ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

J16

PETITION OF SOUTHERN INDIANA GAS AND ELECTRIC COMPANY d/b/a VECTREN ENERGY DELIVERY OF INDIANA, INC. FOR AUTHORITY TO IMPLEMENT ITS 2009-2011 FINANCING PROGRAM BY (1) ISSUING NOT TO EXCEED $ 270,000,000 IN AGGREGATE PRINCIPAL AMOUNT OF SECURED OR UNSECURED LONG-TERM DEBT ISSUED TO UNAFFILIATED LENDERS AND LOAN AGREEMENTS SECURING TAX-EXEMPT BONDS OR DEBT IN THE FORM OF UNSECURED PROMISSORY NOTES TO VECTREN UTILITY HOLDINGS, INC. ("VUHI"), ITS IMMEDIATE PARENT COMPANY, PURSUANT TO THE PREVIOUSLY APPROVED FINANCIAL SERVICES AGREEMENT; (2) EXECUTING AND DELIVERING EVIDENCES OF INDEBTEDNESS RELATING TO SUCH LONG-TERM DEBT; (3) ENTERING INTO INTEREST RATE RISK MANAGEMENT TRANSACTIONS; (4) ISSUING AND SELLING NOT TO EXCEED $ 180,000,000 OF COMMON AND/OR PREFERRED STOCK; AND (5) USING THE NET PROCEEDS FROM THE FINANCING PROGRAM TO REIMBURSE ITS TREASURY AND, THEREAFTER, TO REPAY AND REFUND OUTSTANDING LONG-TERM DEBT, REPAY ITS SHORT-TERM DEBT, AND FINANCE ITS CONSTRUCTION PROGRAM.	)	**CAUSE NO. 43695** **APPROVED:** OCT 21 2009

<u>BY THE COMMISSION:</u>
David E. Ziegner, Commissioner
Aaron A. Schmoll, Administrative Law Judge

On May 28, 2009, Southern Indiana Gas and Electric Company d/b/a Vectren Energy Delivery of Indiana, Inc. ("Petitioner") filed its petition in this Cause for authority to carry out its financing program for the period through December 31, 2011.

Pursuant to the schedule agreed to at the Prehearing Conference, and notice of hearing given as provided 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 September 22, 2009, in Room 224 of the National City Center, 101 West Washington Street, Indianapolis, Indiana. Petitioner and the Indiana Office of Utility Consumer Counselor ("OUCC") were represented at the hearing.

Based upon 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 its securities. The Commission has jurisdiction over Petitioner and the subject matter of this proceeding.

2. **Petitioner's Characteristics and Business**. Petitioner is an operating public utility incorporated under the laws of the State of Indiana. Petitioner has charter power and authority to engage in and is engaged in the business of rendering electric and gas distribution service within the State of Indiana under indeterminate permits, franchises and necessity certificates heretofore duly acquired. Petitioner owns, operates, manages and controls, among other things, plant, property, equipment and facilities that are used and useful for the production, storage, transmission, distribution and furnishing of electric utility service to approximately 141,000 customers and gas utility service to approximately 111,000 customers in southwestern Indiana. Petitioner is a wholly-owned subsidiary of Vectren Utility Holdings, Inc. ("VUHI"), which is a wholly-owned subsidiary of Vectren Corporation. Vectren Corporation is a holding company whose stock is publicly-traded and listed on the New York Stock Exchange. VUHI also owns all the common stock of Indiana Gas Company, Inc. ("Vectren North") and Vectren Energy Delivery of Ohio, Inc. ("VEDO").

3. **Petitioner's Capitalization and Outstanding Securities.** As of December 31, 2008, Petitioner's total capitalization amounted to $1,156,000,000 and consisted of long-term debt in the amount of $555,000,000 (including $80 million of debt subject to tender and $41.3 million of long-term debt held in Petitioner's Treasury on December 31, 2008, that was remarketed to investors in March 2009); common stock in the amount of $293,000,000; and retained earnings and accumulated other comprehensive income in the amount of $308,000,000. At that date, the long-term debt of Petitioner was represented by ten series of first mortgage bonds totaling $245,000,000 and five series of unsecured notes to VUHI totaling $312,000,000. A schedule showing the long-term debt was attached to Petitioner's Verified Petition as Exhibit A. All of the outstanding long-term debt and common stock have been duly authorized by Orders of this Commission.

