ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF NORTHERN INDIANA PUBLIC SERVICE COMPANY FOR APPROVAL OF: (1) AN ADJUSTMENT TO ITS ELECTRIC SERVICE RATES THROUGH ITS ENVIRONMENTAL COST RECOVERY MECHANISM FACTOR AND ENVIRONMENTAL EXPENSE RECOVERY MECHANISM FACTOR PURSUANT TO IND. CODE §§ 8-1-2-6.6, 8-2-1-6.8, CH. 8-1-8.7, CH. 8-1-8.8 AND 170 IAC 4-6-1, *ET SEQ.* AND THE COMMISSION'S ORDERS IN CAUSE NOS. 42150, 43188, 43969 AND 44012; AND (2) MODIFICATIONS OF AND REVISED COST ESTIMATES RESPECTING CLEAN COAL TECHNOLOGY SET FORTH IN ITS ELEVENTH PROGRESS REPORT PURSUANT TO THE ONGOING REVIEW PROCESS UNDER IND. CODE § 8-1-8.7-7 AND APPROVED IN CAUSE NOS. 42150, 43188 AND 44012.	)	CAUSE NO. 42150 ECR 21 APPROVED: OCT 16 2013

ORDER OF THE COMMISSION

Presiding Officers:
Kari A. E. Bennett, Commissioner
Jeffery Earl, Administrative Law Judge

On February 1, 2013, Northern Indiana Public Service Company ("Petitioner" or "NIPSCO") filed its Verified Petitioner in this Cause. NIPSCO also prefiled the direct testimony of Ronald Plantz, Kurt W. Sangster, Derric J. Isensee, and Anthony L. Sayers. Also on February 1, 2013, Petitioner filed a Motion for Protection and Nondisclosure of Confidential and Proprietary Information, which was granted a preliminary determination of confidentiality by the Presiding Officers in a Docket Entry dated February 14, 2013.

On February 6, 2013, the NIPSCO Industrial Group ("Industrial Group") filed its Petition to Intervene, which was granted by the Presiding Officers in a Docket Entry dated February 14, 2013. On March 12, 2013, the Indiana Office of Utility Consumer Counselor ("OUCC") prefiled the direct testimony of Wes R. Blakley and Cynthia M. Armstrong.

On March 14, 2013, the Commission issued a docket entry ordering NIPSCO to file its rebuttal testimony on March 18, 2013 and to include information relating to the return on and of the Bailly Unit 7 Second Catalyst Layer that was included in Petitioner's rate base in Cause No. 43969.

On March 18, 2013, NIPSCO filed a Motion to Modify Procedural Schedule and for Extension of Time to Prefile Rebuttal Testimony requesting that the procedural schedule be modified and converted to a bifurcated proceeding to allow the parties to address NIPSCO's request for approval of its Eleventh Progress Report. NIPSCO's request for a modified procedural schedule and bifurcated proceeding was granted at the March 21, 2013 evidentiary hearing.

The Commission issued an Order on Less Than All of the Issues on April 24, 2013 ("Phase I Order") which approved, among other things, Petitioner's requested ECRM and EERM factors to become effective May 1, 2013. The Phase I Order indicated that NIPSCO's proposed modified Compliance Plan and CPCN modifications will be addressed in Phase II of this proceeding.

On April 26, 2013, NIPSCO filed the rebuttal testimony of Paul S. Kelly. On May 7, 2013, NIPSCO filed a response to the March 14, 2013 Docket Entry request for additional information.

Pursuant to notice given as required by law, proof of which was incorporated into the record, an evidentiary hearing was held in this matter at 9:30 a.m. on May 10, 2013, in Hearing Room 222, 101 West Washington Street, Indianapolis, Indiana. Petitioner, the OUCC, and the Industrial Group appeared and participated in the hearing. No member of the public appeared or participated at the hearing.

Based on the evidence presented and the applicable law, the Commission now finds:

1. **Notice and Jurisdiction.** Notice of the hearing in this case was given and published by the Commission as required by law. Petitioner is a public utility as that term is defined in Ind. Code 8-1-2-1(a). Under Ind. Code §§ 8-1-2-6.6 and 8-1-2-6.8 and Ind. Code chs. 8-1-8.7 and 8-1-8.8, the Commission has jurisdiction over a public utility's cost recovery related to the use of clean coal technology ("CCT)". Therefore, the Commission has jurisdiction over the Petitioner and subject matter of this case.

2. **Petitioner's Characteristics and Generating System.** Petitioner is a public utility organized and existing under Indiana law, with its principal office at 801 E. 86th Street, Merrillville, Indiana. NIPSCO owns and operates property and equipment used for the production, transmission, delivery, and furnishing of electric utility service to the public in northern Indiana.

3. **Background and Relief Requested.** In the November 26, 2002 Order in Cause No. 42150 ("42150 Order"), the Commission approved NIPSCO's proposal that the Commission maintain an ongoing review of its QPCP construction and expenditures and submit to the Commission annually a report of any revisions of its plan and cost estimates for such construction ("Progress Report"). In the August 25, 2010 Order in Cause No. 43526 ("43526 Order"), the Commission ordered NIPSCO to file its Progress Reports on the status of QPCP tracked in the ECRM as part of its ECRM filings rather than in a separate proceeding. The December 28, 2011 Order in Cause No. 44012 ("Phase I 44012 Order") approved Petitioner's

request to file semi-annual progress reports (as opposed to annual progress reports) as part of the ongoing review process under Ind. Code § 8-1-8.7-7.

Pursuant to the ongoing review process under Ind. Code §8-1-8.7-7, in this proceeding NIPSCO requests approval of its Eleventh Progress Report on the status of QPCP tracked in the ECRM and approval to recover the revised costs of its qualified pollution control property ("QPCP") through the ECRM. Specifically, NIPSCO requests that the Commission approve its revised Compliance Plan and CPCN modifications as set forth in Exhibit PR attached to the Company's Verified Petition initiating this Cause, including the updated project scopes, construction schedules, and cost estimates described therein. In Phase II of this proceeding, we will address NIPSCO's request for approval of its Eleventh Progress Report and the OUCC's recommendation that the Commission reject tracker treatment for the installation of a replacement second layer catalyst for Bailly Unit 7's Selective Catalytic Reduction ("SCR") facility included in NIPSCO's Eleventh Progress Report.

