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STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF DUKE ENERGY INDIANA,)
INC. FOR APPROVAL OF AUTHORITY FOR)
DEFERRED ACCOUNTING TREATMENT)
FOR OPERATING EXPENSES ASSOCIATED)
WITH THE RESTORATION OF EXTENSIVE)
SYSTEM DAMAGE RESULTING FROM THE)
JANUARY 27, 2009 ICE STORM)

CAUSE NO. 43743

APPROVED:

JUL 14 2010

BY THE COMMISSION:

David E. Ziegner, Commissioner
Scott R. Storms, Chief Administrative Law Judge

On July 22, 2009, Duke Energy Indiana, Inc. (“Duke Energy Indiana”, “Petitioner”, or “Company”) filed its Petition with the Indiana Utility Regulatory Commission (“Commission”) initiating this Cause. In its Petition, Duke Energy Indiana requested approval to utilize deferred accounting treatment for operating expenses associated with the restoration of extensive system damage resulting from a January 27, 2009 ice storm (“Ice Storm”).

A Prehearing Conference was held in this Cause on August 18, 2009, at 9:30 a.m., in Room 224, of the National City Center, 101 West Washington Street, Indianapolis, Indiana. A Prehearing Conference Order was issued by the Commission in this matter on August 26, 2009, which established the procedural schedule in this proceeding.

Pursuant to proper notice of hearing, published as required by law, proof of which was incorporated into the record by reference, a public Evidentiary Hearing was held in this Cause on November 12, 2009, at 9:30 a.m., in Room 222, of the National City Center, 101 West Washington Street, Indianapolis, Indiana. At the Evidentiary Hearing, Duke Energy Indiana offered into evidence its Petition in this Cause and the direct verified testimony and exhibits, of Mr. Jim L. Stanley, President of Duke Energy Indiana. The Petitioner also offered into evidence the direct and rebuttal testimony of Mr. Anthony C. Geswein, General Manager of Electric System Operations; Mr. Danny Wiles, General Manager, U.S. Franchised Electric & Gas Accounting; and Ms. Diana L. Douglas, Director of Rates. The Indiana Office of Utility Consumer Counselor (“OUCC”) offered the testimony of Mr. Greg A. Foster, Utility Analyst in the Electric Division of the OUCC’s Energy Group. All evidence and exhibits were admitted into the record without objection. No members of the general public appeared at the Evidentiary Hearing in this matter.

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

- 1. Commission Jurisdiction and Notice.** Due, legal and timely notice of the Prehearing Conference and Evidentiary Hearing in this Cause was given and published by the

Commission as required by law. Duke Energy Indiana is a public utility within the meaning of Ind. Code § 8-1-2 and is subject to the jurisdiction of the Commission in the manner and to the extent provided by the laws of the State of Indiana. The Commission has jurisdiction over the parties and the subject matter of this Cause.

2. Duke Energy Indiana's Characteristics. Duke Energy Indiana is a public utility corporation organized and existing under the laws of the State of Indiana with its principal office in Plainfield, Indiana, and is a second tier wholly-owned subsidiary of Duke Energy Corporation. Duke Energy Indiana is engaged in rendering electric utility service in the State of Indiana. The Company owns, operates, manages, and controls plant, property, and equipment used and useful for the production, transmission, distribution, and furnishing of electric utility service. Duke Energy Indiana directly supplies electric energy throughout its 22,000 square mile service area to approximately 775,000 customers located in 69 counties in the central, north central, and southern parts of the State of Indiana. It also serves various wholesale customers and provides steam service to one customer from its Cayuga Generating Station.

3. Relief Requested. In its Petition, Duke Energy Indiana requests that the Commission authorize it to utilize deferred accounting treatment, from the effective date of this Order through the effective date of the Commission's Order in Petitioner's next general retail rate proceeding, for operating expenses associated with the Ice Storm allocable to the retail jurisdictional customers and for approval to seek subsequent recovery of such expenses through an amortization in Petitioner's next general retail electric rate proceeding.

4. Petitioner's Case-in-Chief. In his direct testimony Mr. Jim Stanley described two recent severe storm events faced by Duke Energy Indiana. The first was a September 2008 wind storm that was produced from the remnants of the Category 4 Hurricane Ike ("Wind Storm"). The second was an Ice Storm that occurred in January 2009. Mr. Stanley indicated that the Company sustained severe damage to its electric transmission and distribution system as a result of the Wind Storm, with total damages of approximately \$18.6 million. However, Mr. Stanley also indicated that while each storm was significant, Duke Energy Indiana's request in this proceeding was limited to the Ice Storm and that the Company was not seeking deferral of costs associated with the Wind Storm.

With respect to the specific relief requested in this proceeding, Mr. Stanley testified that the Ice Storm in January 2009 ravaged Duke Energy Indiana's service territory, causing major damage to its electrical system. According to Mr. Stanley, the Ice Storm, similar to the Wind Storm, was concentrated in the southern part of the state in Duke Energy Indiana's service areas in the communities of Clarksville, New Albany, Jeffersonville, Corydon and Madison, Indiana.

Mr. Stanley described the unique challenges presented by the Ice Storm in terms of restoring customers' power, including: (1) a reduced pool of available nearby resources to assist in restoration efforts due to neighboring utilities being similarly situated; (2) a heavy snowfall accumulation in central Indiana, making it more difficult to mobilize repair crews; (3) hazardous road conditions due to the snow and ice, with entire roadways closed as a result of trees and limbs falling under the weight of the ice; (4) below freezing temperatures for several days, further hampering repairs; (5) limited hotel availability in southern Indiana for the Company's repair crews due to the similar devastation in Kentucky; and (6) sixty to ninety-minute commutes

for repair crews to the outage areas, which required the Company to lease two large buses and 65 fifteen passenger vehicles to transport repair crews from staging areas to outage areas.

