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JLB

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF SOUTHERN INDIANA GAS AND)
ELECTRIC COMPANY d/b/a VECTREN)
ENERGY DELIVERY OF INDIANA, INC. FOR)
APPROVAL OF AN ADJUSTMENT TO ITS)
RATES THROUGH ITS APPROVED)
QUALIFIED POLLUTION CONTROL)
PROPERTY CONSTRUCTION COST)
ADJUSTMENT APPLICABLE TO APPROVED)
PROJECTS TO COMPLY WITH THE)
MULTIPOLLUTANT RULES PURSUANT TO)
THE COMMISSION'S ORDER IN CAUSE NO.)
42861)

CAUSE NO. 42861 ECR 5

APPROVED: APR 29 2009

BY THE COMMISSION:
Gregory D. Server, Commissioner
Angela Rapp Weber, Administrative Law Judge

On February 16, 2009, Southern Indiana Gas and Electric Company d/b/a Vectren Energy Delivery of Indiana, Inc. ("Petitioner") filed its Petition in this Cause requesting approval of changes in its Qualified Pollution Control Property ("QPCP") Construction Cost Adjustment ("QPCP-CC2") approved by the Commission's Order in Cause No. 42861 dated February 22, 2006 ("2006 Order"). On February 25, 2009, Petitioner filed its case-in-chief, which consisted of the testimony and exhibits of Ronald G. Jochum, Petitioner's Vice-President of Power Supply, Scott E. Albertson, Petitioner's Director of Regulatory Affairs, and M. Susan Hardwick, Petitioner's Vice President, Controller and Assistant Treasurer. On March 26, 2009, Petitioner submitted to the Commission a late-filed exhibit. On March 27, 2009, the Office of Utility Consumer Counselor ("OUCC") filed the testimony of Wes R. Blakley, a Senior Utility Analyst, and the testimony and exhibits of Cynthia M. Pruett, a Utility Analyst.

Pursuant to notice of hearing given as provided by law, proof of which was incorporated into the record and placed in the official files of the Commission, a public hearing was held on April 6, 2009, in Judicial Courtroom 224, National City Center, 101 West Washington Street, Indianapolis, Indiana. At the evidentiary hearing, representatives for the Petitioner and the OUCC appeared and participated. The parties' prepared testimony and exhibits were admitted into the record without objection. No member of the public appeared at the hearing.

Based upon the applicable law and evidence herein, the Commission now finds:

- 1. Notice and Jurisdiction.** Due, legal and timely notice of the hearing in this Cause was given as required by law. Petitioner published notice of the filing of its Petition in newspapers of general circulation in each county in which Petitioner has retail electric customers. Petitioner is a "public utility" as defined in Ind. Code § 8-1-2-1(a) and is subject to

the jurisdiction of this Commission in the manner and to the extent provided by Indiana law. The Commission has jurisdiction over Petitioner and the subject matter of this Cause.

2. **Petitioner's Characteristics.** Petitioner is a public utility incorporated under the laws of the State of Indiana, with its principal office and place of business in the City of Evansville. Petitioner provides electric and gas utility service to the public in Indiana. It owns, operates, manages and controls plant and equipment used to provide such service.

3. **Petitioner's Proposed Adjustments.** The 2006 Order granted Petitioner a Certificate of Public Convenience and Necessity for two core environmental projects designed to comply with new and more stringent rules of the United States Environmental Protection Agency. These two projects included (a) installation of a fabric filter at Culley Unit 3 and (b) construction of a flue gas desulfurization system ("FGD") at Warrick Unit 4 (the "Project").

The 2006 Order approved a Settlement Agreement ("Settlement") between Petitioner and the OUCC that, among other things, determined the Projects to be Clean Coal Technology, Qualified Pollution Control Property and Clean Coal and Energy Projects as defined in Ind. Code § 8-1-8.8-2. The Settlement provides a mechanism for Petitioner to adjust its rates to timely recover a return on the capital costs associated with the Projects (including while they are under construction) with the return fixed at 7.98%. The 2006 Order approved ongoing review of the Multipollutant Projects as construction proceeds as part of Petitioner's periodic QPCP-CC2 filings. The Order also approved an adjustment mechanism for Petitioner to recover operating expenses relating to the Projects. The Warrick Unit 4 FGD is the only project currently included in the QPCP-CC2 tracker.