4. **Petitioner's Phase II Evidence.** Mr. Sangster, Director of Major Projects, stated that since the Tenth Progress Report, NIPSCO has identified aspects of its Compliance Plan that require further modification. Exhibit PR attached to the Company's Verified Petition initiating this Cause sets forth NIPSCO's Compliance Plan containing the NO_x Compliance Plan, Clean Air Interstate Rule/Clean Air Mercury Rule ("CAIR/CAMR") Compliance Plan, and the Multi-Pollutant Compliance Plan, highlighted to show necessary changes and NIPSCO's updates of estimated costs. The plan modifications can be broken down into several categories: scheduling changes, additions and/or subtractions from the Compliance Plan, and changes in estimated costs.

With respect to scheduling changes, Mr. Sangster testified the construction start date for the Unit 12 SCR Catalyst 4th Layer was revised to show the actual start of construction date; the in-service dates for the Unit 8 SCR Catalyst 3rd Layer, Unit 12 SCR Catalyst 4th Layer, Unit 14 SCR Catalyst 3rd Layer, Unit 14 Economizer Waterside Bypass, Unit 15 Selective Non-Catalytic Reduction ("SNCR") Installation, Continuous Particulate Monitors Addition (Unit 17), Continuous Particulate Monitors Addition (Unit 18), and Continuous Particulate Monitors Addition (Unit 7, Unit 8) were revised to show the actual in-service dates; the Unit 8 SCR Catalyst 4th Layer, Unit 14 SCR Catalyst 4th Layer and Unit 7 SCR Catalyst 2nd Layer projects have had their in-service schedules modified for 2013 and 2014; and the Construction Start Date and In Service Date for the Unit 12 Economizer Waterside Bypass project were revised to reflect the current schedule.

With respect to the proposed additions/subtractions, Mr. Sangster testified NIPSCO has included three catalyst layer project additions to its Compliance Plan. These projects include: (1) Unit 8 SCR Catalyst 4th Layer (new); (2) Unit 14 SCR Catalyst 4th Layer (new); and (3) Unit 7 SCR Catalyst 2nd Layer (replacement). The Unit 8 SCR Catalyst 4th Layer and Unit 14 SCR Catalyst 4th Layer are both new additional fourth layers. The Unit 7 SCR Catalyst 2nd Layer is a replacement layer. He testified that NIPSCO has canceled the Continuous Particulate Monitors Addition for U7, U8 bypass so NIPSCO proposes to remove this project and its previously approved cost estimate from its list of Compliance Plan projects. He indicated that the Indiana Department of Environmental Management ("IDEM") no longer allows NIPSCO to operate the U7, U8 bypass stack with flue gas, so particulate matter monitoring is no longer necessary.

Mr. Sangster described the three additional SCR Catalyst Layers. He testified that NIPSCO defines the catalyst layers as individual, complete layers of catalyst separated by elevation within the SCR. Each of the SCR systems was designed and built as a 3 + 1 system. The 3 + 1 system is a standard design within the electric utility industry and is defined as an SCR system that is originally loaded with 3 separate and distinct layers of catalyst with a fourth layer to be added at a later time as defined by the Catalyst Management Plan. Mr. Sangster stated that the decision to use a 3 + 1 system instead of a 3 + 0 system was based on reducing the number of catalyst layer replacement events, and subsequently reducing the cost to rate payers. He explained that in a 3 + 1 catalyst layer SCR system, the original three new catalyst layers are sufficient for operation of the SCR, however as the layers deactivate at different rates the fourth layer needs to be added. He stated the layers are replaced and/or added per the Catalyst Management Plan due to the fact that over time, the SCR catalyst layers lose effectiveness, the ability to catalytically convert NO_x to nitrogen and water vapor. He stated that if not replaced, the SCR system would cease to function properly and become inoperable.

Mr. Sangster testified the Catalyst Management Plan defines which layers are replaced at what frequency. He explained that layers closer to the SCR system inlet are "used up" faster than other layers and therefore need to be replaced sooner than other layers. He testified NIPSCO's Catalyst Management Plan has been designed and evaluated since 2000. He explained that knowing the original operating design basis and deactivation rate, NIPSCO can determine the number of catalyst layer replacement events and the net present value ("NPV") for both reactor designs. Mr. Sangster stated the Catalyst Management Plan can be modified depending on the rate that catalyst layers are being "used up or deactivated" and the outage schedule. He stated that another consideration for the Catalyst Management Plan is the pitch of the catalyst layer will affect the rate at which the catalyst layers are "deactivated" due to the fact that a larger pitch catalyst has less original activity than a smaller pitch catalyst. He stated the Catalyst Management Plan is evaluated annually to ensure the best economic value for the rate payers and to ensure that NIPSCO complies with the CAIR and the Consent Decree regulations.

Mr. Sangster testified that NIPSCO has regularly informed the Commission and its stakeholders about its ongoing efforts to replace and add catalyst layers through its annual (and more recently) semi-annual progress reports (e.g., NIPSCO discussed and requested approval of revised cost estimates for stand-alone catalyst layer projects as part of its progress reports in Cause Nos. 43144, 43593, 43840, 42150 ECR 17, and 42150 ECR 19). Mr. Sangster testified that while NIPSCO has typically not included its full Catalyst Management Plan as part of its testimony in prior cases, going forward, NIPSCO will provide a copy of its confidential Catalyst Management Plan as part of its February ECRM filings to help keep the Commission and all stakeholders informed about the plan. Mr. Sangster sponsored the most current version of the Catalyst Management Plan for each unit as Petitioner's Exhibit No. KWS-1 (Confidential), Petitioner's Exhibit No. KWS-2 (Confidential), Petitioner's Exhibit No. KWS-3 (Confidential) and Petitioner's Exhibit No. KWS-4 (Confidential).

