ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

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| PETITION OF NORTHERN INDIANA PUBLIC SERVICE COMPANY FOR APPROVAL TO ISSUE A NOTE NOT TO EXCEED $120,000,000 IN AGGREGATE PRINCIPAL AMOUNT FOR THE PURPOSE OF FINANCING THE ACQUISITION OF THE SUGAR CREEK GENERATING FACILITY. | ) CAUSE NO. 43563<br>) APPROVED: NOV 12 2009 |

**BY THE COMMISSION:**
**James D. Atterholt, Commissioner**
**Aaron A. Schmoll, Administrative Law Judge**

On August 26, 2008, Northern Indiana Public Service Company ("Petitioner" or "NIPSCO") filed its Verified Petition with the Indiana Utility Regulatory Commission seeking authority to issue a $120 million intercompany note, as described in the Verified Petition.

Pursuant to notice and as provided for in 170 IAC 1-1.1-15, a prehearing conference was convened in this Cause on September 30, 2008. Petitioner, the Office of Utility Consumer Counselor ("OUCC"), Intervenor Board of Commissioners of LaPorte County, Indiana ("LaPorte County"), and Intervenor Industrial Group ("Industrial Group") appeared and participated at the prehearing conference. A prehearing conference order was issued by the Commission on October 15, 2008.

Petitioner's case-in-chief was filed concurrently with its Verified Petition on August 26, 2008. LaPorte County and the OUCC prefiled their cases-in-chief on November 12, 2008 and November 13, 2008, respectively. On December 5, 2008, Petitioner filed its Unopposed Motion for Extension, requesting that its rebuttal testimony be postponed until March, in the hope that interest rates would stabilize in the coming months. The Motion was granted. On March 19, 2009, Petitioner filed its Unopposed Motion to Amend Verified Petition, seeking to expand the requested financing authority to include the issuance of external debt, on a secured or unsecured basis, for a term of between five and twenty years. The Motion was granted. On March 30, 2009, Petitioner filed its Amended Verified Petition, and also rebuttal testimony. On May 19, 2009, LaPorte County and the OUCC filed their respective supplemental testimony responding to Petitioner's Amended Verified Petition. On June 23, 2009, Petitioner filed its supplemental rebuttal testimony.

Pursuant to notice, duly published as required by law, proof of which was incorporated into the record by reference and placed in the official files of the Commission, an Evidentiary Hearing in this Cause was held on July 23, 2009 at 10:00 a.m. in Room 222 of the National City Center, 101 West Washington Street, Indianapolis, Indiana. Petitioner, the OUCC, and Intervenors LaPorte County and Industrial Group were represented at the hearing. No members 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 and published as required by law. 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, including with respect to the issuance of debt, Ind. Code § 8-1-2-76 to Ind. Code § 8-1-2-81. The Commission has jurisdiction over Petitioner and the subject matter of this proceeding.

2. **Petitioner's Characteristics and Business.** Petitioner is an Indiana corporation with its principal office and place of business in Merrillville, Indiana. Petitioner is a public utility engaged with charter power in supplying electric and gas service under indeterminate permits and franchises, duly acquired, to the public in 30 counties in the northern part of the State of Indiana.

3. **Proposed Financing.** Petitioner's witness, Mr. Vincent Rea, Assistant Treasurer for Petitioner and Assistant Treasurer for NiSource Finance Corp., testified on behalf of Petitioner. In his August 26, 2008 testimony, Mr. Rea testified that Petitioner proposes to issue and sell a note in the amount of up to $120 million (the "Note") to its affiliate NiSource Finance Corp. for the purpose of partially financing the recent acquisition by Petitioner of the Sugar Creek Generating Facility ("Sugar Creek" or "Facility"). Mr. Rea testified that Petitioner acquired the Facility on May 30, 2008 for $329.7 million, and that the Facility was purchased using a short-term intra-system financing vehicle called the NiSource Money Pool, which is available to many NiSource Inc. ("NiSource") subsidiaries. Mr. Rea explained that the proposed $120 million financing would result in the Facility being financed with 63% equity and 37% debt, which is reflective of the equity to debt ratio of Petitioner as it existed on June 30, 2007, and which is consistent with testimony presented by Petitioner in Cause No. 43396, in which Petitioner sought approval of the acquisition.

Petitioner originally proposed issuing a $120 million Note to NiSource Finance Corp., an affiliate of Petitioner. Mr. Rea testified that doing so would be a cost effective and timely long-term financing alternative, and would provide Petitioner with maximum financial flexibility. Mr. Rea explained that the interest rate for the Note will be determined by the corresponding applicable Treasury yield (as reported in Federal Reserve Statistical Release, H.15 Selected Interest Rates (Daily)) effective on the date a Note is issued, plus the yield spread on corresponding maturities for utilities with a credit risk profile equivalent to Petitioner's (as reported by Reuters Corporate Spreads for Utilities) effective on the date a Note is issued. For maturities not specifically referenced in the Statistical Release or Reuters, Petitioner will calculate the interest rate based upon a simple linear interpolation method. The lender, NiSource Finance Corp., will receive no markup.