4. **Relief Requested.** Petitioner requests that the Commission approve QPCP-CC2 adjustments that will provide a return on construction costs for the Warrick Unit 4 FGD incurred through December 31, 2008. Petitioner also requests approval of an increase in the cost estimate for the Warrick Unit 4 FGD Project.

5. **Status of The Warrick Unit 4 FGD Project.** Petitioner submitted testimony regarding the status of the Warrick Unit 4 FGD Project for the purpose of the Commission's ongoing review. Ronald G. Jochum, Petitioner's Vice President-Power Supply, testified that the FGD at Warrick Unit 4 (a unit for which Petitioner and Alcoa Power Generating Co. ("Alcoa") share ownership on a 50/50 basis) is operational as of December 31, 2008. In addition, he stated that construction is complete except for a few remaining items (such as painting, lighting, site grading and clean-up), which will be completed while the unit is in service. Mr. Jochum testified that none of this additional work would impact the operational capability of Warrick Unit 4. Mr. Jochum also explained that Alcoa is ultimately responsible for the management of the Project and Fluor Inc. ("Fluor") provides engineering, procurement and construction management services. Mr. Jochum said Petitioner and Alcoa established a construction committee that is the means for Petitioner's input into the project. The construction committee has responsibility to track the cost of the Project through interface with the Fluor and Alcoa team members.

Mr. Jochum testified that as of December 31, 2008, Petitioner incurred capital costs for the Warrick Unit 4 FGD of approximately \$94.2 million, excluding allowance for funds used during construction ("AFUDC") and capitalized overheads, and \$97,564,000, including AFUDC

and capitalized overheads. Mr. Jochum stated that he reviewed the cost data and verified that the information is accurate. Mr. Jochum asserted that the costs incurred through December 31, 2008 were prudently incurred and appropriate for a project of this nature.

Mr. Jochum testified that the Commission's Order in Cause No. 42861 ECR-3 approved a total project cost estimate of \$92 million (exclusive of AFUDC and capitalized overheads) for the Warrick Unit 4 FGD. He stated that in a report dated December 28, 2008, Alcoa provided an increased cost estimate for the Project in the amount of \$98.3 million (exclusive of AFUDC and capitalized overheads).

Mr. Jochum explained that the revisions to the cost estimate were necessary because of cost pressure attributable to additional overtime, finalization of engineering details and installation of increased quantities of materials. He testified that a review conducted by Alcoa's insurance carrier determined that the Project required a major reinforcement to satisfy boiler safety code compliance standards, which increased costs by approximately \$3 million. Mr. Jochum stated that the finalization of the engineering details indicated a need for significantly greater quantities of general piping, electrical cable and other commodities, which contributed to the increase in the estimate. Mr. Jochum stated that there were significant increases in mechanical installation costs and the cost for electrical and instrument installation. Mr. Jochum also testified that support services necessary to complete the start-up activities were underestimated by at least \$1 million.

Further, Mr. Jochum explained that overtime hours were incurred to complete the Project in advance of the originally projected in-service date of April 2009. He stated that Alcoa, the Project leader, recommended that Project staffing be assigned to work sixty hours per week to allow the Project to be ready for testing and checkout by mid-December 2008 and so that the Project could be placed in service on January 1, 2009. He said the decision was made to expedite completion of the Project after an evaluation by Fluor indicated that the cost to complete it three to four months later would be essentially the same. Mr. Jochum stated that although the acceleration of the in-service date caused overtime to be incurred, other costs were avoided because under the original schedule, additional overhead costs would have been incurred. For example, some of the contractors would have had to demobilize and remobilize, and the cost of rental of many major pieces of construction equipment would have been extended by at least four months. In addition, Mr. Jochum pointed out that a substantial number of the startup and checkout specialists and engineers necessary to place the Project in service were committed to other projects in the March-April period.

Mr. Jochum stated that Vectren South reviewed Fluor's evaluation and was involved in the decision to expedite the Project. Mr. Jochum stated that although the decision was essentially a break-even cost decision, there were other advantages to placing the FGD in service earlier. Mr. Jochum noted that one advantage to completing the Project early was that Petitioner would not have to consume SO₂ emission allowances for compliance in 2009, which could potentially be sold, resulting in 90% of the proceeds flowing through to Petitioner's customers via its Qualified Pollution Control Property Operating Expense Adjustment. Mr. Jochum testified that Petitioner has been working closely with Alcoa and Fluor to monitor and contain costs and that accelerating completion of the Project mitigated inflationary pressures on the

commodities that were required to complete the Project. According to Mr. Jochum, the Project team also made a number of cost saving changes as the installation was being performed.