Mr. Sangster described the additions and replacements the current plan calls for in the near future. He testified that aside from Unit 12 SCR Catalyst 4th Layer project which was approved as part of NIPSCO's Ninth Progress Report in Cause No. 42150 ECR 19, for 2013, the Catalyst Management Plans (Petitioner's Exhibit Nos. KWS-1 (Confidential), KWS-2 (Confidential), KWS-3 (Confidential) and KWS-4 (Confidential)), call for the three additional projects: (1) Unit 8 SCR Catalyst 4th Layer (new); (2) Unit 14 SCR Catalyst 4th Layer (new); and (3) Unit 7 SCR Catalyst 2nd Layer (replacement). He stated that due to a recent change in the outage schedule, the Unit 7 and Unit 8 outages were postponed from the Fall of 2013 to the Spring of 2014. He explained that the Catalyst Management Plan will need to be revised to show installation of the Unit 8 SCR Catalyst 4th Layer and the Unit 7 SCR Catalyst 2nd Layer in 2014, the only two layers in the plan for 2014 at this time.

With respect to the three additional catalyst layers included in the Eleventh Progress Report, Mr. Sangster explained that the cost estimate for the Unit 8 SCR Catalyst 4th Layer is \$1,750,000; the Unit 14 SCR Catalyst 4th Layer is \$2,300,000; and the Unit 7 SCR Catalyst 2nd Layer is \$1,400,000. He stated that NIPSCO utilized previous estimates and actual costs to generate analogous estimates on these exact same units and then escalated to budget year dollars for inclusion in the Eleventh Progress Report.

Mr. Sangster explained why the three additional catalyst layer projects meet the definition of QPCP and CCT under Indiana Code §§ 8-1-2-6.6, 8-1-2-6.8, 8-1-8.7-1 and 170 IAC 4-6-1. He stated that catalyst layers are components of air pollution control devices that directly reduce emissions of NO_x — a nitrogen based pollutant which is associated with combustion. He explained that an SCR is specifically designed for the catalyst layers to be replaced as the catalyst is "deactivated". He stated that without new catalyst layers being installed to remove the NO_x from the flue gases, the SCR cannot function. He testified the three additional catalyst layers will be used on three of NIPSCO's coal burning energy generating facilities, including Bailly Unit 8, Schahfer Unit 14, and Bailly Unit 7. He also stated that catalyst layers associated with SCRs were not in general commercial use at the same or greater scale in new or existing facilities in the United States as of January 1, 1989. Mr. Sangster testified NIPSCO will not seek recovery of any operating and maintenance expenses associated with the three additional catalyst layer projects through the EERM.

With respect to changes in estimated costs, Mr. Sangster testified the Revised Plan Cost Estimate Budget column on Exhibit PR was updated for Unit 8 SCR Duct Burners, Continuous Particulate Monitors Addition (U15), Continuous Particulate Monitors Addition (U12), Unit 12 SCR Catalyst 3rd Layer, Unit 7 SCR Catalyst 1st Layer and Unit 8 SCR Decomposition Chamber Winterization to reflect the final cost of these projects. He stated the approved cost estimate for all six projects was \$19,976,590, while total spend for all six projects was \$17,955,309. He stated the actual spend was \$2,021,281 less than approved and came in a little more than 10% under budget. He stated the Continuous Particulate Monitors Addition (U7, U8 bypass) has been cancelled, so its cost estimate of \$375,000 has been removed from the overall Compliance Plan.

5. <u>OUCC's Direct Testimony</u>. Ms. Armstrong, Senior Utility Analyst for the OUCC, recommended the Commission reject rate tracker treatment for the installation of a replacement second layer catalyst for Bailly Unit 7's SCR unit, but approve tracker recovery for additional fourth catalyst layers for the Bailly Unit 8 and Schahfer Unit 14 to enhance the SCR performance.

Ms. Armstrong stated that rate tracker treatment for the Bailly 7 second catalyst replacement layer should be denied because it would result in duplicate recovery for the second catalyst layer. She supported that statement by showing that the costs of the Bailly Unit 7 second catalyst layer are already embedded in base rates, as shown by NIPSCO's statement that the proposed Bailly 7 second catalyst layer is a replacement of the original second catalyst layer. She stated that because the Bailly Unit 7 SCR was added to rate base in Cause No. 43969, NIPSCO began recovering these costs through base rates rather than through the tracker.

In OUCC Attachments CMA 4 and CMA 5, Ms. Armstrong showed that NIPSCO did not make adjustments to account for the retirement of the old catalyst layers in the ECRM or EERM. Absent these adjustments for the retirement of the catalyst layers, Armstrong declared, the continued tracking of catalyst layer replacements will result in these assets being recovered from ratepayers twice. Through base rates, ratepayers will continue to pay for equipment that is being retired and no longer used and useful, while also paying for the replacement catalyst layer in the ECRM and EERM tracker. She argued this would be unfair to NIPSCO's ratepayers.

Ms. Armstrong noted that only three to four catalyst layers are necessary to operate the SCR and remove the appropriate amount of NO_x emissions. She explained that over the OUCC's objections, the Commission allowed cost recovery for the replacement of the first catalyst layer on the Bailly Unit 7 SCR in ECR 20 via the ECRM. She asserted that if the costs of the Bailly Unit 7 second catalyst layer's replacement are tracked, then the Bailly Unit 7 SCR would be recovered as if it has five catalyst layers, when it actually has only three. She noted that while the amounts associated with the replacement layers have not been very large to date, the OUCC is concerned that the amount associated with the double recovery of catalyst layers will grow over time as layers are replaced multiple times.