Mr. Rea testified that issuing the Note to NiSource Finance Corp. has several advantages. By financing through its affiliate, Petitioner will avoid underwriting commissions, which on a transaction of this magnitude could be in the range of .70% - .75% of the principal. Thus, through the proposed financing, Petitioner will avoid underwriting commissions of $840,000 to

$900,000. In addition, through the proposed financing, Petitioner will not incur incremental legal fees, accounting and auditing fees, rating agency fees, or other transaction fees. These additional costs would likely be in the range of $225,000 to $250,000. The total avoided transactional costs associated with the proposed financing with NiSource Finance Corp. range from $1.1 million to $1.2 million. In addition, the proposed financing provides Petitioner maximum financial flexibility, allowing it to take advantage of favorable interest rates and market conditions as they arise. Also, after its first anniversary, any debt issued under the proposed financing may be redeemed by Petitioner prior to maturity, without payment of a call or early redemption premium. This is a significant benefit to Petitioner, as under current market conditions, similar forms of long-term debt carry "make whole" provisions, which assess significant early redemption or call premiums.

Mr. Rea represented that if Petitioner is given authority for the proposed financing, Petitioner will make a compliance filing within two weeks of the issuance of the Note, informing the Commission of the interest rate for the Note, and the underlying calculations that were used.

In his Rebuttal Testimony filed on March 30, 2009, Mr. Rea discussed two additional financing options that were proposed in Petitioner's Amended Verified Petition, which was filed concurrently with Mr. Rea's Rebuttal Testimony. In response to the OUCC's testimony that Petitioner should not restrict itself to affiliated lenders, Mr. Rea testified that Petitioner amended its Petition to request authority to issue, at its option, a note, bond or other evidence of indebtedness pursuant to any one of the following options for financing Sugar Creek:

1. Issuance of an intercompany note with a term of from one to twenty years.

2. External issuance of an unsecured note with a term of between five and twenty years.

3. External issuance of a secured note with a term of between five and twenty years.

Mr. Rea stated that in light of the extraordinary economic climate and its impact on the financial markets, Petitioner would be well served by expanding its financing options beyond the issuance of intercompany notes to its parent company, NiSource. By having Commission approval for different financing alternatives, Petitioner would be well-positioned to access the capital markets in the current distressed economic climate. Mr. Rea stressed that these external financing options for Petitioner might not be necessary under normal financial market conditions, however, in the current unprecedented financial environment they offer Petitioner cost-effective options for raising capital under difficult market circumstances.

Mr. Rea testified that Option #1 is very similar to what was originally proposed by Petitioner in this Cause, i.e., the issuance of an intercompany Note to Petitioner's affiliate, NiSource Finance Corp. However, whereas Petitioner originally intended for the Note to have a term of twenty years, Petitioner is now requesting flexibility to issue the Note for a term of between one and twenty years. Petitioner would issue such an intercompany Note within forty-five (45) days of a final, non-appealable order granting Petitioner the requested authority.

According to Mr. Rea, while it would be Petitioner's preference to issue a Note for twenty years in order to better match the financing term of the Note with the life of the underlying asset, a shorter term would give Petitioner the flexibility to take advantage of any interest rate opportunities that might exist for shorter term notes. And, with regard to the shortest possible maturities, this option would allow Petitioner to "tread water" so to speak, and wait for a better opportunity to lock in longer-term financing rates.

Mr. Rea testified that Option #2 involves the issuance of external debt at face value of an unsecured Note in the amount of one hundred twenty million dollars ($120,000,000) for a term of between five and twenty years. Petitioner proposes to sell the unsecured Note directly to one or more purchasers, or indirectly through one or more underwriters, dealers or agents. Purchasers will not be affiliates of Petitioner. The terms for the issuance of such unsecured Note will be negotiated by Petitioner with underwriters, purchasers or agents. After approval of the negotiated terms by Petitioner's Board of Directors, by an authorized committee thereof or by persons authorized by Petitioner's Board of Directors, it is anticipated that the parties would sign an agreement setting forth the terms of the Note.

Mr. Rea stated that Option #3 is an issuance of external debt at face value of secured debt in the amount of one hundred twenty million dollars ($120,000,000) for a term of between five and twenty years. The debt would be secured by all of the assets of Petitioner, or by specific Petitioner assets such as Sugar Creek. Petitioner proposes to sell the secured Note directly to one or more purchasers, or indirectly through one or more underwriters, dealers or agents. Purchasers will not be affiliates of Petitioner. The terms for the issuance of such secured Note will be negotiated by Petitioner with underwriters, purchasers or agents. After approval of the negotiated terms by Petitioner's Board of Directors, by an authorized committee thereof or by persons authorized by Petitioner's Board of Directors, it is anticipated that the parties would sign an agreement setting forth the terms of the Note.

In conjunction with the issuance of any debt secured by Petitioner's assets, Mr. Rea stated that Petitioner would also need authority to pledge those same assets as security for previously issued Series 2003 Jasper County Pollution Control Bonds. Pursuant to the Insurance Agreement that accompanied the issuance of those Bonds, Petitioner is contractually prohibited from issuing subsequent debt that has priority over Petitioner's assets, including after-acquired assets such as Sugar Creek. Thus, if Petitioner issues secured debt in the amount of $120 million, Mr. Rea testified that the Commission will need to approve the pledge of those same Petitioner assets on a *pari passu* basis to the holders of the $55 million 2003 Pollution Control Bonds.