4. **Petitioner's Proposed Financing Program.** Petitioner requests the authorization and approval of this Commission to carry out, from time to time, during the period from the date of the Order issued herein through December 31, 2011, a financing program consisting of one or more or a combination of the following:

(a) issuing and selling not to exceed $270,000,000 in aggregate principal amount of long-term debt;

(b) issuing and selling additional common stock or preferred stock (including tax deductible preferred stock) or a combination thereof for an aggregate sale price not to exceed $180,000,000; and

(c) entering into one or more interest rate risk management transactions as described below.

5. **Purposes of the Financing Program.** The proceeds of the financing program, after payment of expenses, will be used to reimburse Petitioner's treasury for monies actually expended for (i) the acquisition of property, material, or working capital; (ii) the construction, completion,

extension, or improvement of its facilities, plant, or distribution system; (iii) the improvement of its service; and (iv) the discharge or lawful refunding of its obligations. Thereafter, Petitioner shall use the net proceeds of the financing program to repay and refund outstanding long-term debt, to repay short-term borrowings and to finance its construction program.

Robert L. Goocher, Vice President and Treasurer of Petitioner, who also holds the same positions with Vectren Corporation, VUHI, Vectren North and VEDO, testified about Petitioner's financing needs during the 2009-2011 period. Mr. Goocher estimated Petitioner's external financing requirements for the remainder of 2009 and for the 2010-2011 period to be $450 million. He said Petitioner has capital spending requirements of $436 million over the period of the financing program, of which 40% to 60% is estimated to require external financing. Mr. Goocher testified there are other potential refunding requirements of $168,000,000 due to maturing debt and because of noteholder "puts" that become effective during the period of the financing program. Mr. Goocher testified that on December 1, 2011, $250,000,000 of VUHI's long-term debt matures. Of that $250,000,000 issue, approximately $88,000,000 is attributable to Petitioner. In addition, as of August 3, 2009, the owners of Petitioner's 1999 Series 6.72% Senior Notes with a principal amount outstanding of $80,000,000 had the right to require Petitioner to prematurely redeem that series. Mr. Goocher further stated that although not currently anticipated, depending on market conditions at the time, it may be advantageous for Petitioner to redeem in whole or in part additional outstanding debt prior to the maturity date thereof.

Mr. Goocher stated that Petitioner requests financing authority for a multi-year period in order to provide flexibility to react quickly to changing market conditions and take advantage of capital market opportunities that may arise during the period of the financing program. He cited the unprecedented volatility and instability in the financial markets in recent years, which reached near crisis levels in the fall of 2008, as evidence of the need to make sure Petitioner can access the capital markets when windows of opportunity present themselves so Petitioner can maintain adequate liquidity to meet its operational needs and reduce future financial risk.

6. New Long-Term Debt. Mr. Goocher testified that long-term debt issued pursuant to the financing program (i) is likely to have maturities of five to forty years; (ii) will bear interest at a fixed or variable rate; (iii) largely is expected to be issued through Petitioner's existing debt pooling arrangement with VUHI pursuant to the Financial Services Agreement previously approved by the Commission; (iv) will likely be in the form of unsecured promissory notes; and (v) will be issued and sold for not less than 95% of the face amount thereof plus accrued interest to the date of delivery. Under the debt pooling arrangement previously described in the Commission's Orders in Cause Nos. 41908, 42807, and 43332, the debt requirements of Petitioner, Vectren North and VEDO ("Participants") are pooled, thereby creating larger more attractive debt issues with lower interest rates, lower transaction costs and better financial market access than the Participants would have if they financed separately. In accordance with the Financial Services Agreement, VUHI sells its own long-term debt securities in the public or private markets in the amount of the combined long-term debt requirements of the Participants and reloans the proceeds to the Participants on the same terms as apply to the VUHI debt. To maximize the benefits of the pooling arrangement, the Participants provide joint and several guarantees of VUHI's debt to make VUHI's debt issues attractive to investors and to achieve lower debt costs. These guarantees are provided pursuant to on-going authority previously granted in Cause No. 42807.

Mr. Goocher testified that Petitioner also may engage in tax-exempt financings. In a tax exempt financing, bonds would be issued by a governmental entity and sold to an underwriter which will market the bonds in a public offering. The proceeds of the tax-exempt bond issue will be deposited with a trustee and Petitioner will borrow the deposited funds pursuant to a loan agreement between Petitioner and the governmental entity acting as the issuer. The terms on which Petitioner will repay the loan under the loan agreement will be the same as the terms applicable to the tax-exempt bonds. Petitioner will pay the principal and interest to the trustee in accordance with the loan agreement, and the trustee will use these funds to pay the bondholders. The loan agreement will provide Petitioner, at certain times, with the option to change the interest rates and remarket the tax-exempt bonds without retiring the bonds, issuing new bonds or changing the face amount or maturity date of the bonds.