Ms. Armstrong further explained that there are no other electric investor-owned utilities that have been allowed to track the costs of replacement parts for pollution control equipment once the pollution control projects have been included in rate base. She noted that Vectren South Electric ("VSE") has gone through this process twice since the CCT statute was implemented. She stated that VSE received approval to construct SCRs on Brown Units 1 and 2, Culley Unit 3, and Warrick Unit 4 in Cause Nos. 41864 and 42248 Phase II. When VSE filed a general rate case in October 2006, she explained, these projects were rolled into rate base and the costs were no longer tracked. She testified that earlier in 2006, VSE received approval to install a fabric filter on Culley Unit 3 and a flue gas desulfurization system ("FGD") on Warrick Unit 4. She stated that since VSE did not incur costs on the Culley fabric filter and Warrick FGD projects until after it filed its rate case in Cause No. 43111, the company began a new tracking mechanism under the base Cause No. 42861. She noted that VSE rolled the Warrick Unit 4 FGD into rate base in its next base rate case, Cause No. 43839. She explained that since all of VSE's pollution control project costs were embedded in base rates once the Commission issued its final order in Cause No. 43839, Vectren's ECR tracker ceased.

Ms. Armstrong recommended that if the Commission were to approve the inclusion of the Bailly Unit 7 second catalyst replacement layer in NIPSCO's Annual Progress Report and allow tracker recovery of this asset, then NIPSCO should provide a reasonable credit in the ECRM and EERM to reflect the retirement of catalyst layers embedded in NIPSCO's base rates when the company replaces them in the future. She emphasized that the OUCC viewed the better approach as not tracking replacement of catalyst layers that are already embedded in the utility's base rates.

Ms. Armstrong also testified that OUCC does not oppose the inclusion of the new fourth catalyst layers on the Bailly Unit 8 and Schahfer Unit 14 SCRs in NIPSCO's environmental tracker, because they will save ratepayers money over the long term and were not included in base rates previously. Ms. Armstrong stated that the overall removal efficiency of the SCR will improve with the additional catalyst layers and explained that NIPSCO will need to replace fewer catalyst layers over time. As a result, NIPSCO's need to replace catalyst layers will be reduced over time. She added that since these specific catalyst layers are an actual addition to the SCRs that were included in rate base in Cause No. 43969, recovery of these additional layers through the ECRM and EERM should not present the same problem with double recovery that tracker recovery of the Bailly Unit 7 second catalyst layer replacement presents.

Mr. Blakley, Senior Utility Analyst in the Electric Division for the OUCC, testified that after the catalyst layers go into rate base and base rates, further rate tracker treatment should cease. He stated this would encompass trackers active at the time of the rate case, recovering capital costs, operation and maintenance and depreciation expenses on completed projects. Mr. Blakley stated that at the end of the test year used to calculate NIPSCO's base rates, NIPSCO had approximately $8 million in catalyst layer investments that were included in current base rates, on which NIPSCO is now earning a return on and a return of investment. He testified that this compensates NIPSCO, and NIPSCO does not need further compensation for the simple replacement of components already embedded in base rates.

Mr. Blakley stated that when a utility requests an adjustment in base rates, the utility can ask for and gain approval to adjust pro forma operating expenses and rate base within 12 months of a test year. He testified that once the investment and expenses of the construction work in progress ("CWIP") tracker are included in base rates, further tracker treatment of such embedded costs should cease. He stated that if a new CPCN for a new project is requested, a new tracker can be approved by the Commission to recover investments and costs associated with the new project.

Mr. Blakley explained that in Cause No. 42150 ECR 20, the Commission permitted NIPSCO to include the replacement of certain catalyst layers over the OUCC's objection. At the time of ECR 19, it was not apparent that NIPSCO intended to continue to track these items outside its base rate case. He stated that when the OUCC determined NIPSCO's intentions with respect to tracking replacement catalyst layers in ECR 20, the OUCC objected to this unusual treatment, but the Commission held that no party objected to the projects ECR 19. Thus, Mr. Blakley stated that the replacement catalyst layers for NO_x projects were permitted to be tracked, even though catalyst layers for the completed NO_x projects were already included in base rates.

Mr. Blakley therefore concluded that because the revenue requirements for the second layer catalyst for Bailly Unit 7's SCR are already embedded in base rates, the Commission should not approve rate tracking treatment.

6. **Petitioner's Rebuttal Testimony.** Paul S. Kelly, Director of Regulatory Policy, responded to the OUCC's recommendation to deny cost recovery for the Unit 7 SCR Catalyst 2nd Layer (the "Replacement Catalyst Layer"). Mr. Kelly testified NIPSCO's request for tracker treatment should be approved for the Replacement Catalyst Layer because: (1) this issue of approving "return on" and "return of" tracker treatment for replacement catalyst layers was

already decided in ECR 20 and it is inappropriate to re-litigate an issue the Commission has already decided; (2) the OUCC's position is not consistent with Indiana's CCT and QPCP statutes which allow recovery; (3) the OUCC has inappropriately termed NIPSCO's proposal as a request for double recovery; and (4) under traditional utility accounting, the original catalyst layer will not impact NIPSCO's rate base when it is retired.

Mr. Kelly testified NIPSCO's request for approval of the Replacement Catalyst Layer via the Eleventh Progress Report is exactly the same as its request for approval of the U8 SCR Catalyst 2nd Layer, U14 SCR Catalyst 2nd Layer, U12 SCR Catalyst 3rd Layer, U7 SCR Catalyst 1st Layer, U8 SCR Catalyst 3rd Layer, U14 SCR Catalyst 3rd Layer ("Previous Replacement Catalyst Layers") via NIPSCO's Seventh, Eighth, and Ninth Progress Reports in Cause Nos. 43840, 42150 ECR 17 and 42150 ECR 19, all of which were approved by the Commission. In addition, he stated the U8 SCR Catalyst 3rd Layer and U14 SCR Catalyst 3rd Layer from ECR 19 were approved by the Commission in May 2012 — four months after NIPSCO's new basic rates and charges from Cause No. 43969 were already implemented.