Mr. Stanley testified that in order to restore service to Duke Energy Indiana customers, the Company mobilized its crews and called on employees from its affiliate, Duke Energy Carolinas, together with contractors and crews borrowed from other utilities through Mutual Assistance Groups, working around the clock for five consecutive days. He testified that at the peak of the restoration effort, the Company had 1,890 field response personnel involved in the restoration effort. In addition, Duke Energy Indiana had nearly 400 employees responding to approximately 56,000 customer calls.

Mr. Stanley testified that the total estimated cost (both capital and O&M) to restore the Company's system as a result of the Ice Storm was approximately \$13.6 million. He stated the Company removed from this amount costs charged to capital projects and costs associated with those employees, expenses, etc. that are considered non-incremental and which would be included in base rates currently to arrive at \$11.8 million of incremental operating expenses. He stated Duke Energy Indiana is seeking approval to defer \$11.6 million of the incremental costs that are allocable to retail customers.

Mr. Stanley testified that the severity of the Ice Storm as well as the costs, led management to determine that this expense should be deferred until the next general rate proceeding. He stated that there are no insurance proceeds to offset the Operating Expenses because insurance for this type of business risk is prohibitively expensive. He also testified that the annual on-going level of storm damage expenses included in the Company's current retail electric rates is intended to cover the applicable operating expenses resulting from normal storm damage; this amount is not intended to and is not of sufficient amount to cover the costs resulting from an extraordinary event such as the Ice Storm.

Mr. Stanley further testified that, as the Company has no allowance for extraordinary storms in its base rates, if Duke Energy Indiana did not seek in-between rate case ratemaking treatment for extraordinary expense items like these, then the full costs of such items would be borne by shareholders. According to Mr. Stanley, the Company fully recognizes that the shareholders bear responsibility for some of the unforeseen costs to operate the business and therefore was willing to bear the economic burden of the Wind Storm without seeking special rate recovery. He also noted that Duke Energy Indiana's sister utilities in Kentucky and Ohio did request and receive special ratemaking treatment associated with the Wind Storm. However, notwithstanding Duke Energy Indiana's decision not to seek special rate recovery for the Wind Storm, Mr. Stanley testified that when Duke Energy Indiana's system was hit hard with another extraordinary storm less than four months after the Wind Storm, the Company determined to seek recovery of the incremental operating expenses associated with the Ice Storm. He testified that Duke Energy Indiana believes that a sharing of extraordinary storm damage expense between the Company and customers is an equitable outcome. He stated that in this case, the Company's shareholders are bearing the costs of the more expensive storm.

Mr. Anthony C. Geswein testified that, as Storm Manager for the Ice Storm, he was responsible for Duke Energy Indiana's Control Center Operations and was involved in overseeing and supervising the restoration of the Transmission and Distribution System. Mr.

Geswein testified that the Ice Storm produced an accumulation of up to an inch of ice on Duke Energy Indiana's power lines, causing extensive damage to the electric transmission and distribution system in the Company's southern Indiana service territory. According to Mr. Geswein, in addition to the ice in southern Indiana, the storm dropped more than 12 inches of snow in central Indiana over the three day period beginning January 26, 2009, tying as the sixth largest snowstorm for Indianapolis. Mr. Geswein explained that the snow accumulation made it difficult to mobilize repair crews to assist in southern Indiana and that many state highways were impassable, which led to significant delays in getting material and resources to the areas of need. Mr. Geswein went on to testify that as the storm subsided, a deepening cold weather front moved in, further exacerbating an already very difficult restoration environment. Additionally, during the Ice Storm, prevailing cold temperatures did not allow the ice to melt early in the restoration process. Mr. Geswein explained that as melting began later in the restoration efforts, tree limbs would often spring back and cause additional outages during the melting process.

In his testimony Mr. Geswein compared the damage caused by ice storms with other types of storms, stating that not only does an ice storm result in a significant number of outages and destruction of power lines, poles, crossarms, and transformers, but, in addition, the amount of resources needed to repair the damage is increased due to adverse weather conditions. He stated that unlike a thunderstorm or wind storm, the effects of ice accumulation can last for days and generally the damage to the transmission and distribution infrastructure is far greater due to the numerous limbs and trees that fall into lines and the weight of the ice on the lines. Mr. Geswein explained that power lines coated with ice become extremely heavy, causing the lines and insulators to break while sometimes bringing down entire utility poles. According to Mr. Geswein, as outage cases are repaired in an ice storm, it is common to fix a circuit only to find that there are additional causes of trouble further down the circuit in need of repair. He stated that in this situation what was thought to be one case of trouble often turns out to be three or more cases of trouble after the initial repair, which causes an increase in restoration efforts.

Mr. Geswein testified that his Exhibit B-1 indicates that a significant number of new trouble cases developed every day during the Ice Storm restoration period. According to Mr. Geswein, 45% of the outage cases were discovered or created during the restoration period after the icing event had ended. He also noted that 60% of the cases were resolved on the third and fourth day after the storm subsided when labor concentrations were high and weather conditions were improving.

Mr. Geswein further testified regarding the four storm classification levels used by Duke Energy Indiana to determine the level of activation and support personnel required for a storm or natural disaster. According to Mr. Geswein, under the Company's storm classification system, Level 1 is the least severe and Level 4 is the most severe. Mr. Geswein testified that the Ice Storm was a Level 3 storm causing a significant amount of damage to a large number of customers in the Company's service territory. He explained that with a Level 3 Storm, all available personnel in Line Construction Maintenance are mobilized in addition to the use of non-traditional crews, available contract forces, Duke Energy employees from other areas, and other utility mutual assistance crews, working 16-hour shifts. Mr. Geswein explained that the Ice Storm was categorized as Level 3 rather than Level 4 because it was generally localized in the southern part of Duke Energy Indiana's service territory, as opposed to being more wide-spread throughout its entire service territory. However, with respect to the severity of the

damage in the localized area, Mr. Geswein testified that he believed the Ice Storm was comparable to historical Level 4 storms.