Mr. Goocher stated that depending on market conditions, pricing considerations and interest rate mode selected at the time of issuance of the tax-exempt bonds, Petitioner may obtain a letter of credit or some other form of credit or liquidity enhancement for the tax-exempt bonds. Because the interest on the tax-exempt bonds is exempt from both Federal and Indiana income taxes, the interest rate will normally be less than would be required for comparable taxable bonds. Mr. Goocher stated that to provide maximum flexibility in connection with the issuance of tax-exempt debt, Petitioner seeks authorization to secure its obligations under the loan agreements with First Mortgage Bonds, should that be necessary to obtain the most advantageous terms. Mr. Goocher explained that any First Mortgage Bonds that are issued to secure Petitioner's obligations under a loan agreement supporting tax-exempt bonds will not increase the amount of long-term debt above that incurred under the corresponding loan agreement but instead will only provide security for the payment of that amount. Mr. Goocher stated that the long-term tax exempt debt will likely be issued with maturities between twenty and forty years, with variable or fixed interest rates set based on then-prevailing market conditions, with the option to alter the interest rate mode in the future as provided in the new loan agreements.

Mr. Goocher further testified that Petitioner would also like the ability to issue new long-term debt directly to investors instead of through the VUHI pooling arrangement, should changes in the marketplace make it desirable to do so. Any such debt could be secured or unsecured and will consist in whole or in some combination of promissory notes, debentures, medium-term notes, mortgage bonds or other instruments evidencing debt of Petitioner and may be issued and sold by way of public offerings or private placements.

Mr. Goocher testified that the interest rates on the new long-term debt will be determined at the time of issuance, based on the then prevailing market and economic conditions. Petitioner and VUHI will consult with investment bankers and review pertinent econometric data prior to issuing long-term debt to ensure that the interest rates and terms and conditions of the new debt issues are reasonable.

Mr. Goocher also discussed the benefits of the Financial Services Agreement with respect to the short-term financing needs of the Participants. He said VUHI enters into credit facility agreements that allow it to borrow on a short-term basis and reloan the proceeds to the Participants in accordance with their needs and at the same rate VUHI pays for short-term debt. Mr. Goocher testified that consolidating the short-term financing needs of all three Participants through a syndicated credit facility and commercial paper program at VUHI yields the same kinds of benefits as does the long-term debt pooling arrangement, *i.e.*, greater financial market access, more favorable pricing and lower transaction costs. Mr. Goocher stated that VUHI's existing $515,000,000 multi-year credit facility matures in November 2010 and will be renewed during the period of time covered by this Order.

The Commission's Order dated May 11, 2005 in Cause No. 42807 authorized Petitioner to borrow from VUHI on an ongoing basis in accordance with (a) multi-year credit facility agreements of VUHI so long as each actual borrowing under the facility will be repaid within 365 days and (b) credit facility agreements that contain options allowing VUHI to terminate the facility and convert any outstanding short-term revolving loans into term loans so long as the exercise of the option creates a term loan maturing no longer than 365 days after the facility termination date. Mr. Goocher testified that Petitioner would like to be able to use these multi-year credit facilities in the future, within the parameters set forth in the Order in Cause No. 42807, if the opportunity arises. However, current expectations are that, due to market conditions, the cost of the facility at renewal will be greater and the tenor of the facility shorter than the existing credit facility. Mr. Goocher stated, given the current state of the financial markets, VUHI and its subsidiaries, including Petitioner, are likely to rely less on bank or commercial paper borrowings and issue permanent financings sooner than in the past, when the markets provide windows of opportunity.

VUHI also provides cash management services to the Participants and financing for critical VUHI assets that support the utility group, such as the call center and customer information system.