Mr. Jochum reported that Petitioner decided not to build a pipeline to transport gypsum to the Culley plant's drying facilities. He stated that consideration of a gypsum pipeline was predicated on Petitioner's ability to ship gypsum to a beneficial reuse customer; however, due to the economic slowdown associated with the housing market, Petitioner has been unable to locate a customer for the gypsum. Thus, Petitioner concluded there is no need for a gypsum pipeline at this time. Mr. Jochum said the flyash transportation line that was removed because of the Project was not reinstalled. Instead, a new flyash handling system will transport the flyash by truck to either a structural fill operation, the mine that was the source of the coal or a landfill for storage.

Mr. Jochum testified that he believes the updated Project cost estimate of \$98.3 million is reasonable and that he does not believe further revisions to the cost estimate for the Project will be necessary. Petitioner is participating in construction wrap-up meetings and is making plans to have a final audit completed to ensure proper cost allocation. Mr. Jochum stated that Petitioner will provide the final total cost of the Project in its next ECR filing.

6. OUCC Review. Wes R. Blakley, a Senior Utility Analyst, testified on behalf of the OUCC. He explained that he examined and analyzed Petitioner's testimony and schedules. Mr. Blakley stated that nothing came to his attention that would indicate Petitioner's calculation of the adjustment factors for the relevant period is unreasonable.

Cynthia M. Pruett, a Utility Analyst for the OUCC, testified regarding Petitioner's updated cost estimates for the Project and its expenditures above the current Commission-approved amount. Ms. Pruett testified that excluding AFUDC and capitalized overheads, Petitioner incurred capital costs of \$94.2 million as of December 31, 2008, which is \$2.2 million over the amount approved in Cause No. 42861 ECR-3. Ms. Pruett stated that she discussed with Mr. Jochum the additional work that gave rise to the additional costs and believed the work was necessary.

Ms. Pruett explained that due to unfortunate timing, Petitioner incurred greater costs between the ECR-4 and ECR-5 filing dates than were expected. Ms. Pruett noted that Petitioner filed its petition and case-in-chief for ECR-4 in mid May 2008. In June 2008, Alcoa approached Petitioner with the option of accelerating the FGD installation schedule to support a January 1, 2009 in-service date. Ms. Pruett stated that because of the decision to expedite the Project, Petitioner incurred more costs than expected and that during this six-month period Alcoa and Petitioner also learned of the increase in the Project cost estimate. As a result, Petitioner did not have an opportunity to seek Commission approval for an increase in the Project until after it had incurred expenses beyond the previously approved amount.

Ms. Pruett testified that the OUCC does not oppose Petitioner's recovery of the additional \$2.2 million in this filing. Ms. Pruett further testified that she obtained and reviewed a copy of the cost evaluation presented to Petitioner by Fluor and Alcoa. It appeared from the study that choosing a fall completion schedule was slightly less expensive than remaining on the spring completion schedule. Ms. Pruett stated that early operation of the FGD will prevent the consumption of 4,640 SO₂ allowances and that the additional cost savings associated with

avoiding consumption of allowances provide a benefit to ratepayers. Ms. Pruett therefore concluded that the decision to accelerate the project schedule was reasonable. She recommended that the Commission approve Petitioner's requested cost estimate increase for the FGD project to \$98.3 million.

7. **Actual and Estimated Warrick Unit 4 FGD Construction Costs.** Based on the evidence presented, we find that the costs for the Warrick Unit 4 FGD incurred through December 31, 2008 are reasonable and appropriate. We approve an updated estimate for the project of \$98.3 million exclusive of AFUDC and capitalized overheads.

8. **Compliance with Applicable Requirements.**

A. **Amount of QPCP Construction Costs.** Petitioner's witness M. Susan Hardwick sponsored Petitioner's Exhibit MSH-2, Schedule 2, setting forth the construction costs as of December 31, 2008 for which Petitioner seeks ratemaking treatment in this Cause. Petitioner also submitted workpapers showing a detailed breakdown of this amount. The total including AFUDC and capitalized overheads is \$97,564,019.

B. **Rate of Return on QPCP Construction Costs.** Petitioner's Exhibit MSH-2, Schedule 3 demonstrates that Petitioner used a rate of return of 7.98% to calculate the proposed revenue requirement relating to the construction costs for the Warrick Unit 4 FGD. This is consistent with the 2006 Order.