Mr. Geswein testified that Duke Energy Indiana has historically averaged approximately three Level 3 storms in a given year, and a Level 4 storm every three or four years on average. Mr. Geswein compared severe storms Duke Energy Indiana experienced in the last nine years on various storm metrics including: the type of storm, outage count, case count, days to restore, and total storm cost. According to Mr. Geswein, his Exhibit B-3 demonstrates that despite being categorized as a Level 3 storm, the Ice Storm was an extraordinarily severe storm across all of the metrics. He stated that the case count, which better represents the restoration effort, together with the time to restore because of the severe working conditions, and the high cost of the storm, demonstrate that the Ice Storm could be classified as the second worst storm of the decade (with the worst being the 2008 Wind Storm). Mr. Geswein testified that the Ice Storm took a heavy toll on the Company's electric transmission and distribution system, including the destruction of 104 poles, 140 crossarms, over 34,000 feet of cable/wire, 33 transformers, 25 arrestors, 109 cutouts, and required 376 insulators, over 5,000 connectors, almost 10,000 splices and over 2,000 fuses to restore power. He stated that approximately 116,000 of Duke Energy Indiana's customers were without power.

Mr. Geswein testified that Duke Energy Indiana can draw upon several resources, in addition to its direct employees, to solicit assistance during major storm events, including the Regional Mutual Assistance Groups ("RMAGs"). He explained that the RMAGs provide a cooperative, regional approach to identify and mobilize resources in an entire geographical region by allowing for the coordination of resources and the safe and efficient deployment to assist in storm restoration in a timely manner. He stated that there are about nine of these organizations in the United States and Duke Energy participates in three (Great Lakes, Midwest, and Southeastern). Mr. Geswein testified that a total of 422 mutual assistance resources were utilized during the Ice Storm. In addition, he stated that the Company had approximately 892 local resources, 540 resources from Duke Energy Carolina and outside contractors, and 36 off-system tree resources over a five day period for the Ice Storm restoration effort. This equates to a total of approximately 1,890 field resources utilized during the Ice Storm. He stated that the field resources need to have the proper equipment and materials, be assigned to a particular area, and be assigned cases of work to get the maximum number of customers restored in the shortest amount of time. In addition, he said that they need to be fed and housed for the duration of the storm restoration. He testified that for the Ice Storm restoration effort, Company personnel had to coordinate 1,100 hotel rooms in over 36 hotels in 17 communities.

Mr. Geswein testified that during the initial hours of the Ice Storm, Duke Energy Indiana received a few thousand customer calls. He stated that it was on the next day, Wednesday, January 28, that the call center received the majority of its outage reports (almost 86,000 Duke Energy Indiana customers were without electricity on this day). He also stated that on that day the Company had crews arrive from Duke Energy Carolinas and through the RMAGs. He testified that most of Duke Energy Indiana's customers had power restored by Saturday and all customers' service was restored by Sunday evening. Mr. Geswein testified that, in his estimation, if Duke Energy Indiana did not have access to its Duke Energy affiliate and RMAG crews, the restoration period would have more than doubled. He testified that Duke Energy Indiana took advantage of all available resources in order to restore electric service in the most

timely and cost-effective manner possible. He stated that the Ice Storm was an extraordinary storm and an extraordinary restoration effort.

Mr. Danny Wiles testified regarding the types of costs incurred by Duke Energy Indiana in conjunction with the Ice Storm. According to Mr. Wiles, Duke Energy Indiana incurred costs for materials and supplies, such as poles, transformers, fuses, and wire and also incurred costs for the labor and expenses of contracted crews, including line crews, tree crews and crews loaned from affiliated and non-affiliated utilities. Mr. Wiles stated that the Company also incurred internal labor and support expenses, including transportation costs, lodging and meals that were incremental over what would have occurred absent the Ice Storm. Mr. Wiles testified Duke Energy Indiana incurred \$13.6 million in total Ice Storm restoration-related costs. Mr. Wiles testified that some of the costs incurred have been capitalized, which are not subject to the request in this proceeding (approximately \$0.2 million of Ice Storm costs were capitalized). He stated that the Company is also not asking for deferral of payroll taxes and O&M costs that were determined to be non-incremental costs. He testified that of the remaining \$11.8 million in incremental operating expenses, Duke Energy Indiana is requesting deferral accounting treatment for only the retail jurisdictional portion, which is \$11.6 million. He testified that under traditional accounting treatment, the Company would be required to recognize such operating expense currently as charges to operating income.

Mr. Wiles testified that Duke Energy Indiana is requesting that the Commission approve the deferral of the retail jurisdictional portion of the incremental Ice Storm operating expenses using a regulatory asset account (FERC CFR account 182.3) until the recovery of such costs are included in rates in Duke Energy Indiana's next retail electric rate case. Mr. Wiles stated that, in his opinion, deferral of the retail jurisdictional portion of the incremental Ice Storm operating expenses until they can be included in rates will minimize the timing difference between cost recognition on the Company's books and cost recovery. He stated that in order for the Company to defer the expenses and reflect the costs as a regulatory asset, it must be probable that such costs will be recovered through rates in future periods. He said that in order to satisfy the probability standard, the Commission's Order in this proceeding should specifically approve the accounting and ratemaking treatment proposed by Duke Energy Indiana. Mr. Wiles testified that the accounting treatment proposed by Duke Energy Indiana is in accordance with generally accepted accounting principles in the Statement of Financial Accounting Standards ("SFAS"), specifically SFAS 92 and SFAS 71.

Mr. Wiles also testified that in addition to the costs associated with the Ice Storm, Duke Energy Indiana had incurred approximately \$2.8 million of storm damage restoration costs for other major storms for the period January through July 2009. He stated that of that amount, \$2.5 million were incremental operating costs. He also noted that, although the books for August had not yet closed, additional costs were incurred for a Level 3 straight line wind and flooding event that occurred on the system on August 4, 2009, which would bring the incremental operating expenses in excess of the amount included in current retail base rates.

Ms. Diana Douglas, testified that Duke Energy Indiana's current retail rates include an annual amount of \$2.6 million for storm damage restoration expenses for major storms, as approved by the Commission in Cause No. 42359 (Duke Energy Indiana's last retail electric general rate case). According to Ms. Douglas, this amount was based on the actual expenses

incurred during the twelve-month test period ended September 30, 2002, as adjusted for changes that were fixed, known and measurable within twelve months. She testified that the \$2.6 million is the level of major storm operating expense which was included in rates and does not address any capitalized storm restoration costs.