7. **Common and Preferred Stock**. Petitioner requests authority to issue and sell additional common stock or preferred stock (including tax-deductible preferred stock) or a combination thereof, for cash, for an aggregate sale price not to exceed $180,000,000. The additional common stock issued by Petitioner will be sold to VUHI. Petitioner will sell any preferred stock, for cash, (i) by way of public offerings or private placements to non-affiliated parties, or (ii) to VUHI in the event VUHI sells its own preferred stock, some or all of the proceeds of which will be allocated to Petitioner. In the event of such a preferred stock sale by VUHI, Petitioner will sell preferred stock to VUHI with terms that match those applicable to the VUHI preferred stock for an amount equal to the proceeds of the VUHI preferred stock sale allocated to Petitioner. Any preferred stock will be sold at a price of not less than the par value per share plus accrued dividends, if any, from the date of issuance to the date of delivery. Mr. Goocher stated that although it is unlikely Petitioner will issue preferred stock during the period of the financing program, it would like to have the ability to do so to take advantage of any market opportunities that may arise during the period of the financing program. Mr. Goocher testified that, to the extent preferred stock is issued, it would likely be in the form of a Cumulative Preferred series or a convertible security. Before issuing any preferred stock pursuant to this authority, Petitioner's Board of Directors will, by resolution, in accordance with Petitioner's Amended and Restated Articles of Incorporation, as amended (the "Articles"), fix and determine the relative rights, preferences, qualifications, limitations and restrictions of each series of preferred stock. Petitioner has a sufficient number of authorized but unissued shares of common stock and preferred stock under its Articles and, therefore, no shareholder action will be required for these transactions.

8. **Timing of Authority.** Petitioner also requests authorization to use, if necessary, the unused available authority granted by the Commission's Order dated November 20, 2007 in Cause No. 43332 (the "2007 Order") as authority to engage in additional financings through the 30-day appeal period applicable to the Order in this Cause, in which event the amount of long-term debt or common equity authorized by this Order will be treated as reduced by the amount of any such financing consummated since the filing of Petitioner's Verified Petition through the end of the appeal period. Petitioner proposes to replace any existing unused authority available under the 2007 Order thirty days after the date of this Order with the new authority granted by this Order. Mr. Goocher explained investors normally will not close on a financing transaction while the Order providing authorization for the transaction is still subject to appeal. Therefore, if the Order in this Cause terminates the existing financing authority as of the date it is issued, Petitioner could be faced with a gap in its ability to issue long-term debt and common stock. To avoid such a gap, Petitioner proposes that the Commission confirm that Petitioner can use the financing authority granted by the 2007 Order during the thirty day appeal period, provided any such issuances are treated as reductions in the authority available from the Order in this Cause. This will allow Petitioner to issue new long-term debt or common stock up to the amount of the unused authority under the 2007 Order during the thirty day appeal period.

9. **Capitalization Ratios.** Mr. Goocher stated that Petitioner seeks to maintain its permanent common equity ratio in the range of 50% to 60%. Petitioner believes that keeping the equity component of its capital structure in this range will allow it to maintain interest coverage ratios, cash flow ratios and other quantitative measures at a level permitting good credit ratings. Mr. Goocher testified maintaining adequate equity levels provides financial flexibility and greater financial market access during adverse business environments and economic conditions. Mr. Goocher's exhibits included a schedule showing Petitioner's actual capital structure as of December 31, 2008 and *pro forma* capital structure reflecting the implementation of the financing program (adjusted for potential retirements of outstanding long-term debt) as follows:

	Actual At 12/31/08		Adjusted For Financing Program	
Description	Amount	Ratio	Amount	Ratio
Long-Term Debt	$554,896,000	48.0%	$731,896,000	48.4%
Common Equity	601,165,000	52.0%	781,165,000	51.6%
Total	$1,156,061,000	100.0%	$1,513,061,000	100.0%

10. **Interest Rate Risk Management Transactions.** Petitioner requests authority to enter into one or more interest rate risk management transactions. Examples of these hedging instruments include forward starting interest rate swaps, treasury rate locks, interest rate caps, collars, floors and other derivative products. Mr. Goocher testified that these instruments are contractual agreements that will allow Petitioner to lock-in an interest rate in advance of completion of a long-term debt issuance, reduce interest rate volatility and mitigate interest rate risk.

11. **Amortization of Issuance and Interest Rate Risk Management Costs.** Mr. Goocher testified that Petitioner proposes to amortize issuance costs and interest rate risk management costs associated with new long-term debt issued pursuant to the authority granted herein over the life of the new debt issue and in the case of interest rate risk management costs associated with currently outstanding debt, over the remaining life of such long-term debt.