C. **Revenue Requirement.** Petitioner's Exhibit MSH-2, Schedule 3 provides the derivation of the revenue requirement, including tax calculations, associated with the ratemaking treatment for the FGD construction costs. Petitioner's exhibits show that the total annual revenue requirement as of December 31, 2008 is \$11,498,163.

D. **Net Operating Income for Fuel Adjustment Clause.** Pursuant to 170 IAC 4-6-21, Petitioner shall add the approved return on the FGD project to its net operating income authorized by the Commission for the purposes of Ind. Code § 8-1-2-42(d)(2) and Ind. Code § 8-1-2-42(d)(3) in all subsequent Fuel Adjustment Charge proceedings. However, the Commission requires that, for purposes of computing the authorized net operating income for Ind. Code § 8-1-2-42(d)(2) and Ind. Code § 8-1-2-42(d)(3), the increased return shall be phased-in over the period of time that the Petitioner's net operating income is affected by the earnings modification resulting from the Commission's approval of these adjustments.

E. **Allocation of Revenue Requirement.** Petitioner's Exhibit SEA-3, Schedules 1 and 2 demonstrates the method and allocation of the QPCP-CC2 construction cost revenue requirement among the utility's customer classes. Petitioner's allocation factors reflect the production plant demand allocation from Petitioner's most recent electric rate case (Cause No. 43111). These schedules also show the derivation of the adjustments for each customer class.

F. **Tariff Sheets.** Petitioner's Exhibit SEA-2 contains the tariff sheet reflecting the adjustments.

G. Approval of Adjustments. The Commission finds that Petitioner complied with the rules and procedures applicable to its request, including the requirements of 170 IAC 4-6-1 *et seq.* and the 2006 Order. The Commission further finds that the proposed adjustments are properly calculated and should be approved.

9. Amount of Adjustments. Petitioner's Exhibit SEA-3, Schedule 3 compares the annual revenues for the twelve months ended December 31, 2008 with revenues adjusted for the proposed adjustments. The rate impacts vary from 0.46% for the Rate SGS (Small General Service) class to 0.88% for the Rate A (Residential) class. The overall impact is a 0.79% increase. The following table summarizes the adjustments and the rate increases for each rate class.

Rate Schedule	Item Adjusted	Rider Adjustments	Increase
A	Energy	\$0.003472 / kWh	0.88%
EH	Energy	\$0.001790 / kWh	0.63%
B	Energy	\$0.001235 / kWh	0.51%
SGS	Energy	\$0.001581 / kWh	0.46%
DGS/MLA	Energy	\$0.002728 / kWh	0.87%
OSS	Energy	\$0.002345 / kWh	0.82%
LP	Energy	\$0.001441 / kWh	0.66%
HLF	Energy	\$0.001501 / kWh	0.77%
	Billing Demand: First 4,500 kva	\$4,053.88 / mo.	
	Billing Demand: Over 4,500 kva	\$0.901 / kVa	

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

1. The construction work and construction costs for the Warrick Unit 4 FGD project incurred as of December 31, 2008 are hereby approved.
2. An increase in the estimated cost of the Warrick Unit 4 FGD Project to \$98.3 million (exclusive of AFUDC and capitalized overheads) is hereby approved.
3. Petitioner's proposed adjustments to its QPCP Construction Cost Adjustment as set out in this Order shall be and hereby are approved.
4. Pursuant to 170 IAC 4-6-21, Petitioner shall add the return on the FGD project construction costs approved herein to its net operating income authorized by the Commission for purposes of Ind. Code § 8-1-2-42(d)(2) and Ind. Code § 8-1-2-42(d)(3) in all subsequent Fuel Adjustment Charge proceedings. However, for purposes of computing the authorized net operating income for Ind. Code § 8-1-2-42(d) and Ind. Code § 8-1-2-42(d)(3), the increased return shall be phased-in over the appropriate period of time that Petitioner's net operating income is affected by the earnings modification resulting from the Commission's approval of these QPCP-CC adjustments.

5. Petitioner shall file with the Electricity Division of the Commission an amendment to its tariff reflecting the approved adjustments in the form of Petitioner's Exhibit SEA-2.

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

HARDY, GOLC, LANDIS, SERVER AND ZIEGNER CONCUR:

APPROVED: APR 29 2009

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

A handwritten signature in cursive script, reading "Brenda A. Howe", is written over a horizontal line.

**Brenda A. Howe
Secretary to the Commission**