Mr. Kelly testified that it is inappropriate to re-litigate the same issue that the Commission already decided and then separately affirmed on a Petition for Reconsideration in ECR 20. The principal of res judicata is applicable in this case. He explained the substantive facts are the same: a replacement SCR catalyst layer at the same generating station and an existing asset already in basic rates and charges. He stated the OUCC acknowledges that the Commission ruled on this issue in ECR 20, and the OUCC has not offered further support or argument to change the conclusion from ECR 20 for purposes of this proceeding. Mr. Kelly testified that if the Commission were to follow the OUCC's proposed treatment, NIPSCO would be left with two catalyst layers at the same generating station (Bailly Units 7 & 8) that are receiving completely different regulatory treatment (one receiving none whatsoever) even though they perform the same function and would both be installed after NIPSCO's most recent basic rates and charges went into effect.

Mr. Kelly testified the OUCC's position is inconsistent with Indiana's CCT and QPCP statutes because the CCT and QPCP statutes and rules grant timely recovery of CCT and QPCP assets under construction or placed in service to reduce emissions. He explained that the Replacement Catalyst Layer is CCT and QPCP under Indiana Code §§ 8-1-2-6.6, 8-1-2-6.8, 8-1-8.7-1 and 170 IAC 4-6-1. He stated Catalyst layer assets are essential to meeting emissions limits. Mr. Kelly testified that because catalyst layers qualify as both CCT and QPCP under Indiana Code §§ 8-1-2-6.6, 8-1-2-6.8, 8-1-8.7-1 and 170 IAC 4-6-1, there is no question that the cost of catalyst layers (whether original or replacement) should be recovered through NIPSCO's ECRM and EERM. He testified that the OUCC's alternative position that NIPSCO should give a reasonable credit for the costs of the original layer embedded in basic rates and charges is also inconsistent with Indiana's QPCP and CCT statutes, which do not require or even reference any type of credit for costs included in basic rates and charges.

Mr. Kelly testified that if the CCT and QPCP statutes were read so narrowly as to preclude a utility from being able to recover the costs of future modifications to CCT and QPCP already embedded in basic rates and charges, it would discourage utilities from making efficient investments in existing technology and would encourage utilities to make investments in strictly new CCT and QPCP projects to ensure timely recovery of costs. He stated the CCT and QPCP statutes are not intended to create such perverse incentives; rather, they encourage investment in technology that allows electric utilities to continue to use coal-fired generation and comply with increasing and ever-changing environmental regulations. Mr. Kelly stated it is simply bad policy to place artificial constraints on utilities that do not exist in the authorizing statute.

Mr. Kelly testified that in addition to NIPSCO's ECR 19 and ECR 20, the Commission recognized the importance of granting recovery for projects related to assets already in NIPSCO's basic rates and charges. He stated in Cause No. 43188 (NIPSCO's ECRM and EERM), the Commission approved NIPSCO's request for a Certificate of Public Convenience and Necessity for modifications to the Schahfer Unit 17 and 18 wet FGD facilities even though the original FGD facilities were already being recovered in NIPSCO's basic rates and charges from Cause No. 38045.

Mr. Kelly testified the OUCC has mischaracterized this issue as double recovery. He explained that in the case of the Replacement Catalyst Layer, NIPSCO is not asking ratepayers to pay twice for the same asset. Instead, the original and replacement catalyst layers are two different assets, both used to reduce air emissions, and it is appropriate for NIPSCO to recover the cost of both of these assets. Mr. Kelly stated that the original catalyst layer will not impact NIPSCO's rate base when it is retired, so even if NIPSCO were to have a rate case the day after the replacement catalyst layer is put into service, NIPSCO's rate base would not be reduced from the retirement, but would actually increase due to the addition of the replacement catalyst layer. He stated recovery of the Replacement Catalyst Layer does not amount to "double recovery" of a single cost because regulatory accounting principles allow, in fact they are specifically designed for, recovery of both the original and replacement layers.

Mr. Kelly testified that retirement of an asset will have no impact on NIPSCO's rate base. He described the basic accounting for the capitalization and depreciation of an asset. A new asset is capitalized at its original cost and each year a portion of the asset is depreciated. This annual depreciation is treated as an expense when calculating current year income. The depreciation is also accumulated in a separate balance sheet account which is taken as an offset to the asset's original cost to calculate net book value. For ratemaking purposes, the net book value is basically synonymous with the utility concept of rate base.

Mr. Kelly described the characteristics of depreciation expense for ratemaking purposes. He explained that depreciation expense is often referred to as "return of" in utility circles because annual depreciation is designed to return invested capital back to the utility over the useful life of the asset. Depreciation expense is a component of the utility revenue requirement and is recovered in the utility's basic rates and charges. Because one of the goals of ratemaking is to allow utilities the opportunity to recover their costs as well as the opportunity to earn a reasonable return on invested capital (i.e. rate base), the return of through depreciation and return on (i.e. rate base x rate of return) through allowed Net Operating Income ("NOI") are necessary components of a utility's revenue requirement.

Mr. Kelly explained that because depreciation is designed to return invested capital back to the utility, depreciation rates are designed to recover the amount of investment not yet recovered through basic rates and charges; that is, depreciation is designed to only recover the net book value at the time the depreciation rate is created. This is an important point because while depreciation expense is calculated by multiplying the original cost (also known as gross value) by the depreciation rate, the depreciation rate is only designed to collect the net book value (gross value less accumulated depreciation).

Mr. Kelly explained how retirements impact NIPSCO's rate base. He stated that while utilities account for the capitalization and annual depreciation expense in a similar manner to other businesses, regulatory fixed asset accounting principles require a unique nuance when retiring an asset. When the utility asset is retired, the gross value and accumulated depreciation accounts are both reduced by the same amount — the originally installed cost. He stated it does not matter if the asset has been in service for 1 day or 100 years, the entry and amounts are the same. Because the gross value and accumulated depreciation reserve are both reduced by the same amount, the effect is that there is no change in net book value/rate base.