Ms. Douglas further testified regarding how capitalized storm damage restoration costs are handled for ratemaking. Ms. Douglas stated that the net depreciated cost of storm damage restoration costs that have been capitalized and are used and useful at the time of a general rate case is included in the rate base. She said that once that amount is approved, the Company then has the opportunity to recover a return on such investment over the remaining life of the property, together with the recovery of the cost through applicable depreciation expense. Ms. Douglas testified that Duke Energy Indiana is not requesting any special ratemaking treatment for the Ice Storm damage restoration costs that were capitalized. She testified that at the time of the Company's next retail electric general rate case, the net depreciated cost of the capitalized Ice Storm damage restoration costs will be presented for inclusion in rate base the same as any other transmission or distribution plant in service that has been added since the last retail electric general rate case.

In her testimony, Ms. Douglas explained that the annual level of storm damage expenses included in Duke Energy Indiana's current retail electric rates is intended to cover the applicable operating expense resulting from a normal on-going level of major storm damage; it is not intended to cover the costs resulting from an extraordinary event such as the Ice Storm. She stated that in order to include the operating expense associated with such storms in the utility's cost of service, a deferral proceeding such as this one becomes necessary.

Ms. Douglas testified that Duke Energy Indiana does not receive any insurance proceeds to offset the Ice Storm costs. She explained that, with the exception of coastal utilities in hurricane-prone areas, catastrophic transmission and distribution insurance is cost-prohibitive as it carries a \$100 million deductible per incident (meaning that in a year where there are multiple storms, the insurance claims would result in deductibles of \$100 million for each storm). She testified that Duke Energy Indiana's management has determined that insurance against this type of loss has been too expensive and not in the customers' best interest.

Ms. Douglas testified that the determination of the retail jurisdictional share of the incremental operating expenses incurred by Duke Energy Indiana as a result of the Ice Storm was based on the separation study approved in Cause 42359. She stated that almost all direct costs incurred in the Ice Storm were related to distribution facilities, so an allocation factor developed for distribution operation and maintenance expense was used. She went on to say that after adjusting for jointly owned facilities and the wholesale portion of the facilities, retail jurisdictional customers were allocated 98% of the costs.

Ms. Douglas explained that under the Company's proposal for deferral accounting treatment for the incremental operating expenses resulting from the Ice Storm, Duke Energy Indiana's shareholders will carry the cost of the Ice Storm operating expenses until those costs are ultimately recovered by the Company in rates, because the Company is not requesting that the Commission approve the accrual and recovery of financing or carrying costs on the deferred expenses. She stated that by deferring the Ice Storm operating expenses until the next retail

electric general rate case without an accrual of a return or carrying costs thereon and also in carrying the capitalized costs of the Ice Storm until the next retail electric general rate case, Duke Energy Indiana's shareholders are participating in the overall costs of the Ice Storm.

Ms. Douglas also testified that cost deferral would not result in the Company earning more than the return it has been authorized. She stated that given the significant level of under-earning that has been experienced in the relevant periods for the Company's recent fuel clause filings, deferral of the Ice Storm costs is not expected to cause the Company to earn more than its authorized return. She further stated that it is likely the Company will continue to significantly under-earn until its next retail general electric rate case.

Ms. Douglas testified that if Duke Energy Indiana's deferral accounting treatment is denied, the Company would be required to charge the Ice Storm operating expenses, extraordinary costs that were reasonably incurred to restore service to customers, against earnings and shareholders' equity. She stated that in effect, the Company's shareholders would become guarantors against such extraordinary operating risks. If the deferral accounting treatment is approved by the Commission, Ms. Douglas stated that the Company will propose amortization of the deferral amount over a reasonable period of time as part of its next retail electric general rate case.

5. OUCG's Direct Testimony. Mr. Foster testified in his direct testimony that his understanding of Ind. Code § 8-1-2-68 was that the Commission could not set a utility's rates retrospectively, but only for the future. However, Mr. Foster stated that an exception to this general prohibition has been recognized, allowing for future rate adjustments for past expenses flowing from an extraordinary storm. According to Mr. Foster, in order for a storm to qualify as an "extraordinary storm" the Commission determined in Cause No. 39195 (*Ind. Util. Reg. Comm'n*, February 26, 1992) that it need not necessarily be unprecedented, but must clearly be among the worst encountered. Mr. Foster testified that the Ice Storm was classified by the Company as a Level 3 storm. He stated that because there have been three Level 4 storms since 2001, this fact alone indicates that the Ice Storm, although severe, was not among the most severe and should not be entitled to extraordinary regulatory treatment.

Accordingly, Mr. Foster testified that he believes that Duke Energy Indiana's proposal represents single-issue ratemaking and should not be allowed. According to Mr. Foster, Duke Energy Indiana has picked out one single expense incurrence, which was larger than projected at the time of its last base rate case, and has asked that it be allowed to retroactively recover this past expense in its next rate case. Mr. Foster stated that Duke Energy Indiana makes no mention of other expense levels set in its last rate case that may not have materialized or may be less than it otherwise projected. Mr. Foster also testified that Duke Energy Indiana ignores decreases in the cost of capital that may have occurred since the time of its last base rate case and wants to track an increase in storm damage expense without presenting any evidence as to how its other expense components or return components may have changed since the Company's last base rate case.

Mr. Foster testified that Duke Energy Indiana is well compensated for the risk of its business and ratepayers should not have to pay more as a result of the Company's retroactive and single-issue ratemaking proposals. He testified that Duke Energy Indiana's current retail rates

include an annual amount of \$2.6 million for storm damage and restoration expenses. He also stated that the Company is compensated for the operational risk as reflected in its 10.5% authorized return on equity (“ROE”) approved by the Commission. He stated that Duke Energy Indiana’s authorized ROE currently represents a premium of approximately 732 basis points relative to risk free ten-year U.S. Treasury securities.