Mr. Rea testified that Petitioner's choice among the three financing options would be based on a number of factors. First, under normal market circumstances, Mr. Rea stated Petitioner would prefer to issue an intercompany Note because of the flexibility it offers when compared to external issuances. Second, to the extent possible, Petitioner would prefer to issue a twenty-year Note, because that would better match the life of the underlying asset, Sugar Creek, which is being financed. However, he stated both of these preferences must be tempered by a recognition that the current state of the capital markets may force both Petitioner and NiSource Finance Corp. to pursue financing alternatives not previously considered.

**4. Petitioner's Capitalization and Outstanding Securities.** Petitioner's witness Mr. Rea sponsored Exhibit C to the Petition, which is Petitioner's balance sheet as of June 30, 2008. That Exhibit shows that as of June 30, 2008, the capitalization of Petitioner amounted to $2,128,600,000 and consisted of long-term debt in the amount of $673,266,000, and common equity in the amount of $1,455,334,000. All of the outstanding bonds, preferred stock and common stock have been duly authorized by orders of this Commission.

Mr. Rea also sponsored Exhibit H to Petitioner's Exhibit No. 1, which demonstrated, on a *pro forma* basis the effect the issuance of the proposed $120 million Note would have on Petitioner's capitalization. That Exhibit shows that Petitioner's capitalization will total approximately $2,248,600,000, and will consist of 35% debt and 65% equity capital, assuming the entire proposed financing is completed. Mr. Rea further testified that the total proposed issuance of $120 million, when combined with the outstanding stock, bonds, notes maturing in more than twelve months or other evidence of indebtedness would not exceed the fair value of the property of Petitioner.

**5. OUCC's Testimony.** In his November 13, 2008 testimony, Greg A. Foster, Utility Analyst for the OUCC, provided the OUCC's financial analysis of Petitioner's requested $120 million financing authority, involving the issuance of an unsecured long-term note to partially finance the acquisition of the Sugar Creek Generating Facility. As part of his analysis, Mr. Foster reviewed Petitioner's unaudited financial statements and various reports from Standard and Poor's. He also reviewed Value Line reports regarding utility bond interest rates and on NiSource (NIPSCO's parent company).

Mr. Foster's analysis focused on: (1) the specified uses of the proceeds, (2) the interest rate structure, (3) NiSource's Cash Flows, and (4) Petitioner's capitalization. According to Mr. Foster, the OUCC had no objection to NIPSCO's proposed use of the proceeds to partially finance its acquisition of the Sugar Creek Generating Facility with debt capital.

As to the terms of the proposed financing, Mr. Foster noted that, when affiliated parties bargain with and engage in transactions with one another, there is always a concern as to whether the transactions were conducted at arm's length. In this case, he stated that the OUCC had no objections to an affiliate transaction as long as the proposed new debt is issued at the lowest interest rates reasonably obtainable, regardless of whether the Petitioner borrows from an affiliate. Since various terms of the proposed inter-affiliate transaction were left for future negotiations between the Petitioner and its parent company, Mr. Foster testified that the OUCC proposed to reserve its right to raise additional concerns and possibly to object to the terms of the inter-affiliate financing transaction at a future point in time. Mr. Foster noted that his major concern in this case was the interest rate on the proposed inter-affiliate debt.

Mr. Foster explained that the Petitioner planned to determine the interest rate on the Note based on the corresponding applicable Treasury yield (as reported by the Federal Reserve) plus a yield spread corresponding to utilities with a credit risk profile equivalent to NIPSCO's. Petitioner's testimony included an illustrative example, resulting in an interest rate of 6.71%. Mr. Foster testified that Value Line reports recent BBB (25/30 year) utility bond yields of 7.45%. Petitioner's proposed debt is of a somewhat shorter maturity. Mr. Foster indicated that the

OUCC does not object to the proposed financing authority requested, provided the interest rate does not exceed 7.50%. Mr. Foster testified that if NIPSCO cannot issue an inter-affiliate note below that level, it should re-evaluate available financing options, including the possible use of secured debt or debt with a shorter term than twenty years. Mr. Foster also stressed the importance of NIPSCO not restricting itself to affiliated lenders.

Mr. Foster testified that the OUCC is aware of NiSource's newly aggressive capital-spending program, which will result in negative free cash flow. Mr. Foster referred to the Standard & Poor's (S&P) Ratings Direct reports for both NIPSCO and NiSource that were attached to Mr. Rea's testimony. He noted that on page 2 of the NIPSCO S&P Ratings Direct report, S&P states "Although we expect cash flows to remain stable, we anticipate the company's financial profile to deteriorate over the next few years." Mr. Foster also referred to the following excerpt from page 3 of the NiSource S&P Ratings Direct report: "Given these spending levels and cash from operations of about $1 billion, we expect NiSource to have a negative free cash flow of $200 million to $300 million per year from 2009 and beyond. With the debt-financed purchase of Sugar Creek, free cash flow deficit in 2008 could be near $700 million." The report also stated that NiSource's liquidity and its access to the debt and equity markets should be adequate to meet its ongoing operating and capital requirements. However, Mr. Foster cautioned that the above reports are dated December 28, 2007 -- long before the start of the current financial/credit crisis.

Mr. Foster observed that Petitioner's pro-forma debt to equity ratio calculation is 35% debt / 65% equity, based on Petitioner's Exhibit H. Given that relatively low debt ratio, the OUCC did not object to Petitioner's additional requested debt financing authority.