Mr. Kelly described why utilities account for retirements in this manner. He explained that utilities use the FERC chart of accounts in order to group similar assets and to develop depreciation rates. While the assets within each account have similar characteristics such as equipment type and estimated service lives, each asset is still unique and subject to real world circumstances. As an example, wood poles may be estimated to last for over 30 years; however, many poles are retired prematurely due to traffic accidents and storm damage. Other poles may have extended lives well beyond 30 years. Regulatory accounting and subsequent ratemaking recognize these inherent mismatches and compensate by requiring all assets to be retired at full historical cost. Utilities do not recognize a gain or loss from each asset's unique retirement. These service life variances, which leave behind under- or over-collected net book value at retirement, are corrected when the next depreciation study is conducted. The next depreciation study incorporates each account's over- or under-collection so the utility continues to recover its final basis in the retired assets in depreciation expense.

Mr. Kelly described, based on traditional utility ratemaking and accounting, how the original and replacement catalyst layers would be treated from a ratemaking perspective if NIPSCO were to have a rate case immediately following the in-service date of the replacement catalyst layer. He explained that if NIPSCO were to have a rate case the day after the replacement catalyst layer is put into service, NIPSCO's rate base would include the unrecovered net book value in the original catalyst layer in addition to the full value of the replacement catalyst layer (as explained above). Therefore, NIPSCO's basic rates and charges would reflect the recovery of a return on its unrecovered investment on both layers. Similarly, NIPSCO's depreciation study would incorporate the unrecovered basis in the original asset in addition to the new asset in order to create depreciation rates which would recover the uncollected net book value of both assets. Therefore, under traditional ratemaking principles, new basic rates and charges would include the recovery on (e.g., return on investment) and recovery of (e.g., depreciation expense) both assets.

Mr. Kelly described, in general, how NIPSCO's depreciation rates and total revenue requirement are established. He explained that in the absence of specific statutes or Commission rules, NIPSCO's depreciation rates and total revenue requirement are established together in rate cases. When the next depreciation study is conducted, the aggregate effect of all additions and retirements and related over/under recoveries are then integrated into a new depreciation rate for each account. This new rate rebalances the depreciation rate to incorporate the full range of activity that has occurred within the account since the last study. When those rates are reset, so is the total amount of depreciation expense within a utility's revenue requirement. He stated that while the two are typically set together, both are already stale when they take effect. The day that the revenue requirement and depreciation rates go into effect, a utility's total depreciation expense (and the make-up of the related functional accounts) has already changed. Some assets that were used to calculate the depreciation expense in basic rates and charges have been retired and replaced. New assets for new service have entered those accounts with no associated expense in basic rates and charges. This inherent regulatory lag for utility fixed assets is the traditional norm, and utilities do not constantly reset rates between rate cases for changes in total depreciation expense for retirements, replacements, and additions.

Mr. Kelly summarized how these account and ratemaking concepts relate to the OUCC's position in this case. He stated that the OUCC is simply incorrect to suggest that, because the original catalyst layer is included in NIPSCO's overall rate base, NIPSCO should not be afforded timely recovery of the replacement catalyst layer provided by the CCT and QPCP statutes and rules. He testified the statutes and rules were specifically designed to eliminate the regulatory lag associated with these CCT and QPCP investments. Further, if NIPSCO were to conduct a full general rate case the day after the original catalyst layer is retired and the replacement catalyst layer is put into service, NIPSCO's basic rates and charges would reflect the recovery on (e.g. return on investment) and recovery of (e.g. return of invested capital through depreciation expense) both assets. Mr. Kelly testified that for these reasons, NIPSCO's request for tracker recovery of the Replacement Catalyst Layer should be approved.

Mr. Kelly testified that while it is not clear what the OUCC has requested in its alternative based on its filed position, it appears that the OUCC is asking the Commission to review and adjust one item of one component of NIPSCO's overall revenue requirement outside the context of a rate case, and that is not appropriate. He stated that the OUCC's alternative "credit" approach amounts to a request to engage in single line item ratemaking because basic rates and charges are not designed to recover single line items or components. Basic rates and charges are designed to collect authorized revenue requirements which are established *en masse* at a point in time. He stated it would be inappropriate to try to carve out a single line item from NIPSCO's overall revenue requirement because assets are being placed in service and retired all of the time just as other components of NIPSCO's revenue requirement are constantly changing.

Mr. Kelly testified that the Commission has resisted requests for single issue rate making because a utility's revenue requirement is made up of multiple components measured at a single point in time. Statutory grants of trackability in summary proceedings do not change this principle even for assets that are replacing equipment no longer recovered in a tracker but in basic rates and charges. He stated the OUCC's initial position (no recovery) is unsupportable and should be rejected as clearly at odds with the statutory grant of recovery. He testified that the OUCC's alternative "credit" argument should also be rejected because it is a request for single line item ratemaking that circumvents traditional asset accounting principles for utilities. Therefore, Mr. Kelly testified it would not be appropriate for NIPSCO to provide a credit in the ECRM or EERM to reflect the retirement of an original catalyst layer that is included in NIPSCO's rate base.

7. **Response to March 14, 2013 Docket Entry**. In its response to the Presiding Officers' request for additional information, NIPSCO indicated the estimated return associated with the original Bailly Unit 7 Second Catalyst Layer that was included in Petitioner's base rates approved in Cause No. 43969 is $48,209 and that this estimate is based on an estimated net book value of $690,674 and the weighted average cost of capital of 6.98% that was approved in Cause No. 43969. NIPSCO indicated that the depreciation expense (return of) associated with the Bailly Unit 7 Second Catalyst Layer that was included in Petitioner's base rates approved in Cause No. 43969 is $24,548 and that this estimate is based on an estimated gross value of $755,316 and the depreciation rate for the respective composite asset group. The effective depreciation rate for FERC Account 312.1 is 3.25% and this was approved in Cause No. 43969.

8. **Testimony Adduced at the Hearing**. Mr. Sangster testified that when a fourth catalyst layer is added, it is considered a new layer. When asked whether the OUCC objected to the tracking of any new layers for the SCR, Mr. Sangster testified that each subsequent capital project is a new layer. He stated that to replace the existing layer, a new layer is put in, and in ECR 20, the OUCC did object to that. When asked whether the layers by themselves function as the QPCP, Mr. Sangster stated, no, the layers themselves don't function, but the device needs them to function. He also confirmed on cross-examination that a layer is a part and not the whole.

