

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

VERIFIED PETITION OF DUKE ENERGY)
INDIANA, INC. FOR SPECIAL CONTRACT)
AUTHORITY TO INCREASE ITS RATES AND)
CHARGES FOR STEAM SERVICE TO)
TEMPLE-INLAND, INC. UNDER THE)
AGREEMENT FOR HIGH PRESSURE STEAM)
SERVICE DATED JUNE 1, 1974 AND)
SUPPLEMENTAL AGREEMENTS DATED)
NOVEMBER 21, 1977, MARCH 14, 1983, JUNE)
18, 1992, SUBSEQUENTLY APPROVED FIRST,)
SECOND AND THIRD AMENDMENTS)
THERE TO AND TO MAKE OTHER REVISIONS)
TO SUCH AGREEMENTS AND AMENDMENTS)
PURSUANT TO IND. CODE §§ 8-1-2-24 AND -25.)

CAUSE NO. 44087

APPROVED:

JAN 25 2012

ORDER OF THE COMMISSION

Presiding Officers:

Kari A.E. Bennett, Commissioner

Aaron A. Schmoll, Senior Administrative Law Judge

On October 5, 2011, Duke Energy Indiana, Inc. (“Duke Energy Indiana” or “Petitioner” or “the Company”) filed its Verified Petition and supporting Case-in-Chief testimony and exhibits in this Cause. Also on October 5, 2011, Petitioner filed its Motion for Protection of Confidential Material.

Pursuant to public notice as required by law, the Commission conducted a Prehearing Conference on November 2, 2011 at 10:00 a.m. in Room 224 of the PNC Center, 101 West Washington Street, Indianapolis, Indiana. The Prehearing Conference Order establishing the procedural schedule in this Cause was issued November 22, 2011. On November 29, 2011 the Indiana Office of Utility Consumer Counselor (“OUCC”) filed its Notice of Intent to Not File Testimony.

Pursuant to public notice as required by law, the Commission conducted an Evidentiary Hearing on January 11, 2012 at 9:30 a.m. in Room 224 of the PNC Center, 101 West Washington Street, Indianapolis, Indiana, at which the prefiled evidence of Petitioner was admitted into evidence without objection. No members of the public appeared or provided testimony at the hearing.

The Commission being duly advised in the premises based upon the applicable law and the evidence presented herein, now finds:

1. **Notice and Jurisdiction.** Due, legal, and timely notice of the hearing in this Cause was given and published by the Commission as required by law. Petitioner is an Indiana corporation with its principal office in the Town of Plainfield, Hendricks County, Indiana at 1000 East Main Street, Plainfield, Indiana. Duke Energy Indiana's corporate power and authority includes supplying steam utility service to the public in the State of Indiana. Accordingly, Duke Energy Indiana is a "public utility" and a "energy supplier" within the meaning of those terms as used in the Indiana Public Service Commission Act, as amended, 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.

2. **Background and Relief Requested.** Through a series of customer specific contracts and amendments thereto Petitioner has since 1974 rendered high pressure steam service to its sole steam service customer, the Temple- Inland paper manufacturing facility located contiguous to Petitioner's Cayuga generating station in Cayuga, Indiana. In this proceeding, Petitioner seeks approval of additional contract changes as reflected in the proposed Fourth Amendment to the Third Supplemental Agreement to the Steam Supply Agreement ("Fourth Amendment"), between the Company and Temple-Inland Inc. ("Temple-Inland") (collectively, the "Parties"). The Fourth amendment is agreed to and fully supported by Temple-Inland.

3. **Petitioner's Evidence in Support of Requested Relief.** Ms. Maria T. Birnbaum, Director, Rate Services, Indiana Rate Department for Duke Energy Business Services LLC ("Duke Energy Business Services") sponsored, described and supported the Fourth Amendment between the Company and Temple-Inland dated August 26, 2011. She described the business relationship between the Company and Temple-Inland, the history of the Steam Agreement between the Company and Temple-Inland, and the Parties' efforts to negotiate and reach agreement on updated rates and charges for steam service to Temple-Inland. She described the key provisions of the proposed Fourth Amendment and how it fits within the current Steam Agreement with its prior Supplements and Amendments. She described the derivation and justification of the proposed steam rates and charges and also described the cost of service analysis that helps demonstrate the reasonableness of the proposed new rates and charges for steam service. Finally, she discussed the Company's proposal to share a portion of the increased steam revenues as a result of the Fourth Amendment with retail electric customers.

Ms. Birnbaum further explained how agreement was reached on the terms of the proposed Fourth Amendment. Duke Energy Indiana and Temple-Inland engaged in extensive, arms length good faith negotiations regarding the Company's need for increased steam rates, Temple-Inland's interest in economic steam service and a mutual interest in modifying certain contractual terms. After many exchanges occurring since January of 2010, both Parties believe they have reached a fair result embodied in the Fourth Amendment.

