis, subject to refund pending a decision on the matters remaining pending in Cause No. 38702 FAC62 S1. For a residential customer using 1,000 kWh the proposed factor will result in a decrease of 5.09% of his or her electric bill compared to the amount billed under I&M's current rates.

9. Wind Purchase Power Agreements. I&M Witness Allen testified in support of I&M's request for approval of ratemaking treatment for costs related to I&M's wind power purchase. Applicant's Exhibit 5 at 5. OUCC Witness Eckert testified that I&M has forecasted the total cost of wind power that it will be incurring in the future by using the cost per MWh from the Wind Power Purchase Agreement ("Wind PPA"), and has identified the wind power MWhs and costs on separate line items. Public's Exhibit No. 2 at 2-3. These wind purchases are shown consistent with the Commission's Order in Cause No. 38702 FAC63 and the inclusion of these costs conforms to the Commission's November 28, 2007 Order in Cause No. 43328 and the January 6, 2010 Order Cause No. 43750. Accordingly, the record supports and the Commission so finds that the wind power purchase costs reflected in I&M's filing are reasonable and approves the ratemaking treatment of such costs.

10. Coal Hedging Program. In its Application, I&M also requested authority to implement a coal hedging program as a result of changing fundamentals in the coal market. I&M Witness West testified that changing conditions occurring in the fuel markets have caused coal prices to become volatile. Applicant's Exhibit 2 at 3. He stated that I&M has historically physically hedged its coals costs by using long-term coal agreements which help reduce price volatility, in combination with short-term spot agreements, but many coal suppliers are no longer willing to enter into long-term fixed price supply contracts. *Id.* at 4-5. Consequently, he stated that I&M believes the use of financial hedging instruments will assist in reducing the impact of potential coal price spikes to customers. *Id.*

The OUCC indicated that it had no objection to I&M's request for authority to implement a coal hedging program, but reserved its right to review specific hedging transactions in future FAC proceedings.

Based on the evidence presented, we find that I&M has failed to provide sufficient evidence for the Commission to approve its coal hedging program at this time. I&M Witness West testified that financial hedging transactions may not ensure a lower fuel cost, but would instead provide additional price stability. Applicant's Exhibit 2 at 5. However, no historical market analysis or other study was undertaken to determine how the proposed hedging program might be expected to perform. Applicant's Exhibit 8. Nor did I&M provide any supporting evidence to justify the cost-benefit relationship of its proposed hedging program.

In addition, the Commission's February 24, 2010 Docket Entry sought information from the parties concerning whether any consideration had been given to a performance feedback methodology related to the proposed hedging program. The responses were varied.[2] SDI responded that a mechanism which shared net results may incent superior performance. The Industrial Group indicated that it had considered such a methodology, but that several issues needed further

[2] To the extent necessary, the Commission takes administrative notice of the Industrial Group's March 3, 2010 Response and SDI's March 2, 2010 Response to the Commission's February 24, 2010 Docket Entry.

exploration. The OUCC indicated that it did not consider such a mechanism. Applicant responded that inclusion of a performance-based mechanism would serve as a distinct disincentive for implementation of a hedging program.

Consequently, the Commission finds that it lacks sufficient evidence to approve Applicant's proposed coal hedging program. However, we note that the sub-docket established in FAC62 includes the topic of I&M's fuel hedging and planning activities. Accordingly, we do not foreclose the opportunity for I&M, or any other party, to pursue the submitted, or another distinct, coal hedging program in that subdocket proceeding or in a future FAC proceeding.

11. **Required Reporting.** I&M's FAC filing continues to utilize the semi-annual filing practice and was unopposed; accordingly, the Commission has approved a fuel cost factor for a six month period. However, as required by Ind. Code § 8-1-2-42(c), the OUCC should perform a quarterly review of I&M's books and records pertaining to the cost of fuel and report to the Commission by May 25, 2010. Applicant has agreed to cooperate and provide reasonable support in the OUCC's fulfillment of this requirement.

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

1. In accordance with Ind. Code § 8-1-2-42, the fuel cost adjustment charge set forth in Finding No. 8 above for the billing months of April 2010 through September 2010 shall be and hereby is approved and authorized on an interim basis, subject to refund as discussed herein.

2. I&M's ratemaking treatment for the cost of wind power purchases pursuant to the Commission's Orders in Cause Nos. 43328 and 43750 shall be and hereby is approved.

3. I&M's request to implement a coal hedging program at this time is hereby denied for failure to provide sufficient evidence.

4. I&M shall file tariff sheets that reflect the findings of this Order with the Electricity Division of this Commission prior to placing into effect the fuel cost factors approved herein.

5. This Order shall be effective on and after the date of its approval.

HARDY, ATTERHOLT, LANDIS, MAYS AND ZIEGNER CONCUR:

APPROVED: MAR 24 2010

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

Brenda A. Howe
Secretary to the Commission