When asked whether operations and maintenance ("O&M") expense as part of base rates is designed to cover the cost of replacement parts, Mr. Sangster said not entirely. He explained that a catalyst layer is the size of the room and about a meter tall and is made up of approximately 60 to 100 modules and NIPSCO can remove those individual modules which are approximately 3 feet by 5 feet long. He stated that if the entire catalyst layer is replaced, that is a capital replacement, but if someone was to go in and remove an individual module from one location or another location, that would be O&M.

When asked by the Administrative Law Judge ("ALJ") to explain under what conditions he might replace simply one or a few individual modules instead of the entire layers, Mr. Sangster explained there have been pluggages in certain modules that have rendered them ineffective. He also stated other utilities have experienced localized fires where catalyst modules would be destroyed. He explained NIPSCO would take those out individually if they were damaged and replace them as long as the entire layer wasn't damaged as well. He confirmed that in that instance, it would be considered an O&M project rather than a capital project.

When asked by the ALJ whether removing a catalyst layer from one level and installing it at another level would be considered a capital project or O&M expense, Mr. Sangster stated he would have to ask the Controller for their accounting feedback but initially he would probably assume it to be O&M because it wasn't a new layer. He confirmed that if he took a layer from Level 1 and moved it to Level 4, and then put a new layer into Level 1, that would be capital.

Finally, Mr. Sangster answered questions from the bench regarding "regeneration" of catalyst layers. He explained that regeneration is when a catalyst layer is removed and re-impregnated with chemicals. He stated that NIPSCO has evaluated that option, but it doesn't last as long as the original catalyst because it's just on the surface layer, which isn't as effective as the original catalyst and looking at the overall life plan, the regenerated catalyst tends not to be a good option for NIPSCO. He stated that regeneration would be considered O&M. He stated that NIPSCO would always be evaluating the option of regeneration to see if it is worthwhile in the future.

When asked how NIPSCO determines whether something is an asset on its own, Mr. Plantz explained there is not just one factor involved. He explained that NIPSCO looks at GAAP, the IRS, and Code of Federal Regulations for guidance as to whether something should be capitalized or O&M. He stated that within one company "one man's asset is—is his asset". He stated that different companies apply different thinking to what is capital and what is O&M. He stated that NIPSCO's decision-making process is well within GAAP and that Deloitte, NIPSCO's external auditor, concurs with NIPSCO's capital versus O&M treatment. Mr. Plantz disagreed with counsel for the OUCC when counsel suggested that NIPSCO can choose whether or not to make a particular component into an asset or track it through O&M. He stated NIPSCO has a consistent policy and it has to adhere to that policy or NIPSCO would be hearing from its external and internal auditors. Mr. Plantz agreed that NIPSCO can choose how it determines whether an item is O&M or capital.

In response to a question from the ALJ, Mr. Plantz confirmed that there would have been O&M expense associated with the Level 2 catalyst layer that was included in the revenue requirement. When asked what kind of expenses would have been included in that O&M, Mr. Plantz stated that Mr. Sangster talked about maybe cleaning certain components of one of the layers or modules and that would be an example of O&M. He also stated his understanding from Mr. Sayers is the layers get vacuumed and other things to try to prolong their effectiveness. Finally, Mr. Plantz confirmed that NIPSCO has a formal written decision-making process to determine capital versus O&M expenses

9. Commission Findings and Conclusions.

A. Replacement Catalyst Layer. The OUCC challenges NIPSCO's request to include the replacement layer in its CPCN and to recover associated costs through the ECRM. In the alternative, the OUCC suggests that NIPSCO should provide a reasonable credit in the ECRM to reflect the retirement of the existing catalyst layer that is already embedded in NIPSCO's base rates. In our November 21, 2012 Order in ECR 20, we approved cost recovery for replacement layers through NIPSCO's ECRM. Our decision in that case was premised on the facts that the projects had already been approved through the ongoing review process in ECR 19 and that no party had objected to the projects in ECR 19. In this case, we are considering the prudency of including such projects in the CPCN in light of the OUCC's evidence against such inclusion.

The parties do not dispute that the replacement catalyst layer qualifies as CCT and QPCP. In addition, the parties do not dispute that the installation of a new catalyst layer (e.g., a fourth layer where three layers previously existed) qualifies for ratemaking treatment under the ECRM. Rather, the dispute is essentially whether replacement of an existing catalyst layer should be considered an O&M expense that is already included in NIPSCO's existing base rates and charges or a capital expense that would qualify for ratemaking treatment under the ECRM.

NIPSCO presented confidential evidence of its Catalyst Management Plan for each of its generating units that contain SCRs. That plan demonstrates that NIPSCO anticipates that catalyst layers will diminish in effectiveness over time and will need to be replaced. In some instances a first or second catalyst layer that is replaced might still be effective enough to be re-installed as a fourth catalyst layer. Mr. Sangster testified that a catalyst layer's area is the size of a large room, consisting of 60 to 100 three foot by five foot modules and is approximately three feet tall. The estimated cost of the replacement catalyst layer is $1.4 million. Mr. Sangster indicated that while the replacement of individual modules (e.g., in the event of a small fire or pluggage) would be considered O&M, the replacement of the entire layer is considered a capital project. Mr. Plantz said that NIPSCO accounts for the replacement of an entire layer as a capital expense based on the company's policy for differentiating expenses between capital and O&M. That policy considers, in part, Generally Accepted Accounting Principles ("GAAP"), the Internal Revenue Service, and the Code of Federal Regulations for guidance as to whether something should be a capital project or O&M expense.

NIPSCO provided evidence that the catalyst layers are necessary for the efficient operation of the SCR, and that over time the catalyst layers are used up and need to be replaced. Should catalyst layers not be replaced, the SCR would become inoperable. As such, the catalyst layers are essential to NIPSCO's ability to meet its emissions limits. In addition, the categorization of a catalyst layer installation, whether new or replacement, as a capital expense is consistent with NIPSCO's existing practice of defining capital expenses. Because of this, we find that the replacement catalyst layer qualifies as both CCT and QPCP under Ind. Code §§ 8-1-2-6.6, 8-1-2-6.8, 8-1-8.7-1, and 170 IAC 4-6-1. Therefore, the replacement catalyst layer should be included in NIPSCO's CPCN and NIPSCO should be allowed to recover the costs for the necessary replacement of catalyst layers through its ECRM.