Petitioner also proposes to treat the costs associated with the early redemption of debt and any unamortized issuance expense relating to prematurely redeemed debt issues as issuance expense to be amortized over the life of the refinancing issue. Petitioner proposes to account for these costs for book purposes as an increase in its interest expense, and for ratemaking purposes by reflecting the net effect of these transactions in the embedded cost of debt, consistent with its past practice.

12. OUCC's Case-in-Chief. Greg A. Foster, a Utility Analyst for the OUCC, provided the OUCC's financial analysis of Petitioner's proposed two-year financing program for 2009-2011, which includes the proposed issuance of up to $270 Million secured or unsecured long-term debt, as well as the issuance of up to $180 Million of common and/or preferred stock. Mr. Foster's review focused on Petitioner's proposed uses of the proceeds; the interest rate structure; Petitioner's capitalization, earnings and cash flows; and Petitioner's credit ratings.

Mr. Foster noted that Petitioner identified three purposes for which the loan proceeds would be used:

a) Petitioner's ongoing construction program,

b) The potential refinancing of a portion of Petitioner's existing long-term debt, and

c) The need to reduce Petitioner's short-term debt levels, as well as its future reliance on short-term debt.

Mr. Foster testified that the Petitioner is requesting authority to issue up to $270 million in long term debt to bear interest at fixed or variable rates. He indicated that Petitioner currently has $23 Million of unused long-term debt financing authority available under the Order approving its 2007-2009 Financing Program. That authority is to be terminated and replaced by the new long-term financing authority the Petitioner is seeking in this Cause, assuming there is no timely appeal of that Order. Accordingly, if a new debt issuance is made using financing authority still available under Petitioner's 2007-2009 Financing Program before a final Order is issued in this Cause, Petitioner's requested $270 Million long-term debt financing authority and its $180 Million common stock authority would be reduced by any additional amounts Petitioner borrows under its 2007-2009 Financing Program.

Mr. Foster expressed concern over Petitioner's statement that the "[i]nterest rates on the new long-term debt will be determined at the time of issuance, based on the then-prevailing market and economic conditions." Mr. Foster testified that, in light of present market volatility, he expects the new taxable fixed rate debt to have a higher interest rate than Petitioner's current weighted average annual cost of debt, which was 6.14% as of December 31, 2008.

Mr. Foster testified that Value Line Selections and Opinion recently reported that 25/30 year A (Single A) Utility bonds are yielding 5.79%. He acknowledged that the volatility in the financial markets is beginning to show signs of improvement. Therefore, the spread between A (Single A) rated and BBB (Triple B) rated utility bonds is narrowing. Mr. Foster concluded that, although the 6.14% interest rate is somewhat high, it is not outside the realm of reasonableness. However, he went on to state that, if the interest rate on Petitioner's proposed issuance would materially exceed 6.14%, Petitioner should re-evaluate all viable options to attempt to identify a more cost-effective financing alternative.

Mr. Foster indicated that the Petitioner is also seeking authority to enter into contractual agreements in order to mitigate the interest rate risk associated with Petitioner's proposed securities. The OUCC understands the importance of taking steps to mitigate risk and does not oppose such efforts. However, Mr. Foster emphasized the need for Petitioner to prudently exercise such authority whenever such transactions are executed. Mr. Foster specifically reserved the OUCC's right to review Petitioner's financing decisions to determine whether Petitioner's financing transactions were consistent with the authority granted in this Cause and were reasonable and prudent at the time they were made.

Mr. Foster reviewed Petitioner's capitalization, earnings and cash flows, noting that Vectren South has a slightly higher Total Debt/Total Equity Ratio than the average ratio for the peer group used in Mr. Foster's analysis (1.10 vs. 1.02, respectively). Mr. Foster observed that the Petitioner also has a significantly higher Recurring Operating Earnings than the average for the peer group he used ($129 Million vs. $94 Million).

The OUCC's witness then explained his reasons for including certain companies in the peer group used in his analysis. Mr. Foster used data on ten comparable companies, all monitored by the North American Electric Reliability Corporation (NERC). The NERC is a nonprofit corporation formed by the electric utility industry to promote the reliability and adequacy of bulk power supply in the electric utility systems of North America. NERC's major responsibilities include working with all stakeholders to develop standards for power system operation and for monitoring and enforcing compliance with those standards, assessing resource adequacy, and providing educational and training resources as part of an accreditation program to ensure power system operators remain qualified and proficient.