Mr. Foster recommended that, if the Commission grants the requested financing authority, the authority should expire on June 30, 2009 if the authorized Note has not been executed by then. The OUCC also recommended that, if the requested financing authority is granted, the Petitioner should be required to make a compliance filing within two weeks of the issuance of the Note to inform the Commission and the OUCC of the interest rate for the Note and the underlying calculations.

In light of the economic climate and at the urging of the OUCC, NIPSCO evaluated other financing options and amended its original request. NIPSCO's amended request seeks authority for NIPSCO to select between the three following financing options:

Option #1: Issuance of an Intercompany Note with a term between one and twenty years;

Option #2: External issuance of an unsecured Note with a term between five and twenty years; or

Option #3: External issuance of a secured Note with a term between five and twenty years.

Mr. Vince Rea provided additional testimony to support NIPSCO's amended financing authority request. He testified that, if NIPSCO issued the proposed Note for a ten-year term, the Note would bear interest at the following projected levels:

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| Option #1: | Unsecured Intercompany | 7.5%-8.0% |
| Option #2: | Unsecured External Issuance | 8.85% |
| Option #3: | Secured debt | 7.85% |

After reviewing Petitioner's amended request, Mr. Foster supported NIPSCO's decision to consider more financing options, beyond borrowing from affiliates. However, he expressed concern that Mr. Rea's estimated interest rates were still not what one might expect to see from a company with such a strong balance sheet and equity ratio as NIPSCO.

Mr. Foster opined that the credit markets have begun to stabilize. According to Value Line, single-A rated utility bonds yielded around 6.10% as of May 15, 2009. This is one basis point less than year-ago levels of 6.11%, prior to the current U.S. financial crisis. In contrast, triple-B (BBB) rated utility bonds yielded 7.54% as of May 15, 2009 -- as compared to year-ago levels of 6.39%, before the financial crisis. Mr. Foster observed that, while single-A rated utility bond yields have remained relatively stable, investors now demand over 140 basis points more for triple-B rated utility bonds than they did before last year's financial crisis.

Mr. Foster reviewed recent financing transactions by other Indiana electric utilities. He found that, on March 23, 2009, Duke Energy Indiana (DEI) issued $450 million of First Mortgage Bonds due April 1, 2039 with an effective interest rate of 6.59%. On April 4, 2009, Vectren Utility Holdings Inc. (VUHI) issued $100 million in Senior unsecured notes due April 7, 2020, with an interest rate of 6.28%. Both DEI and VUHI have an A- S&P credit rating.

Mr. Foster testified that NIPSCO's financing options are more expensive as a result of its parent corporation's near "junk" rating. He acknowledged that many factors can affect interest rates including, but not limited to, one or more of the following: length of financing term, amount financed, a company's equity ratio, cash flow, and credit rating. However, as noted in Standard & Poor's, NIPSCO is burdened by NiSource's weak balance sheet and credit ratings:

> *The stand-alone financial profiles of NiSource's utility subsidiaries are much stronger than the consolidated financial profile, where substantial acquisition-related debt is held.* Nevertheless, we view the default risk as the same throughout the organization, due to the absence of regulatory mechanisms or other structural barriers that sufficiently restrict subsidiary cash flow to the holding company.

Mr. Foster's testimony included, as an exhibit, a comparative analysis of S&P Bond Ratings and equity ratios for publicly-traded combination electric and gas companies (Table 1). He noted that ratings varied from AA- to BBB-; equity ratios ranged from a high of 61% to a low of 15%, with an average of 43%. He also indicated that NiSource has an equity ratio of 38% and an S&P Bond Rating of BBB-.

Mr. Foster computed an average of common equity ratios by S&P Bond Rating (Table 2). On average, utilities with a bond rating of A- or better have common equity ratios in the upper forties whereas utilities with a bond rating in the BBB range have common equity ratios in the thirties. Mr. Foster observed that a strong correlation can be drawn between a company's equity ratio and its bond rating.

Mr. Foster also calculated a 55.56% common equity ratio for NIPSCO (Table 3) using the same methodology used by AUS. After narrowing the list of companies in Table 1 to include only those companies with a common equity ratio of 50% or greater, Mr. Foster noted that all had S&P Bond Ratings of A- or better.

Mr. Foster testified that, based on his analysis, NIPSCO's financing options are inextricably tied to NiSource's bond rating; and, as viewed by Standard and Poor's, that bond rating is preventing NIPSCO from being able to obtain debt in the open market based solely on NIPSCO's own merits. Mr. Foster concluded that, with respect to financing, NIPSCO is being penalized by its parent company's weak financial profile.

Mr. Foster testified that, after reviewing NIPSCO's original and amended petitions and all testimony NIPSCO prefiled in this case, his original recommendations in this case have not changed. The Petitioner has not provided sufficient justification to convince Mr. Foster to alter the recommendation in his November 13, 2008 testimony, asking the Commission to cap NIPSCO's authorized interest rate at 7.5% for any debt issued under this authority. He indicated that the 7.5% cap recommended in his earlier testimony remains reasonable and should be adopted by the Commission for any financing authority approved in this Cause.

6. **<u>LaPorte's Testimony</u>.** Mr. Reed W. Cearley testified on behalf of LaPorte County. In his November 12, 2008 testimony, Mr. Cearley expressed concern that Mr. Rea's dual roles as Assistant Treasurer of NiSource Finance Corp. and Assistant Treasurer of NIPSCO would create a conflict of interest in the financing transaction. His concern was that Mr. Rea and NiSource Finance Corp. will have subjective input with regard to other factors that will significantly affect the interest rate for the loan. These include: 1) the timing of the loan; 2) the duration of the loan; 3) the applicable debt and preferred stock rating used to determine the yield spread; and 4) the decision of whether to prepay the loan at any time prior to maturity.

