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STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

IN THE MATTER OF THE VERIFIED)
PETITION OF INDIANA MICHIGAN POWER)
COMPANY FOR APPROVAL OF AN)
ADJUSTMENT TO ITS RATES THROUGH)
ITS ENVIRONMENTAL COMPLIANCE COST)
RIDER ADJUSTMENT FOR THE BILLING)
MONTHS OF APRIL 2010 THROUGH MARCH)
2011 PURSUANT TO THE COMMISSION'S)
ORDER IN CAUSE NO. 43306.)

CAUSE NO. 43856

APPROVED: JUN 23 2010

BY THE COMMISSION:

James D. Atterholt, Commissioner
Loraine L. Seyfried, Administrative Law Judge

On February 9, 2010, Indiana Michigan Power Company (“Petitioner,” “Company” or “I&M”) filed a Verified Petition for an Environmental Compliance Cost Rider Adjustment with the Indiana Utility Regulatory Commission (“Commission”) for the billing months of April 2010 through March 2011, pursuant to the Commission’s Order in Cause No. 43306. I&M filed its direct testimony and exhibits on February 9, 2010.

I&M filed supplemental testimony and exhibits on March 15, 2010. On April 1, 2010, I&M Industrial Group (“Industrial Group”), an ad hoc group of industrial customers located in the electric service territory of I&M, filed its Petition to Intervene, which was granted by docket entry dated April 13, 2010.¹ The OUCC filed its direct testimony and exhibits on April 28, 2010. Also on April 28, 2010, I&M filed second supplemental testimony and revised exhibits. On May 5, 2010, I&M filed its rebuttal testimony and exhibits. On May 14, 2010, the OUCC filed revised testimony and exhibits.

Pursuant to notice given and published as required by law, proof of which was incorporated into the record of this Cause by reference and placed in the official files of the Commission, a public hearing was held on May 14, 2010 at 10:30 a.m. EDT in Room 224, National City Center, 101 W. Washington Street, Indianapolis, Indiana. Petitioner, the OUCC and the Industrial Group participated in the hearing. No members of the general public appeared. At the hearing, Petitioner and the OUCC offered their respective prefiled testimony and exhibits, which were admitted into evidence without objection. Also admitted into evidence without objection was I&M’s responses to questions posed in a Docket Entry dated May 11, 2010.

The Commission, based upon the applicable law and the evidence presented herein, now finds as follows:

¹ The I&M-Industrial Group included Air Products & Chemicals, Inc., Arcelor Mittal USA, Hartford City Paper, LLC, Marathon Petroleum Company, LLC, Praxair, Inc. and The Linde Group.

1. **Notice and Jurisdiction.** Proper notice of the public hearing in this Cause was published as provided by law. Petitioner is a public electric generating utility and is subject to the jurisdiction of the Commission. This Commission has jurisdiction over Petitioner and the subject matter of this proceeding in the manner and to the extent provided by the laws of the State of Indiana.

2. **Petitioner's Organization and Business.** I&M, a wholly-owned subsidiary of American Electric Power Company, Inc. ("AEP"), is a corporation organized and existing under the laws of the State of Indiana, with its principal offices at One Summit Square, Fort Wayne, Indiana. I&M is engaged in rendering electric service in the State of Indiana and owns, operates, manages and controls plant and equipment within the State of Indiana that are used for the generation, transmission, distribution and furnishing of such service to the public.

3. **Background.** In Cause No. 43306, I&M proposed, among other things, an Environmental Compliance Cost Rider to track net emission allowance costs. The Commission approved in its March 4, 2009 Order in Cause No. 43306 ("43306 Order"), the Environmental Compliance Cost Rider as set forth in the Settlement Agreement in that Cause. Under the Environmental Compliance Cost Rider, I&M tracks net emission allowances for purposes of seeking cost recovery from I&M's retail electric customers on an annual basis. The initial Environmental Compliance Cost Rider factors were established pursuant to the 43306 Order.