6. Duke Energy Indiana’s Rebuttal Testimony. Mr. Geswein disagreed with Mr. Foster’s contention that the Ice Storm does not qualify as an extraordinary storm. He stated that Duke Energy Indiana’s storm level classifications, although important in organizing the initial response to a storm, cannot be the overall determining factor as to the ultimate severity and overall impact to Duke Energy Indiana’s system. According to Mr. Geswein, the Company’s storm classification levels are “guidelines” used by the Company to determine the level of activation and support personnel required at the storm’s *onset* and that the Company generally does not revisit a storm classification level after the initial determination, even though additional information may support a revision.

Mr. Geswein testified that a storm is classified based on the Company’s determination of the initial affected geographic area together with the predicted number of customer outages. He stated that the geographic footprint of the Ice Storm was contained to the southern portion of Indiana. In order for the storm to have been classified as Level 4 for response purposes, he stated that it needed to have caused an overwhelming amount of damage over a major portion, if not all, of Duke Energy Indiana’s service territory. According to Mr. Geswein, at the time the Ice Storm was classified as a Level 3 storm, the full extent of the damage to the system and resulting number of outage cases was not yet realized. He explained that a significant number of new trouble cases developed every day during the Ice Storm restoration period, resulting in a much higher outage case count than initially anticipated when the storm was classified as a Level 3.

Mr. Geswein further testified that the Wind Storm was clearly the worst storm damage encountered by Duke Energy Indiana in terms of total customer outages, total case count, and restoration costs. Mr. Geswein did not dispute that the Ice Storm, by itself, was not the worst storm damage ever encountered by the Company. However, he did testify that what makes this case unique is the unprecedented occurrence of the Wind Storm and Ice Storm within four months of each other. He stated that, to his knowledge, Duke Energy Indiana has never encountered, over a six month period, 500,000 customer outages, and almost 11,000 case counts, with a combined total restoration cost to Duke Energy Indiana’s system of more than \$32 million. According to Mr. Geswein, the fact that these two extremely severe storms occurred virtually back-to-back is clearly extraordinary and unprecedented for Duke Energy Indiana.

Mr. Wiles testified that he does not believe Duke Energy Indiana’s request for deferral of storm costs is prohibited retroactive ratemaking because, as Mr. Foster recognized, a commonly held exception exists for expenses flowing from an extraordinary storm event. Mr. Wiles further testified that U.S. Generally Accepted Accounting Principles (“GAAP”) explicitly provide for the creation of a regulatory asset when costs have been incurred in one period but will be recovered in a subsequent period. According to Mr. Wiles, the reason the Financial Accounting Standards Board’s (FASB”) Accounting Standards Codification (“ASC”) 980 on Regulated Operations (which includes guidance that was in SFAS 71 prior to the FASB’s codification of

U.S. GAAP in September 2009) exists is because regulators often allow, or require, recovery of costs in period(s) other than the period in which those costs are incurred.

Mr. Wiles testified that the accounting rules clearly anticipate that regulatory commissions would make determinations that costs should be deferred after the costs are incurred and that storm damage expenses are one type of incurred cost that is eligible for deferral under ASC 980. Mr. Wiles testified that Duke Energy Indiana's regulated affiliates in Ohio and Kentucky have been granted approval to defer storm costs resulting from Hurricane Ike. However, in order for the Company to defer the expenses and reflect a regulatory asset, it must be probable that such costs will be recovered through rates in future periods.

Ms. Douglas testified that Mr. Foster's concern that the Company "had picked out one single expense incurrence, which was larger than projected at the time of its last base rate case" which may have been offset by decreases in other expenses or return components is unfounded. She stated that the "expense test," as described in I.C. § 8-1-2-42(d)(2), requires a showing that actual increases in jurisdictional fuel costs have not been offset by decreases in other jurisdictional operating expenses. She explained that her Exhibit G-1, which is the Company's most recent expense test from its fuel clause proceeding using data from the 12 months ended August 31, 2009, was modified to separately identify the incremental major storm damage expenses. She testified that Exhibit G-2 shows that actual increases in jurisdictional major storm damage expenses have not been offset by decreases in other jurisdictional operating expenses. Ms. Douglas further testified that this would have been the case for the 12 months ended February 28, 2009 and May 31, 2009 if those fuel clause test periods had been chosen for analysis.

Ms. Douglas also testified that the "return test" required in the Company's FAC filings can be used to test whether the utility is earning a return in excess of the return authorized by the Commission in the last proceeding in which the base rates and charges were approved. She explained that in the Company's most recent fuel clause proceeding, the Company's retail jurisdictional electric operating income for the twelve months ended August 31, 2009, was \$139 million less than the authorized income, as adjusted for the phase-in of amounts approved in the Company's environmental and IGCC proceedings. She testified that the Company was also earning less than its adjusted authorized return in prior FAC proceedings, which covered the other twelve month ended test period that would have included the January 2009 storm costs. She concluded that Mr. Foster's concern about single-issue ratemaking and whether Ice Storm expenses have been offset by decreases in other expenses or return components is not valid and should not be a reason to deny the Company's request.

Ms. Douglas went on to testify that the amount included in the Company's current base rates do not cover the costs of an extraordinary storm event such as the Ice Storm or Wind Storm. According to Ms. Douglas, if the Commission determines that deferral of expenses related to extraordinary storm damage restoration efforts is not appropriate for recovery between rate cases, and such expenditures are not otherwise included in base ratemaking as a normal on-going level of storm restoration expense, then a disincentive to take extraordinary measures to restore power to customers could be created. According to Ms. Douglas, Duke Energy Indiana agrees that it is prudent to take extraordinary measures during extraordinary storm events and that restoring service as soon as reasonably possible should be the Company's number one

priority. Duke Energy Indiana believes that there should be a reasonable expectation that the cost of restoring service during these extraordinary events will be recovered as part of the normal course of business. Ms. Douglas testified that the Company agrees with Mr. Foster that test period expenses used to establish base rates should include an amount to specifically cover the cost of abnormal or extraordinary storms that may occur in the future, and there are a number of ways to accomplish this result. She testified that Duke Energy Indiana plans to propose a workable alternative in its next retail electric base rate case that will address the issue on a prospective basis.