Mr. Cearley testified that he was concerned that there could be additional costs to NIPSCO in excess of the avoided transaction costs. This includes the timing of the issuance of the Note. According to Mr. Cearley, NIPSCO would be better served by utilizing the Money Pool as long as possible, but from NiSource Finance Corp.'s point of view, the debt should be converted to a higher-cost long term Note as quickly as possible. By way of example, Mr. Cearley pointed out that based on the Money Pool's interest rate of 3% compared to the market rates at the time of his testimony, NIPSCO would save approximately $635,000 for each month it used the Money Pool instead of issuing the Note to NiSource. Moreover, he stated that this places NIPSCO and NiSource directly at odds with regard to when the Note is issued, as NiSource should want to convert the debt to the Note as soon as possible, whereas NIPSCO is best served by delaying any Note issuance for as long as possible. Additionally, the timing of issuance could have a dramatic effect on the interest rate paid by NIPSCO, and the subsequent total amount paid by NIPSCO. By way of example, Mr. Cearley cited that in the week preceding his testimony, the 20-Year Treasury Yields changed by .23%. Such a change would result in NIPSCO paying $5.5 million less in interest over the life of the Note, if it were issued at that time. Furthermore, Mr. Cearley did not find that any consideration had been given to the timing of the issuance of the Note and its respective impact on the competing interests of NIPSCO and NiSource Finance Corp. (e.g., a $5.5 million dollar difference in total payments).

Mr. Cearley expressed concern that no reason was given for the twenty year term of the proposed intercompany Note and argued that the lower interest rate on a shorter term loan may be beneficial to NIPSCO even if it results in NiSource Finance Corp. receiving a lower interest rate. He also testified that NiSource Finance Corp. should accept NIPSCO's highest credit rating when making a determination regarding the interest rate. Although he recognized the potential advantage to NIPSCO of being able to prepay the Note (after the first anniversary), Mr. Cearley expressed concern that there are no affiliate guidelines identified to establish who will make the determination to prepay and how. Further, Mr. Cearley noted that although the Commission has inquired about such affiliate guidelines, NIPSCO apparently still does not have any such guidelines. Moreover, Mr. Cearley noted that, should NIPSCO issue the intercompany Note and subsequently wish to refinance at a lower rate, NiSource would have little incentive to offer such a lower rate, and Mr. Rea, as Assistant Treasurer to NiSource, may decide to force NIPSCO to remain in a longer-term Note to benefit NiSource. Mr. Cearley testified that, prior to approving any long-term debt financing for NIPSCO, the Commission should require NIPSCO to confirm that it does not intend to sell Sugar Creek.

In his Supplemental Testimony, filed on May 19, 2009 in response to NIPSCO's Amended Verified Petition, Mr. Cearley argued that NIPSCO should not be allowed to choose from one of the three options included in the Amended Verified Petition. Instead, NIPSCO should specify a single financing proposal and support the reasonableness of that proposal. Mr. Cearley expressed concern that Mr. Rea's rebuttal testimony does not discuss or explain how NIPSCO will decide what term of Note to issue, nor does Mr. Rea discuss or explain which term of loan is preferable under current market conditions. Mr Cearley equated NIPSCO's proposal with a delegation of the Commission's authority to determine whether a method of financing is reasonable and in the public's interest. Granting NIPSCO the authority to choose among the three options amounts to *carte blanche* authority to enter into any finance arrangement NIPSCO desires. He testified that the Commission's approval of all three financing options may allow NIPSCO to simply proceed as originally intended with the twenty-year intercompany Note. Given the current conditions in the debt capital markets, Mr. Cearley argued that choosing a twenty-year Note seemed highly questionable without evidence demonstrating the reasonableness of that decision. Furthermore, given Mr. Rea's conflict of interest, Mr. Cearley testified that the Commission should not assume that the decision made by Mr. Rea would be reasonable and in the public interest. Regarding Options #2 and #3 in the Amended Verified Petition, because the terms of issuance will be negotiated at a later date, he stated that the Commission cannot find that the terms of such unknown issuances are reasonable and in the public interest.

Finally, Mr. Cearley reiterated that allowing NIPSCO the authority to choose between Options #1, #2, and #3 does not remove the conflict of interest due to his positions both for NIPSCO and for NiSource. Rather, approving all three options grants him the authority to exercise an option most beneficial to NiSource rather than most beneficial to NIPSCO. Moreover, Mr. Cearley noted that Mr. Rea acknowledged that he will have subjective input when evaluating the loans from both sides of the transaction. Mr. Cearley testified that Mr. Rea's statement indicating that his input is "appropriately tempered by other considerations" does not eliminate the existence of the conflicting considerations involved in Mr. Rea's dual roles.

**7. __Petitioner's Rebuttal and Supplemental Rebuttal Testimony__.** In his Rebuttal Testimony filed on March 30, 2009, Mr. Rea addressed the November 2008 testimony of LaPorte County witness Mr. Cearley, and OUCC witness Mr. Foster.