She testified the current contractual steam rates are out of date. The Company has added substantial investment at the Cayuga plant since the steam demand rates were last updated in 1992 using the twelve month period ended in 1988. The most notable drivers for the increase in the steam production plant were the environmental scrubbers that were installed on Cayuga Units 1 and 2 during 2008.

Ms. Birnbaum described that prior to incurring material capital expenditures for facilities used in supplying steam service, the Company will discuss its plans with Temple-Inland and consider its feedback. She described the out-of-pocket and accrued capital costs Temple-Inland will pay for additions or changes to the water treatment facilities. Temple Inland will also pay its proportionate share of actual and accrued capital costs for certain "Other Facilities." She also described the manner in which Temple-Inland will make payment for its share of costs. The Company is not required to make additions or modifications to the Facilities until Temple-Inland agrees to pay its proportionate share. If notice of termination is given, Temple-Inland will make a lump payment for any additions or modifications to the Facilities.

Ms. Birnbaum then described the derivation and justification for the proposed steam rates and factors. She explained the cost of service analysis used in evaluating the proposed steam rates and why it is appropriate. She described the resulting level of return and documented that the current steam rates are insufficient to yield a reasonable return. She testified the agreed upon steam charges cover the variable cost of providing service and make a contribution to fixed costs.

Ms. Birnbaum explained the increase in steam demand revenues provided for in the Fourth Amendment is warranted in large part by the additions of environmental compliance equipment on the Cayuga generating units, which costs are recoverable from retail electric customers in the Company's environmental riders, Standard Contract Rider Nos. 62 ("Rider 62") and 71 ("Rider 71"). Ms. Birnbaum testified that although the Company has earned less than its authorized return from retail electric customers as evidenced in its FAC filings, the Company is volunteering to credit to retail electric customers a portion of the additional steam demand revenues received from the Fourth Amendment demand rates, through Rider 71. Any such credit would only be applicable until new rates were set in the Company's next retail base rate case, wherein all costs, including costs associated with the environmental plant additions, and revenues would be reset using the new test period data. Ms. Birnbaum explained that typically there are many changes in a utility's revenues and costs in between a base rate case and the increased revenues associated with this Fourth Amendment are no different.

Ms. Birnbaum further explained the credit calculation would be performed by developing the proportion that the proposed demand rates for Temple-Inland's electric service under Riders 62 and 71 will comprise of the total of the base demand rate for their electric service plus the proposed demand rates for Riders 62 and 71. This percentage would then be applied to the incremental steam demand revenues received from Temple-Inland for the reconciliation period covered in the applicable Rider 71 filing.

Mr. Edward O. Abbott, Consulting Engineer, Performance & Measures, for Duke Energy Business Services testified that he supports the approval of the Fourth Amendment. He provided information regarding the Cayuga Generating Station, its provision of steam to the contiguous Temple-Inland paper factory, background of the successful business relationship between Duke Energy Indiana and Temple-Inland, the character of the Fourth Amendment contract negotiations and the agreed upon cost to supply steam.

Mr. Abbott further explained that the fuel cost adjustment factor calculation are performed on computers utilizing software developed specifically for power plants. All of the cycle data needed, including a performance improvement to the High and Intermediate Pressure

turbines, has been incorporated into the thermal model software. The agreed upon results of the computer analysis showed that the kilowatt conversion factor per 1000 pounds of steam should be reduced from 110.3 to 108.4 in the fuel cost adjustment factor calculation. This more accurate factor is reflected in the Fourth Amendment.

Mr. Abbott concluded stating the proposed Fourth Amendment allows Duke Energy Indiana to continue its long approximate 37 year history of providing steam service to Temple-Inland without reducing its current ability to provide safe and reliable electric service, allows Temple-Inland to continue its local operations and employment of Indiana workers and represents a reasonable negotiated accommodation of each party's needs and goals. Mr. Abbott stated he believes the public interest will be served by approval of the Fourth Amendment.

Mr. Craig V. Doty, Mill Controller for Temple-Inland, described the Temple-Inland paper production facility located in Vermillion County, on Highway 63, along the west side of the Wabash River, adjacent to Duke Energy Indiana's Cayuga generating station as approximately 280 acres with various facilities including recycled pulping equipment, a 360,000 ton per year paper machine, paper finishing and packaging equipment, and a finished goods warehouse. He stated steam is an essential element in the production of paper. Steam is used to heat recycled pulp, to dry paper on the paper machine, and to heat the production facilities and offices. The paper mill employs approximately 140 full time employees, one part time employee, and as needed area contractors.

Mr. Doty described the history of the Temple-Inland steam contract initially effective as of June 1, 1974 with steam being supplied to Temple-Inland ever since. He stated that Temple-Inland and Duke Energy Indiana have had a cordial, long term, productive, and professional business relationship, where both parties work together to facilitate their individual business and operational needs in a collaborative and cost effective manner. When issues arise, or when plant management changes, the parties meet, update each other on pertinent information, exchange ideas and observations, and work together in a professional manner to address each others needs. He stated they have been productive and accommodating business neighbors while maintaining and protecting their individual interests and obligations.