However, the OUCC makes a compelling case that if NIPSCO recovers a return on and return of its investment for the replacement layer through its trackers and for the original layer through its base rates and charges, ratepayers are paying for two catalyst layers, when only one is actually in service. Multiplied over several catalyst layers per SCR unit and several SCR units over NIPSCO's generation fleet, this issue could have a significant impact on customer rates. There is no evidence that the original catalyst layer did not function as intended, i.e., that it needed to be replaced prematurely. In light of this, we see no reason that NIPSCO should be prohibited from recovering a return of its investment in the original layer. Similarly, because the replacement layer is necessary for the continued operation of the SCR, NIPSCO should be allowed to recover the full return of its investment in the replacement layer. However, should we grant full recovery of NIPSCO's return on its investment in the replacement layer when it already receives a return on its investment in the original layer through its base rates and charges, then until its next base rate case, NIPSCO would receive a return on investment for two catalyst layers, while only one layer is in service.

Ind. Code § 8-1-8.7-4(b)(2) requires us to approve the estimated costs associated with additions to NIPSCO's CPCN. In making our determination, Ind. Code § 8-1-8.7-3(b)(9) allows us to consider any other factors we consider relevant, including the public's interest. In order to do so, we must seek a solution that allows the utility to recover the costs of necessary replacements to its pollution control systems, but does not require ratepayers to continue paying a return on an investment in catalyst layers that are no longer in service. In light of this and our discussion above, we conclude that NIPSCO shall be allowed to seek recovery of its full depreciation expense (return of investment) for the replacement layer. However, NIPSCO shall only be allowed to seek recovery of the incremental amount of the return on its investment for the replacement catalyst layer that exceeds the return on investment currently included in its base rates and charges for the original catalyst layer.[1] This approach is similar to our treatment of replacement capital projects in *Ind. Mich. Power Co.*, Cause No. 44182, 2013 Ind. PUC LEXIS 212, at *178-79 (IURC July 17, 2013), where we allowed I&M to recover incremental depreciation and property tax expenses through its LCM tracker for replaced equipment that was already included in I&M's base rates and charges. As indicated by Mr. Sangster, NIPSCO shall continue to provide a copy of its Catalyst Management Plan in future ECR proceedings.

B. <u>Approval of Eleventh Progress Report.</u> In its 42150 Order, the Commission approved NIPSCO's proposal that the Commission maintain an ongoing review of its QPCP construction and expenditures and submit to the Commission annually a report of any revisions of its plan and cost estimates for such construction ("Progress Report"). In its 43526 Order, the Commission ordered NIPSCO to file its Progress Reports on the status of QPCP tracked in the ECRM as part of its ECRM filings rather than in a separate proceeding. The Phase I 44012 Order approved Petitioner's request to file semi-annual progress reports (as opposed to annual progress reports) as part of the ongoing review process under Ind. Code §8-1-8.7-7.

Pursuant to the ongoing review process under Ind. Code §8-1-8.7-7, in this proceeding NIPSCO requests approval of its Eleventh Progress Report on the status of QPCP tracked in the ECRM. Specifically, NIPSCO requests the Commission to approve its revised Compliance Plan as set forth in Exhibit PR attached to the Company's Verified Petition initiating this Cause, including the updated project scopes, construction schedules, and cost estimates described therein.

In its ECR-20 Order, the Commission approved NIPSCO's total estimated cost of the Compliance Plan of $803,947,287 ("Tenth Progress Report") and NIPSCO's request to recover these costs through the ECRM.

The total estimated cost of the Compliance Plan presented by NIPSCO in its Eleventh Progress Report is $807,001,006. This represents an increase of $3,053,719 from the currently approved amount. The increase is due to the inclusion of the cost estimates for three new Catalyst Layer Projects (total of $5,450,000). As discussed and modified above with respect to the return on investment, we conclude that it is appropriate for NIPSCO to include the cost of replacement catalyst layers in the ECRM. Accordingly, we conclude these projects should be approved as part of the Eleventh Progress Report. This increase is offset by the removal of the Continuous Particulate Monitors Addition (U7, U8 Bypass) at a reduction of $375,000 and the decrease in the final project cost of six projects (Unit 8 SCR Duct Burners, Continuous Particulate Monitors Addition (U15), Continuous Particulate Monitors Addition (U12), Unit 12 SCR Catalyst 3rd Layer, Unit 7 SCR Catalyst 1st Layer and Unit 8 SCR Decomposition Chamber Winterization) at a reduction of $2,021,281. As part of its Eleventh Progress Report, NIPSCO is requesting approval of its updated QPCP cost estimate of $807,001,006 and approval to recover

[1] This treatment applies only when an original is replaced and retired. In the event the original layer is reinstalled at a higher level, NIPSCO may recover the full return on its investment in the replacement layer.

these costs through the ECRM. NIPSCO also requests authority to recover the depreciation expenses associated with approved CCT and QPCP projects through the EERM.

Based on the record evidence, we find that the changes to the cost estimate for NIPSCO's Compliance Plan are reasonable and should be approved. We also find that the Eleventh Progress Report is reasonable and the modifications to scope, schedule, and cost estimates contained therein should be approved and we authorize NIPSCO to recover these costs through its ECRM and EERM.

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

1. Pursuant to Ind. Code § 8-1-8.7-7, NIPSCO's modified Compliance Plan, as described in NIPSCO's Exhibit PR and modified above is hereby approved.

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

ATTERHOLT, BENNETT, LANDIS, MAYS AND ZIEGNER CONCUR:

APPROVED: OCT 16 2013

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

Brenda A. Howe

Brenda A. Howe
Secretary to the Commission