Mr. Rea addressed Mr. Cearley's four concerns about the apparent conflict of interest faced by Mr. Rea and the potential that subjective input by Mr. Rea would significantly affect the interest rate for the proposed financing. Mr. Rea testified that regarding the timing of an intercompany loan, issuing the Note within 45 days of receiving financing authority from the Commission would place reasonable limitations on his ability to influence the timing of the Note issuance. Mr. Rea stated that while determining the term of the loan requires some subjective input on his part, it is limited by the desire from a financing perspective under normal market circumstances to "match" long-term assets with related long-term debt. However, due to current market circumstances, Petitioner would like the flexibility of choosing the most opportunistic financing term (between one and twenty years) to deliver the best combination of cost and maturity duration for Petitioner.

Mr. Rea testified that the third factor mentioned by Mr. Cearley—the choice of the applicable debt and preferred stock rating used to determine the yield spread—involves a combination of objective and subjective inputs. The objective input comes from ratings provided by Standard and Poor's and Moody's, which currently rate the senior unsecured debt of Petitioner at BBB- and Baa2, respectively. Because these two ratings represent a split-rating (meaning not equivalent between the two rating agencies), it has been the practice of Petitioner and NiSource Finance Corp. in intercompany transactions to subjectively utilize the higher of the two credit ratings when determining the applicable credit spread to assign to the intercompany debt transaction. Thus, although the choice of a higher credit rating is subjective, the choice has been previously exercised and will continue to be exercised in a manner that results in the selection of the credit rating that is most favorable to Petitioner.

Mr. Rea also addressed Mr. Cearley's concern regarding the prepayment of the loan prior to maturity. Mr. Rea testified that, in the public marketplace, the prepayment of loans prior to maturity normally requires a prepayment penalty, or "make-whole" payment, typically an amount that makes such a prepayment unattractive. The outside financing obtained by NiSource Finance Corp. for purposes of funding the intercompany Note will likely include such a provision. Although it would be commercially reasonable for NiSource Finance Corp. to include a similar provision when providing intercompany financing, that has not been the practice, so as to preserve some level of refinancing flexibility for Petitioner should extraordinary circumstances arise.

In his Supplemental Rebuttal testimony, Mr. Rea testified that, in recent years, Petitioner has in fact benefited from its strong balance sheet and equity ratio through the issuance of competitively priced intercompany notes to NiSource Finance Corp. However, Mr. Rea testified that the implication of Mr. Foster's comparison between borrowing costs of A-rated and BBB-rated utility companies oversimplifies the rating process, which takes into consideration multiple financial factors and qualitative considerations as well. Mr. Rea stated that it is important to note that even on a stand-alone basis, any savings resulting from the "slightly higher" rating which could potentially be assigned to Petitioner would only be offset by the additional costs Petitioner would incur when issuing debt in the public markets. Mr. Rea testified that Petitioner would incur the following additional costs in association with a public bond offering (costs which are not associated with the issuance of intercompany notes): (A) a "new issue premium" of 40-50 basis points for issuing debt in the public marketplace (this new issuance premium is added to the "secondary market" bond spreads that are reported in, for example, the Reuters Corporate Spreads for Utilities Report), (B) underwriting fees, (C) outside legal fees, (D) rating agency fees, and (E) auditor fees. While item (A) above would be added to the ongoing annual financing cost, items (B) through (E) would be amortized over the life of the financing and would add approximately 5-7 basis points to the interest rate. Mr. Rea testified that because institutional investors would take into consideration the Baa2/BBB level ratings from Moody's and Fitch along with the improved outlook at S&P, he did not agree with Mr. Foster that Petitioner is viewed as being "just barely investment grade." Mr. Rea also stated that Petitioner has been informed by potential underwriters that Petitioner would be in a position to successfully complete a competitively priced public bond offering, which would reflect the higher relative credit ratings assigned by Moody's and Fitch Ratings.

Regarding the interest rate cap proposed by Mr. Foster and the OUCC, Mr. Rea testified that it is his strongly held position that imposing an arbitrary interest rate cap which is not market-based would establish an undesirable precedent that would put future financing initiatives in jeopardy, especially under challenging market circumstances. In order to efficiently run its operations, Petitioner needs to maintain flexibility and preserve its discretion in its future financing decisions, and should not be penalized for the recent financial markets' turmoil, which has caused borrowing costs to increase for all market participants. He stated that, although Petitioner disagrees with the imposition of an interest "cap" on its financing authority, Petitioner is willing to shorten the financing term from the twenty-year period that was earlier proposed, which should favorably affect Petitioner's borrowing costs. Mr. Rea stated that while Petitioner's preference would normally be to issue a Note for twenty years in order to better match the financing term of the Note with the life of the underlying asset, a shorter term would give Petitioner the flexibility to take advantage of any interest rate opportunities that might exist for shorter term notes. He cautioned that there can be no assurance, of course, that market rates will have declined to more normal levels by the time the issued Note matures. Mr. Rea stated that in the current market environment, a seven- to ten-year financing would be priced with a coupon rate in the range of 6.9%-7.5%, respectively, on an intercompany basis. A public offering would be similarly priced, but would also involve a new issuance premium and transaction costs.