Mr. Doty testified he attended customer meetings and numerous internal Temple-Inland meetings. The negotiations were lengthy, completely arms length, wherein each party sought to achieve its own strategic interests while accommodating the business and operational needs of each other to the extent reasonably possible.

Mr. Doty described the benefits that will flow from the Fourth Amendment. He stated that under the Fourth Amendment Temple-Inland's paper plant will continue to receive the level and quality of steam needed to support paper production operations. The parties will continue their open, supportive exchange of operational information needed to facilitate reasonable operations of both the generating station and the paper plant. The agreed upon pricing terms will allow economic operation of the paper plant under current conditions. Temple-Inland intends to continue its operation of the paper plant, thereby benefiting the area's economy. Duke Energy Indiana will benefit through the continued sale of steam to Temple-Inland. In whole Mr. Doty testified he believes the Fourth Amendment is a reasonable, just, practical, and advantageous

agreement for both Temple-Inland and Duke Energy Indiana. It represents a reasonable negotiated contractual accommodation of each party's needs and goals. He believes the public interest will be served by approval of the Fourth Amendment.

4. **OUCC's Notice Of Intent To Not File Testimony.** Following its review of Petitioner's testimony and exhibits filed in this Cause, the OUCC on November 29, 2011 timely filed a Notice of Intent to Not File Testimony in this proceeding.

5. **Commission Discussion and Findings.** Duke Energy Indiana seeks approval of the Fourth Amendment under the provisions of Ind. Code §§ 8-1-2-24 ("Section 24") and -25 ("Section 25"). Section 24 of the Act provides:

Nothing in this chapter shall be taken to prohibit a public utility from entering into any reasonable arrangement with its customers or consumers, or with its employees, or with any municipality in which any of its property is located, for the division or distribution of its surplus profits, or providing for a sliding scale of charges or other financial device that may be practicable and advantageous to the parties interested. No such arrangement or device shall be lawful until it shall be found by the commission, after investigation, to be reasonable and just and not inconsistent with the purpose of this chapter. Such arrangement shall be under the supervision and regulation of the commission.

Section 25 provides as follows:

The commission shall ascertain, determine and order such rates, charges and regulations as may be necessary to give effect to such arrangement, but the right and power to make such other and further changes in rates, charges and regulations as the commission may ascertain and determine to be necessary and reasonable, and the right to revoke its approval and amend or rescind all orders relative thereto, is reserved and vested in the commission, notwithstanding any such arrangement and mutual agreement.

Therefore, special contracts are lawful if the Commission finds their provisions to be reasonable and just, practicable and advantageous to the parties, and not inconsistent with the purposes of the Act.

We find that the proposed Fourth Amendment agreed to by Duke Energy Indiana and Temple-Inland is a fair and reasonable customer-specific contractual arrangement for the pricing and provision of high pressure steam service to Petitioner's single steam customer. The record establishes that the Fourth Amendment is beneficial to Petitioner, Temple-Inland and to Petitioner's retail electric customers. The Fourth Amendment offers continued steam service at rates and terms acceptable to both Petitioner and Temple-Inland and facilitates the ongoing operation of Temple-Inland's paper mill and the attendant employment of Indiana workers. Petitioner will gain additional needed revenue from steam service and, through its voluntary credit proposal, retail electric rates will be reduced. Ms. Birnbaum's testimony establishes that cost of steam service was a consideration in formulating the agreed rates. The agreed upon steam

charges cover the variable cost of providing service and contribute to fixed costs. Moreover, the record establishes that the contractual provision of high pressure steam service remains secondary to the Cayuga generating station's provision of public electric service. The proposed contractual arrangement facilitates the 37-year-old business relationship between Petitioner and Temple-Inland and furthers the public interest.

In summation, the Commission finds that the proposed Fourth Amendment is a reasonable arrangement and should be approved.

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

1. The proposed Fourth Amendment to the Third Supplemental Agreement to the Steam Supply Agreement is hereby approved in its entirety.

2. Petitioner is authorized to adopt the new base case cost of fuel and new steam to kilowatt-hour conversion factor in future fuel clause filings as specified in the Fourth Amendment to the Third Supplemental Agreement, effective the first day of the month after this order.

3. Petitioner's voluntary proposal to credit retail electric customers a portion of steam demand revenue through Standard Contract Rider 71 until its next base retail electric rate case is hereby approved.

4. The Confidential Information identified in Petitioner's Motion For Protection Of Confidential Material and submitted under seal in this Cause is determined to be confidential and exempt from public access and disclosure pursuant to Ind. Code § 24-2-3-2 and § 5-14-3-4.

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

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

APPROVED: JAN 25 2012

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



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