Mr. Foster explained his reasons for selecting specific companies included in the peer group used in his analysis. One of the primary criteria he considered was the value of each company's Total Assets. He selected members of the peer group that had Total Assets ranging from $627 Million to $2.17 Billion, with an average of $1.57 Billion. Vectren South has Total Assets of $1.66 Billion, so its size is reasonably comparable to that of other members of the peer group.

Mr. Foster also checked Petitioner's ratings. Standard and Poor's (S&P) cited a favorable rate design, cost-recovery mechanisms, including decoupling and gas cost adjustments (GCA), as well as low operating risks at the regulated utility segment level as major strengths of Vectren South. Also, Moody's recently upgraded senior secured debt ratings of investment-grade regulated utilities, including Vectren South, based on "analysis of the history of regulated utility defaults, which indicates that regulated utilities have defaulted at a lower rate and experienced lower loss given default rates than non-financial, non-utility corporate issuers." Petitioner's current bond ratings are "A-" for S&P and "Baa1" for Moody's.

Mr. Foster recommended the Commission approve Vectren South's request for financing authority. He indicated that, in light of the above information and the current U.S. financial markets, Petitioner's proposed capitalization appears to be reasonable. Accordingly, Mr. Foster testified the OUCC does not object to the additional requested financing authority or to Vectren

South's proposed December 31, 2011 deadline for exercising that Authority.

Mr. Foster did, however, recommend the Commission cap the amount of variable interest rate debt at a certain dollar level or a certain percentage of Petitioner's requested $270 Million financing authority. In support of that recommendation, Mr. Foster pointed to recent financial problems experienced by Indianapolis Water which were caused in significant part by the large amount of variable interest rate debt it had issued.

Mr. Foster also responded to questions issued in a Docket Entry by the Commission concerning the appropriate level at which to cap Petitioner's variable interest rate debt and provided support for the OUCC's recommendation. Mr. Foster indicated there are many factors, both known and unknown, that must be considered in order to recommend a specific dollar amount or percentage cap on the amount of variable interest rate debt that the Petitioner should be permitted to issue. He identified several known factors (e.g., the amount of cash on hand and cash flow) and several unknown factors (e.g., the ratio of total debt to total equity, whether any derivatives will be used, and the specific type of debt to be issued, including specific pricing terms) that would have to be considered. He also identified the frequency at which variable rate debt re-prices as another factor that affects the amount of variable interest rate debt that would be prudent.

Mr. Foster also noted that variable interest rate pricing, tied to auction rate securities, or similar type markets, tends to be more volatile than if the variable rate were tied to more stable financial benchmarks, such as U.S. Treasury Securities or LIBOR, with LIBOR tending to be more volatile than U.S. Treasury Securities. Mr. Foster presented a Chart depicting the tremendous level of market volatility during the last eighteen months and the relative volatility of LIBOR, the U.S. Prime Rate, and the Fed Funds Target Rate.

Due to the wide range of options encompassed in Petitioner's proposal, Mr. Foster testified that it would be more appropriate to recommend a range on the amount of variable interest rate debt. He observed that Kevin D. Taylor, Executive Director, Indianapolis Local Public Improvement Bond Bank, recently testified before the Commission in Cause 43645 regarding variable interest rate debt, indicating that, as a general rule of thumb, approximately 10% to 20% of a utility's total debt should be variable interest rate debt. Mr. Foster also noted that the OUCC recommended a 25% cap on variable interest rate debt in its Proposed Order in Vectren North's recent financing case, Cause No. 43714.

Based on his analysis, Mr. Foster opined that a range between 10% and 25% would be a reasonable cap on Petitioner's variable interest rate debt. That range would allow sufficient flexibility, without exposing Petitioner and its customers to extreme financial risk if interest rates were to rapidly escalate. Mr. Foster noted that Petitioner currently has $41.25 million of variable interest rate debt out of $556.7 million in total outstanding debt. After another $270 million of long-term debt is issued, Petitioner would have total outstanding debt of $826.7 million. A cap of 25% of variable interest rate debt on the proposed $270 million debt would equal $67.5 million. Therefore, assuming Petitioner's pending financing authority request is approved, the combined variable interest rate debt could be $108.75 million out of a total of $826.7 million, or 13.15% of total outstanding debt. Mr. Foster testified that the result would be within the range of reasonableness proposed by the OUCC.