4. **Petitioner's Request.** In its Verified Petition, Petitioner seeks Commission approval for an Environmental Compliance Cost Rider Adjustment for the billing months of April 2010 through March 2011, pursuant to the 43306 Order. This is I&M's first annual Environmental Compliance Cost Rider Adjustment petition. In accordance with the timing provided in the 43306 Order, I&M's proposed Environmental Compliance Cost Rider ("ECCR") includes the reconciliation of actual costs from March 23, 2009 through November 30, 2009 and a projection of environmental compliance costs for a forecast period of April 1, 2010 through March 31, 2011. Future ECCR Adjustment petitions will also reconcile actual environmental compliance costs experienced during a preceding twelve month period and will reflect projected environmental compliance costs. Petitioner's Verified Petition originally requested carrying costs for emission allowance inventories in excess of the inventory level included in base rates. Petitioner subsequently agreed to exclude carrying costs on emission allowance inventories. Therefore we need not address this issue further herein.

I&M Witness Scott Krawec stated that the initial ECCR was designed to recover \$8.5 million of Indiana jurisdictional annual environmental compliance costs. He stated that the ECCR consists of two components. The first component is a projection of environmental compliance costs for the forecast period. The second component is a reconciliation of actual jurisdictional environmental compliance costs to actual billing under the ECCR for the period March 23, 2009 through November 30, 2009 (the "reconciliation period"). Mr. Krawec stated the reconciliation component of the ECCR adjusts for the difference between the amount recovered during the months in which the ECCR factor was in effect and the actual costs incurred during that time period.

Mr. Krawec stated that beginning March 23, 2009, I&M has deferred monthly, as a regulatory asset, any under-recovery of ECCR costs and, as a regulatory liability, any over-recovery of ECCR

costs for future recovery or refund, respectively, through the yearly true-up for the ECCR factor to actual results. He stated the under or over-recovery is calculated by comparing revenues collected from the ECCR to actual environmental compliance costs. He stated if the ECCR revenues are less than the environmental compliance costs, I&M records the under-recovery as a regulatory asset; and if the ECCR revenues are greater than the environmental compliance costs, I&M records the over-recovery as a regulatory liability.

Mr. Krawec's Second Supplemental testimony indicates that for the reconciliation period, I&M has under-recovered \$2,003,861. Petitioner's Second Revised Exhibit SMK-1. Mr. Krawec provided a detailed list of I&M's accounts included in the ECCR. Petitioner's Exhibit SMK-2. Mr. Krawec explained how the ECCR factor is calculated. He stated the forecast component of \$10,458,130 is added to the reconciliation component of \$2,003,861. The total of \$12,461,991 is then divided by the projected billing energy to arrive at an ECCR rate per kWh of \$0.000931. Petitioner's Second Revised Exhibit SMK-3.

Mr. Krawec stated I&M is requesting to implement an increase in the ECCR factor. The factor increase will result in annual ECCR revenues of approximately \$12.5 million, or an increase of approximately \$4 million from current levels. Petitioner's Second Revised Exhibit SMK-4. He stated that upon implementation of the new ECCR factor as shown on Petitioner's Second Revised Exhibit SMK-5, a residential customer using 1,000 kWh of electricity per month would experience a monthly rate increase of \$0.33 or 0.4%. Petitioner's Second Revised Exhibit SMK-6.

Mr. Krawec stated I&M will continue to make annual filings in late January to early February of each year. He stated the next annual update to the rider will incorporate any actual (over)/under recovery for the December 1, 2009 to November 30, 2010 period and forecast amounts for the period of April 1, 2011 through March 31, 2012.

I&M Witness Philip J. Nelson supported the forecast of the expenses to be included in the ECCR. He stated the forecast period for this proceeding is April 2010 through March 2011. Mr. Nelson provided forecasted information to determine the amount of allowance consumption expense and gains and losses on the sale of emission allowances to be included in the ECCR. Petitioner's Exhibit PJN-1.

Mr. Nelson explained how the amount included in the initial ECCR that was implemented on March 23, 2009 was determined. He stated the amount was established by the settlement in Cause No. 43306 and that the initial factor was designed to recover \$8.5 million, which is the approximate amount of the Company's test year expense in that Cause. He stated that the test year was the twelve (12) months ended September 30, 2007.

Mr. Nelson explained that the forecasted consumption expenses in this proceeding (approximately \$10 million) are higher than those included in the initial ECCR (\$8.5 million). He stated that although the types of expenses included are the same as those in the settlement, there have been substantial changes to the allowance regulations and markets since the test year.