Ms. Douglas testified that although the “regulatory compact” embedded in regulation and ratemaking provides that regulated utilities should be allowed to recover prudent and reasonable costs of providing service to customers, and that the utility should have the opportunity to earn a fair and reasonable return, the evidence is uncontroverted that Duke Energy Indiana is not currently earning a fair and reasonable return. She stated that even if Duke Energy Indiana were earning its authorized return, which it is not, two major storms with this level of devastation and expense impact within a four month period is extraordinary and, according to Ms. Douglas, falls outside the risk premium included in the authorized return.

7. **Commission Analysis and Conclusion.** The issues in this case demonstrate the financial risk that storm events can present to investor owned electric public utilities, which have an obligation to provide reasonable and adequate service to customers in their monopoly service territory. In many such instances, fulfillment of this obligation during and following storm events can only be met by extraordinary efforts that oftentimes come at an extraordinary expense. Within this backdrop of uncertainty, is a defined average amount within a utility’s base rates to cover storm related expenses that may occur from year to year. As with any standard approach to a variable issue, the amount imbedded in rates to meet this obligation works well within certain parameters but may act to over or under compensate a utility from year to year based on the frequency and severity of storm events. Under such an approach, it is well recognized that the risk and benefit of over or under recovery is shared by the ratepayers and the shareholders based on the rate structure approved by the Commission in the utility’s last rate case.

It is within this context that Duke Energy Indiana filed a request in this proceeding to defer expenses associated with the Ice Storm. As stated in its Petition, and throughout its testimony, Duke Energy Indiana was faced with two extreme storm events within a four month period. The Wind Storm was classified by the Company as a level 4 storm and the Ice Storm was initially classified as a level 3 storm. When taken in combination, the Wind Storm and the Ice Storm resulted in over 500,000 customer outages and restoration costs of more than \$32 million. In this proceeding Duke Energy Indiana has requested deferral of \$11.6 million of the total incurred Ice Storm restoration related cost of \$13.6 million, which is the retail jurisdictional portion of incremental operating expenses resulting from the Ice Storm.

In Petitioner’s last base rate proceeding, the Commission approved the inclusion in retail rates of an annual amount of \$2.6 million for storm damage restoration expenses. The contrast between this amount and the amounts expended for the two storm events provides a degree of insight into the financial impact that the two storm events had on the Company. As discussed at length in this proceeding, although a general rate proceeding is the appropriate time to establish

the level of storm damage expense in base rates to recover typical storm damage restoration expense, this amount is not intended to address extraordinary storm events. A utility does not have the opportunity to recover extraordinary expenses already incurred unless the Commission permits a deferral until the time of the next general rate proceeding.

As discussed in the testimony presented in this matter, the OUCC indicates that Petitioner's request to defer expenses associated with the Ice Storm should be denied as it constitutes single issue ratemaking. In addition, the OUCC contends that the request, if granted, would constitute retroactive ratemaking in violation of Ind. Code § 8-1-2-68.

Retroactive and Single Issue Ratemaking

With respect to the issue of retroactive ratemaking, Indiana courts have long held that past losses of a utility cannot be recovered from consumers and in turn that consumers may not claim a return of excessive profits and earnings from the utility. The chance of a loss or profit from operations is one of the risks a business enterprise must take. This requires the utility to bear losses and allows the utility to reap gains depending upon its managerial efficiency and how it weathers economic uncertainties after rates are fixed. *See Pub. Serv. Comm'n v. City of Indianapolis*, 131 N.E.2d 308, 315 (Ind. 1956). The prohibition against retroactive ratemaking is intended to protect the ratepayers by ensuring that present customers will not be called upon to pay for past deficits in their future bill and to prevent the utility from employing future rates as a means of ensuring the investments of the stockholders. *In re PSI Energy, Inc.*, Cause No. 39195, 1992 Ind. PUC LEXIS 44, at *17 (Ind. Util. Regulatory Comm'n Feb. 26, 1992) ("1992 Storm Case").

Single issue ratemaking occurs when a utility's rates are altered on the basis of only one of numerous factors that are considered when determining the revenue requirements of a regulated utility. The Commission must consider all relevant factors, including all operating expenses and the utility's rate of return, when determining a rate authorization. Single issue ratemaking is disfavored because, between general base rate filings, there are many revenues and expenses that can fluctuate and change. "Making mid-course rate corrections looking at only one item of revenue or expense carries great risk of producing distorted or false results." *Pet. of Ind. Mich. Power Co.*, Cause No. 39314, 1993 Ind. PUC Lexis 460, at *378 (Ind. Util. Regulatory Comm'n Nov. 12, 1993).

While the Commission is generally prohibited from engaging in retroactive ratemaking, there are recognized exceptions. Most notable is through GCA and FAC proceedings, which are pursuant to statutory mandates. *See Ind. Gas Co. v. Util. Consumer Counselor*, 575 N.E.2d 1044, 1052 (Ind. Ct. App. 1991) (concluding the prohibition against retroactive ratemaking does not apply to GCA proceedings). The Commission has also recognized an exception under SFAS 71, Accounting for the Effects of Certain Types of Regulation, which provides rules addressing when certain regulated entities are permitted to defer costs that would otherwise be charged to expense in the period incurred. *Verified Joint Pet. of Duke Energy Ind., Inc., et al.*, Cause No. 43426, 2008 Ind. PUC LEXIS 388, at *68-70 (*Ind. Util. Regulatory. Comm'n*, Aug. 13, 2008) (approving deferral of MISO costs on an interim basis) (citing *In re Joint Pet. of PSI Energy, Inc. and Vectren Energy Delivery of Ind., Inc.*, Cause Nos. 42257 and 42266, 2002 Ind. PUC LEXIS 571 (*Ind. Util. Regulatory. Comm'n*, Dec. 11, 2002)).