13. **Petitioner's Rebuttal.** Mr. Goocher submitted rebuttal testimony responding to Mr. Foster's testimony. Mr. Goocher testified that it is not necessary to limit the amount of variable rate long-term debt that can be issued by Petitioner because Petitioner has a long history of properly managing its capital structure. Mr. Goocher said of Petitioner's $557 million in currently outstanding long-term debt, $41 million comprises variable rate demand bonds as a result of tax-exempt debt that was remarketed to investors on March 26, 2009. Mr. Goocher also noted that Petitioner's capital structure at December 31, 2008 includes $601 million of common equity which distinguishes it from Indianapolis Water which, as a municipal utility, finances almost entirely with debt. Mr. Goocher said Petitioner is encouraged to limit the amount of variable rate debt utilized in order to receive optimal credit ratings, as variable rate debt is one of the many factors considered by the credit rating agencies in establishing rating levels.

Mr. Goocher stated managing a company's permanent capital structure to stay within specific targets for debt and equity, as well as the amount of variable rate to fixed rate debt, is difficult because debt and equity issues tend to be "lumpy" to achieve issuance efficiencies and market access. Therefore, capitalization tends to converge to the targeted levels over time as long-term debt issues mature and new debt and equity financings occur. Mr. Goocher said managing capital structure is a dynamic process. He stated it is important to maintain significant flexibility as to the timing, size and type of financings to deal with this "lumpiness" and to be able to timely respond to changing financial market dynamics.

Although he did not believe that it is necessary to limit the amount of variable rate long-term debt, Mr. Goocher asserted that if the Commission decided that such limits are appropriate, the limit should set be at a fairly high level (perhaps 50% of the requested debt authority amount or $135 million) in order to provide Petitioner with financial flexibility to deal with varying market conditions over the long-term and in recognition of Petitioner's history of prudently managing its capital structure over time, including as to the amount of variable rate debt as part of its total capitalization.

Mr. Goocher also said that regardless of the expected interest rates for its financing plans, Petitioner will continue to evaluate various financing alternatives right up to the time of issuances and will implement the strategy that best supports its public utility obligation to provide safe and reliable service to its customers, even if that means issuing long-term debt at interest rates well above the 6.14% effective weighted average interest rate on Petitioner's existing long-term debt.

14. **Discussion and Findings.** The Commission determines that the proposed financing program outlined herein, including all steps contemplated by the financing program, is advantageous and necessary, in the public interest and in the best interest of Petitioner and its customers. The Commission authorizes Petitioner to issue long-term debt and sell common or preferred stock and to enter into interest rate risk management transactions as described above and in Petitioner's petition and evidence. The Commission further authorizes Petitioner to use the unused available authority granted by the 2007 Order as authority to engage in additional financings through the 30-day appeal period applicable to the Order in this Cause, provided that the amount of any such issuance will be treated as a reduction in the amount of long-term debt or common equity authority available under this Order. The Commission approves Petitioner's proposal with respect to the amortization, accounting and ratemaking treatment applicable to issuance, early redemption and interest rate risk management costs and the unamortized issuance costs associated with prematurely redeemed debt issues as described above.

OUCC witness Foster recommended that there be a cap on the amount of the new long-term debt authority that could be issued as variable rate debt. In response to our docket entry of September 17, 2009, Mr. Foster recommended the cap be set at 25% of the new long-term debt authority granted in this proceeding. Mr. Foster based his proposed cap in part on the testimony in Cause No. 43645 of Kevin D. Taylor of the Indianapolis Local Public Improvement Bond Bank. However, we note that Mr. Taylor's testimony, summarized in the Commission's Interim Emergency Order in Cause No. 43645 dated June 30, 2009, referred specifically to municipal utilities in suggesting 10%-20% as an appropriate range of variable rate debt to total debt. *See* Order in Cause No. 43645, p. 5 ("Mr. Taylor also testified that the general rule of thumb is that approximately 10-20% of a municipal utility's total debt should be variable rate debt . . . .").

We agree with Mr. Foster that Petitioner needs to consider the risks associated with variable rate debt, as well as any risk that may be associated with counterparties or offerors of instruments intended to manage interest rate risk. However, we do not agree that the same risks that were present in the case of Indianapolis Water in Cause No. 43645 are present with respect to Petitioner. We agree with Mr. Goocher that the amount of variable rate debt is a factor considered by rating agencies when assigning credit ratings and that Petitioner has the incentive to maintain a good credit rating. The evidence shows Petitioner's only currently outstanding variable rate debt is $41 million in variable rate demand bonds supported by letters of credit that were issued in connection with tax-exempt debt financings. The evidence further shows that Petitioner maintains a financially strong capital structure, which includes a substantial amount of common equity which distinguishes Petitioner from Indianapolis Water and other municipal utilities. Mr. Foster indicated there are many other variables that must be considered in determining an appropriate level of variable rate debt including cash on hand, cash flow, debt to equity ratios, the specific terms of the debt and the use of derivatives. Given these many variables, we are not convinced that the "rule of thumb" for municipal utilities suggested by a witness in the Indianapolis Water case is an appropriate basis for limiting the amount of Petitioner's variable rate debt, particularly given Mr. Goocher's testimony that debt issues tend to be "lumpy" and converge on target ratios over time. We also note that in other recent financing proceedings we have not imposed caps on the amount of variable rate debt that may be issued by other investor-owned utilities.