Mr. Nelson stated that ultimately market prices will affect allowance consumption expense but the Company expenses allowances based on the weighted average inventory price of allowances

held in current inventory. He stated that the weighted average inventory price is the total dollar balance of current inventory divided by the number of allowances held. He explained that for SO₂, the inventory balance includes zero cost allowances received from the Environmental Protection Agency (“EPA”), allowances purchased from affiliates through the Interim Allowance Agreement and allowances purchased in auctions and on the open market. For NO_x, the inventory is composed of zero cost allowances received from the EPA and allowances purchased on the open market. Therefore, because of this blending, SO₂ and NO_x consumption expense do not respond directly to changes in the market prices of allowances. For CO₂, costs include allowances purchased through exchanges and direct expenditures associated with CO₂ mitigation such as planting trees. For allowances, a CO₂ balance sheet inventory is not maintained and allowances are expensed at the time they are acquired.

5. OUCC Testimony. OUCC Witness Cynthia M. Armstrong addressed I&M’s inclusion of voluntary CO₂ emission allowance costs and emission allowances consumed in generating off system sales in the recovery of environmental compliance costs. Ms. Armstrong indicated that the OUCC objects to the CO₂ emission allowance costs as part of I&M’s Environmental Compliance Cost Rider as CO₂ compliance is voluntary and the inclusion of CO₂ costs was not clear to the OUCC in Cause No. 43306. Specifically, Ms. Armstrong stated participation within the Chicago Climate Exchange (“CCX”) is voluntary and AEP’s requirements to comply with the CCX’s reduction targets are the result of its voluntary entrance to the organization. She compared AEP’s participation within the CCX to a charitable contribution, with the exception that in regard to the CCX, I&M is attempting to pass those charitable costs onto ratepayers, when ratepayers were not given the opportunity to comment on AEP’s entry to the CCX. Ms. Armstrong also stated neither the Commission nor the OUCC were provided with the opportunity to approve AEP’s joining the CCX in 2003. She indicated it would be unfair for ratepayers to bear the burden of these voluntary compliance costs when the Company did not consult with the Commission or the OUCC and inform both agencies of the estimated rate impacts prior to joining the CCX.

Ms. Armstrong further stated that I&M did not make clear to the Commission, the OUCC, or the intervening parties in Cause 43306 whether it intended to recover voluntary CO₂ costs through the ECCR. She specifically referred to John McManus, the primary witness for I&M’s environmental compliance issues, who testified under cross-examination in Cause No. 43306 that I&M did not include CO₂ costs associated with its membership in the CCX in the rate case and could not answer how I&M intended to recover its future voluntary CO₂ costs. Public’s Exhibit Revised 1, pp. 4-5. Ms. Armstrong also testified that the initial ECCR factor of \$8.5 million was based on the NO_x and SO₂ allowance costs incurred during the test year and excluded voluntary CO₂ costs. *Id.*

After removal of the CO₂ allowance costs, the OUCC calculated the new ECCR rate to be \$0.000895 per kWh. This would result in a monthly rate increase of 0.3% or \$0.29 for a residential customer using 1,000 kWh of electricity per month.

Ms. Armstrong also requested I&M to calculate and remove the cost of emission allowances consumed in generating off-system power sales from the ECCR. She noted that I&M filed the supplemental testimony of Mr. Krawec making the requested adjustment. Ms. Armstrong also stated the OUCC intends to review the settlement of costs and proceeds from the AEP Interim Allowance Agreement.

Ms. Armstrong recommended that I&M include the following information in its subsequent ECCR filings:

1. A list of all emission allowance transactions for the reconciliation period that includes all purchases, transfers, and sales made during the reconciliation period. In addition, the prices at which emission allowances were procured or sold should also be provided.
2. Monthly Weighted Average Inventory Cost calculations for the current year during the reconciliation period and the projected period in order to support how I&M derives its monthly emission allowance consumption expense.
3. Monthly unit emissions for the reconciliation and projected periods.
4. Monthly emission allowances consumed for the reconciliation period. For the projected period, I&M should provide the monthly emission allowances it anticipates to consume as well as an explanation of the methodology for estimating projected period emission allowance consumption.
5. A calculation of emission allowances consumed in providing off system sales. I&M should clearly show that these costs were removed from the calculation of the ECCR rate.
6. Clear documentation of the sharing of SO₂ allowances proceeds through the Interim Emission Allowance Agreement.