Mr. Rea testified that, in light of the OUCC's specific request that Petitioner expand its financing alternatives, along with the challenges of the current financial climate, he does not agree with Mr. Cearley's position that a specific financing proposal should be chosen. Doing so would be a direct contradiction of the OUCC's previous request to diversify Petitioner's financing alternatives and would lock Petitioner into a financing option that might not be optimal. Petitioner believes that in consideration of the present volatility in the financial markets, along with Petitioner's past good stewardship of its financing responsibilities, the Commission should grant Petitioner the flexibility it seeks. Furthermore, during this time of financial market turmoil, Mr. Rea testified that it is prudent to keep all financing options on the table, and to make decisions that are prudent, not only with regard to cost, but also with regard to financing flexibility, matching maturities of assets and liabilities as best as possible, and maintaining future access to the financial markets.

**8. Commission Discussion and Findings.** The Commission finds that the purpose for which Petitioner proposes to issue the proposed $120 million Note is in accordance with the provisions of the laws of the State of Indiana relating to the issuance of securities by public utilities. The Commission also finds that the long-term debt Petitioner will have outstanding upon completion of the proposed financing will bear a reasonable proportion to Petitioner's total capitalization and will be reasonable in aggregate amount, with due consideration given to the nature of Petitioner's business, credit, future prospects and earnings and the effect which the issuance of such securities may have on the management and efficient operations of Petitioner. In addition, the Commission finds that Petitioner's total outstanding capitalization, when adjusted for the proposed financing, and the application of the proceeds therefrom, will be reasonable in relation to the total value of Petitioner's property and will not be in excess of the fair value of Petitioner's property used and useful for the convenience of the public.

The OUCC recommended that the financing authority granted in this Cause should restrict Petitioner from issuing debt with an interest rate that exceeds 7.50%. In his Supplemental Rebuttal Testimony, Mr. Rea did not agree with this interest cap proposal, and argued that it would establish an undesirable precedent that would put future financing initiatives in jeopardy. Mr. Rea testified that Petitioner needs to maintain flexibility and discretion in its future financing decisions. Nevertheless, Mr. Rea indicated in his Supplemental Rebuttal Testimony that Petitioner was not opposed to a term of seven to ten years for the proposed financing, a position that he reiterated at the hearing. While Mr. Rea stated it is Petitioner's preference to issue a Note for twenty years in order to better match the financing term of the Note with the life of the underlying asset, he stated a shorter term would give Petitioner the flexibility to take advantage of any interest rate opportunities that exist. Mr. Rea cautioned that a Note with shorter maturity faces a risk that interest rates will increase significantly, which would result in a higher cost for any refinancing of the Note.

The Commission notes that evidence was presented that Petitioner has maintained a Baa2 Moody's rating since 2005. A review of Petitioner's past financing cases in Cause Nos. 42763 and 43370 (orders issued on May 4, 2005 and February 6, 2008, respectively) indicates that in neither case did the OUCC recommend an interest rate cap. Based upon this evidence, the OUCC's proposal is linked more to the higher interest rates that exist in today's financial markets than to any change in Petitioner's financial rating. The Commission understands that turmoil in the financial markets has resulted in significantly higher interest rates for utilities with Baa-level ratings such as Petitioner. However, it would be inappropriate for this Commission to react to this financial turmoil by restricting–and perhaps preventing–Petitioner's ability to access the capital markets at interest rates that are determined by the marketplace. The Commission therefore declines to adopt the OUCC's recommended interest rate cap of 7.50%.

Based on the record and Petitioner's history of prudent management of its capital structure, we do not believe an arbitrary interest rate cap is necessary at this time. However, we find that the OUCC does not waive its right to challenge the reasonableness of decisions made by Petitioner in exercising the authority granted herein based upon the information available at the time of those decisions.

LaPorte County's witness Mr. Cearley testified that Mr. Rea had a conflict of interest due to his dual role as Assistant Treasurer for both Petitioner and NiSource Finance Corp. Mr. Cearley suggested four ways that Mr. Rea could use his subjective input to significantly affect the interest rate for the proposed debt. Mr. Rea testified in response he has a fiduciary duty to both entities, and that the four factors listed by Mr. Cearley involve varying degrees of subjective input, but that such input is appropriately tempered by other considerations. For example, with regard to the choice of bond rating to apply to Petitioner's intercompany notes, Petitioner has always been given the higher rating whenever there was a split rating. With regard to the timing of a loan, Petitioner committed to issuing an intercompany Note within 45 days of receiving financing authority from the Commission, thereby limiting Mr. Rea's subjective input. With regard to the duration of a loan, Mr. Rea testified in Supplemental Rebuttal Testimony, and at the hearing, that Petitioner is willing to use a seven to ten-year term for the proposed financing. The final subjective factor cited by Mr. Cearly relates to Petitioner's ability to prepay loans. Mr. Rea testified that in the public marketplace, the prepayment of loans prior to maturity normally requires a prepayment penalty.

While it would be commercially reasonable for NiSource Finance Corp. to include a similar provision for intercompany financing, that has not been the company's practice, to preserve some level of refinancing flexibility for Petitioner should extraordinary circumstances arise. Mr. Rea noted in his Supplemental Rebuttal Testimony that by limiting the duration of the original financing to seven to ten years, and thereby reducing the interest cost, the need to prepay the notes prior to their original maturity date (and refinancing them to a longer dated maturity) will likely be reduced. Based on the evidence presented, the Commission finds that the concerns expressed by Mr. Cearley are mitigated by the manner in which Petitioner proposes to issue the proposed debt, and any conflict of interest that may exist by virtue of Mr. Rea's role as Assistant Treasurer for both the lender and the borrower has been appropriately addressed by Petitioner. Although Petitioner has volunteered to limit the term of the Note to seven to ten years in response to the OUCC's concern about interest rates, the Commission recognizes that financial markets may continue to improve between the time of the evidentiary hearing and the time this order is issued. Should long-term interest rates improve sufficiently during that interlude, we find that Petitioner should not necessarily feel bound by that seven to ten year commitment, and could consider a longer term, in keeping with the "matching" principle, if this can be accomplished in a manner that is generally consistent with the OUCC's interest rate concern.