In prior cases before this Commission, we have denied requests similar to Duke Energy Indiana's request in this case. However, in *Petition of Indiana Michigan Power Company*, we established certain elements by which a utility might receive approval for deferral for such an extraordinary request:

[W]e do not believe that there may never be occasion to allow an adjustment of a substantial expense or revenue item between rate cases, in some fashion, whether through the use of an FAC or GCA quarterly adjustment, or through deferred amortizations as PSI requested [in the 1992 Storm Case] after sustaining significant storm damage. In considering such requests, it is necessary to consider the balance struck between the utility and its ratepayers by approving such a request. For example, the gravity of the financial event involved and its impact upon the utility is appropriate to consider, as well as the impact such accounting and/or ratemaking treatment will have upon the utility's ratepayers. Further, it is necessary for the utility requesting such extraordinary treatment to be able to demonstrate with convincing evidence that the financial event is in fact occurring, and that such financial impact is fixed, known and measurable. If all of these elements are established, a utility might receive approval for such an extraordinary request.

Cause 40980, 1998 Ind. PUC LEXIS 424, at *13-14 (*Ind. Util. Regulatory. Comm'n*, Nov. 12, 1998).

Analysis of Specific Facts in the Present Proceeding.

Based on the foregoing, the Commission recognizes that the general prohibition against retroactive ratemaking prevents recovery of costs incurred as a result of a severe storm event absent a finding by the Commission that the storm for which cost recovery has been requested rose to a level so extraordinary as to merit an exception to the rule. If this finding is made by the Commission, the exception under SFAS 71 permitting the deferral of costs that would otherwise be charged to expense in the period incurred would apply to the costs of the Ice Storm.

As discussed by the parties, in the 1992 Storm Case, PSI came before this Commission seeking a deferral of storm related costs flowing from an ice storm that occurred in 1991. Based on the facts presented in that proceeding, the Commission denied PSI's request based on its determination that it violated the prohibition against retroactive ratemaking. Although the Commission noted some other jurisdictions had found an exception to the general prohibition for "past extraordinary expenses flowing from an extraordinary storm," 1992 Storm Case at *17 (citing *Narragansett Elec. Co. v. Burke*, 415 A.2d 177, 178 (R.I. 1980)), it did not find that the facts presented in the 1992 Storm Case merited an exception to the rule. *Id.* at *24-25.

While our findings in the 1992 Storm Case provide useful guidance, deferral requests under this provision are considered by the Commission on a case-by-case basis to ensure that exceptions to the general prohibition against retroactive ratemaking are only approved in a manner that comports with the specific facts presented in a proceeding and sound regulatory policy. Accordingly, while our decision in the 1992 Storm Case may guide us generally in our

consideration of the issues presented in this matter, it need not predict the outcome if the facts in this proceeding merit an exception to the general prohibition against retroactive ratemaking in a manner consistent with *Narragansett*.

As an initial matter we note that the issues in this proceeding, taken in total, are different than the facts considered by the Commission in the 1992 Storm Case. The testimony presented in this proceeding demonstrates that although the Ice Storm, by itself, was not the worst storm damage ever encountered by the Company, the unprecedented occurrence of the Wind Storm and Ice Storm within a four month period at a collective cost of \$32 million makes this case unique. Although the Company has limited its request in this matter to recovery of the costs related to the Ice Storm, reviewing the overall financial impact caused by both storms is relevant to our consideration of the issues in this matter.

In reviewing the facts presented in this case, we note that Duke Energy provided retail jurisdictional storm damage restoration incremental operating and maintenance costs for the Ice Storm in the amount of \$11.6 million, to support a determination that the expense is fixed, known and measurable. We further note that Duke Energy Indiana presented evidence in which it indicated, based on the FAC “expense test,” that actual increases in jurisdictional major storm damage expenses have not been offset by decreases in other jurisdictional operating expenses and that the FAC “return test,” reflects that the Company is not earning a return in excess of the return authorized by the Commission in its last rate proceeding. While we find that the testimony presented in this matter supports a determination that the expense associated with the Ice Storm is fixed, known and measurable, we find Duke Energy Indiana’s argument with respect to current earnings, couched in the context of an analysis presented in a FAC proceeding, less persuasive.

The Commission addressed issues regarding the examination of earnings within an FAC proceeding in *Application of Indianapolis Power & Light* and found:

[W]hether a utility is over- or under-earning during the FAC test period in a specific FAC has no direct correlation to the reasonableness of the utility's basic rates and charges. Instead, the earnings test is merely a mechanical test performed to comply with statutory requirements for determining whether the legislative “cap” on the recovery of fuel costs has been exceeded and if a reduction in the otherwise applicable FAC factor is warranted. This holds true even with the addition of the “earnings bank” established by the legislature in 1995 at Ind. Code § 8-1-2-42.3. The earnings bank merely allows a utility to “bank” their losses in order to offset future gains so as to provide a measure of symmetric treatment of over- and under-earnings in the FAC earnings test computations.

Cause No. 38703 FAC 80, 2008 Ind. PUC LEXIS 356, at *14-15 (*Ind. Util. Reg. Comm’n*, Aug. 27, 2008).

The Commission has also noted GCA and FAC proceedings are governed by nearly identical statutory language. In considering this issue *In re Application of Indiana Gas Co.*, the Commission noted:

[W]hile a gas cost adjustment proceeding results in revised rates for services, there is no total consideration of Petitioner's expenses, rate base or fair return. The legislature did not establish the GCA mechanism to lengthen the time between basic rate cases per se but the mechanism was established because general rate cases could not be processed quickly enough in many cases to prevent significant harm to a utility. The legislature did limit the application of the GCA mechanism by requiring a reduction in the gas cost change if such a change would result in a utility earning a return in excess of the return authorized in the utility's last general rate case. All of these factors - the expedited nature of the hearing, the consideration of a single factor such as the cost of gas without consideration of other rate making items and the cap on the use of the procedure if excessive earnings resulted - support the contention that the GCA procedure is an exceptional usage, not a normal rate making action.