6. **Petitioner's Rebuttal.** Mr. Krawec responded to Ms. Armstrong's proposal to eliminate CO₂ emission allowance costs from the requested factor. He stated that I&M's approved rate base emission allowance inventory is made up of the amount of NO_x, SO₂ and CO₂ in I&M's allowance inventory at the end of I&M's test year in Cause No. 43306. He pointed out that I&M's filing in Cause No. 43306 outlined the type of emission allowances in inventory and provided the amount of emission allowance inventory balances for each type of allowance. Petitioner's Exhibit SMK-1R.

Mr. Krawec also pointed to testimony in Cause No. 43306 that: (1) AEP had taken steps to prepare for controls or limits on the emission of CO₂, (2) outlined AEP's commitment to the CCX and the voluntary greenhouse gas credit trading system in the United States, and (3) described how the actions taken by I&M to address future environmental challenges, including limiting and controlling CO₂, benefits the customers of I&M.

Mr. Krawec also noted that I&M responded to discovery setting forth I&M's consumption expenses for SO₂, NO_x and CO₂ in Cause No. 43306. Petitioner's Exhibit SMK-3R. He stated that the 43306 Order approved I&M's environmental tracker without modification from the Settlement Agreement which allows I&M to track net emission allowance credits. He noted that while net emission allowances including SO₂, NO_x and CO₂ were not specifically identified in the Commission's Order or the Settlement Agreement, the OUCC's claim of a lack of knowledge

regarding I&M's intent to recover CO₂ costs through the ECCR is not supported by the exhibits, workpapers and discovery presented in that proceeding.

Mr. Krawec stated that I&M agrees to provide in subsequent filings the information requested by Ms. Armstrong in Items 1 through 4 and to provide the calculation of allowances consumed in providing off-system sales in the same manner as provided in Second Revised Exhibit SMK-1 and Second Revised Exhibit PJN-1. Mr. Krawec testified that with regard to Item 6, I&M agrees to provide I&M's information pertaining to SO₂ allowance transactions through the settlement of the Interim Allowance Agreement.

7. Commission Discussion and Findings. The primary dispute in this proceeding is I&M's inclusion of CO₂ allowance costs in its calculation of its environmental tracker. I&M relies on a workpaper prefiled with its case-in-chief testimony in the rate case and information provided to the OUCC in response to discovery requests to support its contention that the settling parties intended for the ECCR to include CO₂ costs. The OUCC, however, contends that I&M did not make clear its intent to include CO₂ costs based upon (1) the testimony of Mr. McManus, I&M's primary witness for the ECCR in Cause No. 43306, stating that I&M had not included costs associated with CO₂ emissions in its case and that he did not know whether I&M would in the future seek to recover those costs in the ECCR, and (2) the fact that participation within the CCX is voluntary and neither the Commission nor the OUCC were notified or provided with the opportunity to consider AEP's joining the CCX or the estimated rate impact.

For the reasons set forth below, the Commission finds that I&M has failed to present sufficient evidence demonstrating that recovery of CO₂ emission allowance costs in the ECCR was agreed upon in the Settlement Agreement and considered by the Commission in Cause No. 43306. First, although Mr. McManus' prefiled testimony in Cause No. 43306 addressed I&M's environmental compliance requirements and outlined AEP's commitment to CO₂ reduction, when asked at the hearing whether any of the costs that AEP incurs to make these CO₂ reductions are going to be passed onto I&M ratepayers, he stated, "[i]t's my understanding for purposes of this case that there are no such costs included in this case." Industrial Group's Exhibit CX-1, p. J116-117 and K10. He also indicated that he did not know whether it was I&M's intent to track those costs through the ECCR.² *Id.* In addition, although I&M may have submitted a workpaper with its prefiled direct testimony indicating that the test year costs included CO₂ emission allowance costs, that workpaper was not offered into evidence.

Second, even if I&M's case-in-chief indicated an intent to include costs associated with CO₂ emissions in the ECCR, whether the parties to the Settlement Agreement intended to include such costs is another matter. As Mr. Krawec acknowledged during cross-examination in this case, I&M did not get all the relief in the Settlement Agreement that it had originally requested in the rate case. Transcript at p. A-17. Neither the Settlement Agreement, nor the settlement testimony, provides

² We also note that, consistent with Mr. McManus' testimony at the hearing, neither the OUCC's direct testimony nor Petitioner's rebuttal testimony in Cause No. 43306 specifically discuss the inclusion of CO₂ emission allowance costs in the ECCR; rather the testimony focuses on the significance of the emission allowance costs and, specifically, costs associated with SO₂ and NO_x emissions. See, Direct Testimony of Cynthia Pruitt and Rebuttal Testimony of John McManus.