In his Supplemental Testimony, Mr. Cearley testified that the Commission should not grant approval for Petitioner to decide which of the three financing options to pursue. Mr. Cearley suggested that Petitioner should be required to identify a specific financing proposal and support the reasonableness of that proposal. Mr. Cearley expressed concern that the two external financing options, options #2 and #3, involve terms of issuance that would not be negotiated until a later date. Mr. Cearley went on to state that "[t]he Commission cannot find that the terms of such issuances, which are unknown at this time, are reasonable and in the public interest."

Mr. Rea responded in his Supplemental Rebuttal Testimony that Petitioner expanded the number of financing options based on the specific request by OUCC witness Greg Foster. Mr. Rea further testified that in this time of financial turmoil, it is prudent to keep all financing options on the table, and to make decisions that are prudent, not only with regard to cost, but also with regard to financing flexibility and maintaining future access to the financial markets. Mr. Rea testified that Petitioner has demonstrated a strong track record of prudently managing its borrowing activities, as evidenced by the average borrowing cost on Petitioner's existing $510 million portfolio of intercompany notes, which is competitive at 5.73%. Mr. Rea further stated that Petitioner believes that in consideration of the present volatility in the financial markets, along with Petitioner's past good stewardship of its financing responsibilities, the Commission should grant Petitioner the flexibility it seeks.

The Commission notes that it is not unusual for this regulatory body to grant flexibility to utilities that require access to debt capital. At the hearing the Commission took administrative notice of the petitions and orders in Cause Nos. 43350, 43256, and 43332. The Commission notes that the financing flexibility sought and granted in those cases is virtually identical to the flexibility sought by Petitioner in this Cause. It has not been the Commission's practice to limit management's flexibility with regard to a utility's access to the capital markets, and absent compelling evidence regarding the need for such oversight, we are not inclined to do so. While Mr. Cearley speculates about ways Petitioner could abuse the authority it seeks, the simple fact remains that Petitioner's past financings support the conclusion that Petitioner has acted responsibly when exercising its financing authority. The Commission finds Petitioner should not be required to specify in advance the financing option and terms that it intends to pursue.

The testimony of Mr. Rea describes a number of advantages Petitioner will realize as a result of issuing a Note to NiSource Finance Corp. Based on that testimony, the Commission finds that it is in the public interest to allow Petitioner to issue the proposed Note to NiSource Finance Corp., on such terms as are indicated in this Order and Petitioner's exhibits. The Commission also finds that it is in the public interest to allow Petitioner to issue a Note externally, either on a secured or unsecured basis, on such terms that are available in arm's length transactions. If Petitioner issues debt secured by Petitioner assets, the Commission finds that Petitioner, pursuant to the Insurance Agreement that accompanied the issuance of the 2003 Pollution Control Bonds, shall be further authorized to pledge those same assets on a *pari passu* basis to the holders of the $55 million 2003 Pollution Control Bonds.

As noted above, the parties may challenge the reasonableness of Petitioner's ultimate decision in exercising the financing authority granted herein based on the information available at the time the decision is made. Should Petitioner proceed with an internal financing, the interest rate achieved through that financing will be subject to comparison with a market-based rate available at that time, pursuant to the compliance filing described below.

In conclusion, the Commission finds that Petitioner's proposed financing should be approved and a Certificate of Authority should be issued to Petitioner to proceed with such financing. Petitioner shall make a compliance filing within two weeks of the issuance of a Note, informing the Commission of the interest rate for the Note, and if it is issued as an intercompany Note, the underlying calculations that were used. If NIPSCO utilizes an intercompany Note, NIPSCO shall also indicate the comparable interest rate that could have been obtained on the open market at the time of the transaction, with supporting data for its statement.

**IT IS THEREFORE ORDERED BY THE INDIANA UTILITY REGULATORY COMMISION that:**

1. Petitioner shall be and hereby is issued a Certificate of Authority authorizing Petitioner to issue a $120 million Note for the purposes indicated herein, and on such terms and conditions as described in any of the three options herein. In the event Petitioner issues debt secured by Petitioner assets, Petitioner shall be further authorized to pledge those same assets on a *pari passu* basis to the holders of the $55 million 2003 Pollution Control Bonds. This Order shall constitute said Certificate of Authority.

2. Petitioner shall make a compliance filing within two weeks of the issuance of the Note, informing the Commission of the interest rate for the Note, and if the Note is issued on an intercompany basis, the underlying calculations that were used. If NIPSCO utilizes an intercompany Note, NIPSCO shall also indicate the comparable interest rate that could have been obtained on the open market at the time of the transaction, with supporting data for its statement.

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

**HARDY, ATTERHOLT, GOLC, LANDIS, AND ZIEGNER CONCUR:**

**APPROVED:** NOV 1 2 2009

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

Brenda A. Howe

**Brenda Howe**
**Secretary to the Commission**