Cause No. 37394 GCA 23, 1989 Ind. PUC LEXIS 313, at *33-34 (*Ind. Util. Reg. Comm'n*, Aug. 30, 1989).

Our prior consideration of the appropriate use and specific purpose of FAC and GCA proceedings supports a conclusion that FAC proceedings have statutory limitations due to their summary nature, expedited schedule, and limited purpose and are not intended to be mini rate cases. *See Petition of S. Ind. Gas and Electric Co.*, Cause No. 37506, 1984 Ind. PUC LEXIS 446, at *7 (Pub. Serv. Comm'n of Ind. July 11, 1984). However, for the limited purpose for which this information has been presented in this proceeding, we can conclude this constitutes evidentiary support for Duke Energy Indiana's contention it is unlikely to have overearnings in the future.

In the present proceeding we find that the Petitioner has demonstrated the gravity of the financial event involved and its impact upon the utility as well as the impact such accounting and ratemaking treatment will have upon the utility's ratepayers. Further, the evidence presented in this matter demonstrates that the financial event did occur and that the financial impact is fixed, known and measurable. Accordingly, the central issue that remains is whether the Ice Storm was so extraordinary as to warrant the relief requested in this Cause.

Courts have noted that extraordinary expenses flow from an extraordinary storm. "An extraordinary storm is not necessarily an unprecedented one, but one that happens so rarely that it is unusual and not ordinarily to be expected." *Spitzer v. City of Waterbury*, 154 A. 157, 160 (Conn. 1931). Indiana courts have recognized the prohibition on retroactive ratemaking protects consumers from past losses of a utility while also preventing customers from claiming a return of excessive profits and earnings from the utility. As the loss or profit from operations is one of the risks a utility must take, this acts as an incentive to encourage managerial efficiency as a utility can reap gains based on how it weathers economic uncertainties after rates are fixed. *See Pub. Serv. Comm'n*, 131 N.E.2d at 315.

While the prohibition on retroactive ratemaking is a useful tenet with respect to utility regulation, it is not to be blindly applied without consideration of the underlying policy that originally precipitated its adoption in a manner that undermines its original purpose.

Narragansett, 414 A.2d at 178. The prohibition against retroactive ratemaking plays a role in protecting customers from paying a utility’s past operating deficit; however, this aspect of the rule must be weighed against the interest in providing immediate service to customers when responding to an extraordinary storm event. On such occasions, the public interest in quickly restoring heat and electricity to the homes of customers must prevail. *Id.* at 179. Courts have also recognized that it is difficult to perceive how the future efficiency of the utility would be furthered by the application of the rule against retroactive ratemaking to prevent recovery of expenses associated with unforeseen extraordinary storms. *Id.* Courts and utility regulatory commissions have followed this approach and have considered exceptions to the general prohibition against retroactive ratemaking to allow recovery of extraordinary costs associated with unusually severe storms, recognizing the rule against retroactive ratemaking does not come into play in such instances. *Id.* (citations omitted).

Unlike the 1992 Storm case, the request in the present proceeding is the product of the overall expenses from the two most damaging storms in a decade occurring within a four-month period. In considering the request in this matter we find the testimony persuasive that the unprecedented magnitude and proximity in time between the two storm events created an extraordinary situation. While the total expense associated with both storm events is more than \$32 million, Duke Energy Indiana’s request is for approval to defer \$11.6 million in retail jurisdictional incremental operating expenses resulting from the Ice Storm. Such an approach recognizes the substantial cost and severity of both storms while attempting to strike a reasonable balance between the utility’s shareholders and customers. We find such an approach to be reasonable based on the specific facts presented in this case.

The following table depicts the impacts of the Wind and Ice Storm based on the testimony presented by Duke Energy Indiana witness Stanley in this Cause:

| Storm | Date | Total Affected Customers | Duration (days) | Peak Customers w/o Power | Peak Field Resources | Call Center Employee Peak | Number of Calls | Cost (Capital and O&M) | Requested to be Deferred |
|------------|-----------|--------------------------|-----------------|--------------------------|----------------------|---------------------------|-----------------|------------------------|--------------------------|
| Wind Storm | 9/14/2008 | 383,000 | 9 | 212,000 | 1,456 | 500 | 142,000 | \$18,600,000 | \$0 |
| Ice Storm | 1/27/2009 | 116,000 | 5 | 86,000 | 1,890 | 400 | 56,000 | \$13,600,000 | \$11,600,000 |

Based on the evidence presented in this matter we find that the facts presented regarding the Ice Storm, in the context of a utility faced with two major storm events in a four month period at a collective cost of \$32 million, rises to the level of extraordinary and justifies an exception to the general prohibition against retroactive and single issue ratemaking. Accordingly, we hereby authorize Duke Energy Indiana to utilize deferred accounting treatment, from the effective date of this Order through the effective date of the Commission’s Order in Petitioner’s next general retail rate proceeding, for the lesser of the actual amount or \$11.6 million in Ice Storm Operating Expenses allocable to the retail jurisdictional customers. Notwithstanding this conclusion, the Commission does not reach a determination in this Cause regarding the reasonableness of the deferred amount. The Commission will consider the reasonableness and appropriateness of any actual recovery of the amount deferred in this

proceeding in the Petitioner's next rate case in which all parties may present evidence with respect to the issue.

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

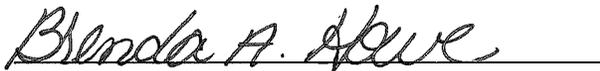
1. Duke Energy Indiana's request to utilize deferred accounting treatment, from the effective date of this Order through the effective date of the Commission's Order in Petitioner's next general retail rate proceeding, for the lesser of the actual amount or \$11.6 million in Ice Storm Operating Expenses allocable to the retail jurisdictional customers is hereby approved by the Commission.

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

ATTERHOLT, LANDIS, MAYS AND ZIEGNER CONCUR; HARDY ABSENT:
APPROVED:

JUL 14 2010

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



Brenda A. Howe

Secretary to the Commission