evidence demonstrating that the parties contemplated or intended CO₂ emission allowance costs to be included in the ECCR. The Settlement Agreement merely states that the parties agree I&M is authorized to track net emission allowance credits in its environmental tracker; it does not identify what specific net emission allowances are included. However, both Mr. Lewis' and Mr. Curry's settlement testimony indicates that the ECCR is to track emission allowance costs similar to what has been approved for other Indiana utilities. *See*, 43306 Order at p. 26 and 29. No other Indiana utilities have received Commission approval to recover CO₂ emission allowance costs. Consequently, we find that the testimony offered specifically in support of the Settlement Agreement supports a finding that the ECCR agreed upon by the parties was to track SO₂ and NO_x emission allowance costs and that costs associated with CO₂ emissions were not contemplated for inclusion in the ECCR.

Furthermore, when the Commission has previously considered utility requests for trackers, it has typically approved trackers when costs are: incurred due to compliance mandates, variable and significant, and beyond the control of the utility. *See e.g.*, *In re Petition of PSI Energy*, Cause No. 42359 (May 18, 2004) and *In re Petition of SIGECO*, Cause No. 43111 (August 15, 2007). In response to a May 11, 2010 Docket Entry, I&M acknowledged that CO₂ emission allowances are not currently mandated, but also indicated that they are anticipated to reduce future compliance costs. However, Mr. Krawec testified on cross examination that no one knows when carbon regulation will be passed or when it would become effective. Transcript at p. A-10, A-11. He also did not know whether current allowances could be used in the future. *Id.* With respect to the other factors, I&M indicated that the costs are variable and, because the price is set in the open market, not subject to I&M's control. Petitioner's Exhibit 2. However, while I&M may not set the price for CO₂ emission allowances, such costs are not beyond the control of the utility because AEP has voluntarily agreed to participate in the CCX and to incur the associated costs.

It is clear that a request to recover CO₂ emission allowance costs would have been a case of first impression for the Commission and that such costs fall outside of the factors typically required for approval in a tracker. Therefore, it is reasonable to have expected I&M (and the parties), had they intended CO₂ emission allowance costs to be included in the ECCR pursuant to the Settlement Agreement, to fully discuss and explain why the recovery of such costs is reasonable and in the public interest. However, neither I&M nor any of the parties in that Cause presented such discussion or a specific indication that the ECCR was to include the recovery of CO₂ emission allowance costs. Consequently, we find that I&M has failed to present sufficient evidence demonstrating that recovery of CO₂ emission allowance costs in the ECCR was contemplated by the Settlement Agreement in Cause No. 43306.

We would further note that the Commission's approval of a tracker does not by itself authorize a utility to track any and all costs it incurs, either now or in the future, that may happen to fall within the general description of the tracker costs. In other words, if a utility desires to include costs in a tracker other than those specifically approved, then it is required to seek approval to track those specific costs and to provide sufficient evidence demonstrating those costs are appropriate for inclusion in the tracker. Therefore, if I&M desires to include emission allowance costs it incurs for pollutants other than SO₂ or NO_x in its ECCR, it must first seek Commission approval to include those costs in the tracker.

Accordingly, I&M's request to include CO₂ emission allowance costs in this ECCR proceeding is denied. With the exclusion of these costs, the new ECCR rate shall be \$0.000895 per kWh. I&M is instructed to file a revised exhibit reflecting the proposed factor without the CO₂ emission allowance costs included.

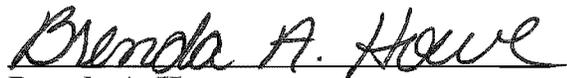
IT IS THEREFORE ORDERED BY THE INDIANA UTILITY REGULATORY COMMISSION that:

1. Petitioner's proposed Environmental Compliance Cost Rider rate as modified in Paragraph 7 above is hereby approved.
2. Petitioner shall file with the Electricity Division of the Commission an amendment to its tariff reflecting the Environmental Compliance Cost Rider rate approved herein.
3. Petitioner shall include in its subsequent Environmental Compliance Cost Recovery filings the information requested by OUCC Witness Armstrong and agreed to by I&M Witness Krawec.
4. This Order shall be effective on and after the date of its approval.

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

APPROVED: JUN 23 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**