Based on the record and Petitioner's history of prudent management of its capital structure, we do not believe an arbitrary variable rate debt 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, including decisions to issue variable rate debt, based upon the information available at the time of those decisions.

The Commission confirms that Petitioner continues to be authorized to participate in multi-year credit facilities on the terms and subject to the limitations described in the Order in Cause No. 42807 dated May 11, 2005.

The Commission finds the long-term debt and common equity that Petitioner will have outstanding pursuant to the financing program described herein 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 that the issuance of such securities may have on the management and efficient operations of Petitioner. Petitioner's total outstanding capitalization, when adjusted for the financing program, and the application of the proceeds therefrom, appear to 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 issuance of long-term debt and common and preferred stock pursuant to the financing program is reasonably necessary for the purposes for which such securities may be authorized by the Commission and is in accordance with the provisions of the laws of the State of Indiana relating to the issuance of securities by public utilities. Therefore, the Commission finds that the financing program proposed by Petitioner should be approved and authorized by the Commission.

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

1. Petitioner shall be and hereby is authorized during the period from the date of this Order through December 31, 2011, to carry out and consummate the financing program described herein, including by taking all steps contemplated thereby and by entering into and executing such agreements and instruments as are appropriate therefor.

2. In connection therewith, Petitioner shall be and hereby is authorized to:

   a. issue, sell and deliver up to $270,000,000 in aggregate principal amount of secured or unsecured long-term debt with fixed or variable interest rates, as described herein;

   b. use any unused financing authority granted by the 2007 Order in Cause No. 43332 until expiration of the thirty-day appeal period for this Order, provided any such use shall be treated as reducing the amount of financing authority that Petitioner may issue thereafter pursuant to the authority granted in this Cause;

   c. issue and sell additional common stock or preferred stock or a combination thereof in an amount not to exceed $180,000,000 as described herein;

   d. enter into interest rate risk management transactions as described herein and to treat the costs of such transactions as debt costs to be amortized in the same way as the issuance costs related to the issue to which they apply;

   e. amortize the issuance costs associated with new long-term debt issued pursuant to the authority granted herein over the life of the new issue, to treat the costs associated with any early redemption of any outstanding long-term debt, including any premium and any unamortized issuance expense of any such prematurely retired issues, as debt costs to be amortized over the life of the refinancing issue, and to treat such costs for accounting and ratemaking purposes as described herein; and

f. continue to enter into multi-year credit facility agreements the use of which will not reduce Petitioner's long-term debt authority provided in this or future financing Orders, provided any amounts borrowed thereunder are repaid within 365 days from the date of the borrowing.

3. The foregoing authority shall expire on December 31, 2011 to the extent it has not been utilized by that date. This Order is the sole evidence of our approval and shall constitute a certificate of authority as provided in Ind. Code § 8-1-2-80.

4. Petitioner shall be, and hereby is, required to file with the Commission and serve on the OUCC a written report on each occasion when it exercises its authority to issue long-term debt, preferred stock and common stock authorized by this Order summarizing the type of terms of the financing, including the effective interest rate of any new debt, and the nature and terms of any interest rate risk management transactions relating thereto. Furthermore, within twelve (12) months after the date of the Order and every twelve (12) months thereafter while the authority granted by this Order remains in effect, Petitioner shall file with the Commission and serve on the OUCC an annual report summarizing the extent to which Petitioner made short-term borrowings from VUHI pursuant to the Financial Services Agreement during the prior year and the range of interest rates applicable thereto and attaching copies of any promissory notes signed by Petitioner pursuant to the Agreement since the filing of the prior annual report.

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

HARDY, GOLC, LANDIS, AND ZIEGNER CONCUR; ATTERHOLT ABSENT:

APPROVED: OCT 21 2009

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