

ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

APPLICATION OF SOUTHERN INDIANA GAS)
 AND ELECTRIC COMPANY D/B/A VECTREN)
 ENERGY DELIVERY OF INDIANA, INC.)
 (“VECTREN SOUTH”) FOR APPROVAL OF A) CAUSE NO. 38708 FAC 102 S1
 CHANGE IN ITS FUEL COST ADJUSTMENT)
 FOR ELECTRIC SERVICE IN ACCORDANCE)
 WITH THE ORDER OF THE COMMISSION IN) APPROVED:
 CAUSE NO. 37712 EFFECTIVE JUNE 18, 1986)
 AND SENATE BILL NO. 529 EFFECTIVE APRIL)
 11, 1979)

DEC 0 8 2014

ORDER OF THE COMMISSION

Presiding Officers:

David E. Ziegner, Commissioner
Gregory R. Ellis, Administrative Law Judge

On February 24, 2014, in accordance with Ind. Code § 8-1-2-42, Southern Indiana Gas and Electric Company d/b/a Vectren Energy Delivery of Indiana, Inc. (“Vectren South”) filed its Verified Application in Cause No. 38708 FAC 102 for approval for a change in its fuel cost charge (“FAC”). The Indiana Utility Regulatory Commission (“Commission”) issued its Order in Cause No. 38708 FAC102 on April 23, 2014 creating this sub-docket proceeding for the purpose of reviewing Vectren South’s 2014 - 2015 coal supply plan.

On June 9, 2014, Vectren South submitted its Motion for Protection of Confidential and Proprietary Information seeking a determination that designated confidential information (“Confidential Information”) involved in this proceeding be exempt from public disclosure under Ind. Code § 8-1-2-29 and Ind. Code ch. 5-14-3. The Confidential Information was granted protection on a preliminary basis through a docket entry on June 19, 2014.

Vectren South filed the direct testimony of Wayne D. Games, Vice President of Power Supply, on June 10, 2014. On July 2, 2014, Vectren South filed a motion to modify the procedural schedule in this proceeding based on the sale of its coal mine affiliate, Vectren Fuels, LLC (“Vectren Fuels”), to Sunrise Coal, LLC (“Sunrise Coal”) and the entry by Vectren South into new supply contracts. Vectren South indicated that as a result of these new contracts, it would need to withdraw its original direct testimony and file replacement direct testimony. The Commission issued a docket entry on July 17, 2014 modifying the procedural schedule.

On July 18, 2014, Vectren South filed the revised direct testimony and exhibits of Mr. Games along with the direct testimony of Emily S. Medine, a principal in the consulting firm of Energy Ventures Analysis, Inc. The Indiana Office of Utility Consumer Counselor (“OUCC”) filed the testimony of Michael D. Eckert, Senior Utility Analyst, on September 12, 2014. On September

19, 2014, Vectren South filed the rebuttal testimony of Mr. Games and Ms. Medine.

The Commission held an Evidentiary Hearing in this Cause at 9:30 a.m. on October 14, 2014, in Room 224, PNC Center, 101 West Washington Street, Indianapolis, Indiana. Vectren South and the OUCC were present and participated. The testimony and exhibits of Vectren South and the OUCC were admitted into the record without objection. No members of the general public appeared or sought to testify at the hearing.

Based upon the applicable law and the evidence presented, the Commission finds:

1. **Notice and Jurisdiction.** Notice of the hearing in this Cause was given and published by the Commission as required by law. Vectren South is a public utility as defined in Ind. Code § 8-1-2-1(a). Under Ind. Code § 8-1-2-42, the Commission has jurisdiction over changes to Vectren South's rates and charges related to adjustments in fuel costs. Therefore, the Commission has jurisdiction over Vectren South and the subject matter of this Cause.

2. **Vectren South's Characteristics.** Vectren South is a corporation organized and existing under the laws of the State of Indiana. Its principal office is located at One Vectren Square in Evansville, Indiana. Vectren South is engaged in rendering electric utility service to the public and owns and operates electric generating plant and distribution system for the production, transmission, delivery and furnishing of this service.

3. **Vectren South's Case-in-Chief.** Vectren South's witness Mr. Games provided testimony regarding Vectren South's recent execution of several long-term supply contracts with local producers to secure coal over time and provide for pricing that tracks the market. He indicated that Vectren South utilizes Illinois Basin coal, mostly from Indiana mines, as its primary fuel source for electric generation. Coal is purchased under a combination of multi-year contracts and spot purchases which allow for Vectren South to maintain a reliable source of coal without over-committing for purchases. By staggering contract terms and price reopener provisions, Vectren South is able to obtain current market pricing for a portion of its coal supply. This is done to mitigate potential market volatility.

Mr. Games testified that Vectren South currently relies on five term contracts that have been in place for several years to supply coal to its base load generation units. He noted that since January 2012, Vectren South's fuel costs have been similar to the costs of their Indiana peer utilities. He indicated that based on public data, Vectren South's 2013 fuel costs were lower than most of its peer utilities. He concluded that based on public data, as reported by the OUCC, Vectren South's fuel costs have been the lowest in the state.

Mr. Games testified that apart from Vectren Fuels, Vectren South recently purchased spot coal from Indiana mines owned by Peabody Coal and Sunrise Coal. He indicated that given the increased burn in 2014 as well as reduced inventory to start the year, Vectren South is buying spot coal in 2014 from Alliance Coal, Peabody Coal, and Vectren Fuels to supplement contract supply. He noted Vectren South entered 2014 with almost all of its existing supply contracts requiring re-

pricing or replacement over the next two years. As explained by Mr. Games, Vectren South recently completed its studies of how best to comply with the EPA's mercury regulations and had concluded that coal quality will play an important role in its future emissions compliance strategy for its baseload generating units. Based on Vectren South's prior experience, Sunrise Coal and Vectren Fuels could supply coal with the quality to meet its needs.

Mr. Games also provided testimony indicating that Vectren South commenced negotiations with Sunrise Coal and Vectren Fuels in order to secure a long-term supply of compliance coal commencing in 2015. Those negotiations led to contracts with a number of attributes that were desired by Vectren South, including: significant annual volume optionality, staggered price reopeners, contract termination rights to the extent required for environmental reasons, and a re-pricing process based on actual market data. These contracts can be extended beyond their primary terms as needed by Vectren South. He stated Sunrise is aware of the terms of the new Vectren Fuels' contracts, and has agreed that upon closing, Sunrise will take over responsibility for the contracts. He also noted that all contracts remain in place for the remainder of 2014 and 2015, with the exception of the Warrick contract - the new Warrick contract commences 2015.

Ms. Medine provided testimony regarding the reasonableness of the three new contracts between Vectren South and Vectren Fuels, Inc. (collectively the "Contracts") and the contract between Vectren South and Sunrise Coal (the "Carlisle Contract"). She indicated the Contracts are similar to each other in they provide a long-term supply, they provide terms for extension, they allow for Vectren South to increase/decrease the annual tonnage, and they allow for Vectren South to increase/decrease the quarterly tonnage. The Contracts also provide that the base contract price will be periodically renegotiated and that the interim pricing between the renegotiations is fixed based upon a percentage annual escalation. She testified that long-term contracts continue to play an important role in the market. However, she noted the Contracts differ from earlier long-term contracts with respect to providing clear and unambiguous rights to terminate the agreements in the event that continued operation of the respective Vectren South unit becomes uneconomic due to new environmental regulations. Ms. Medine also indicated her market price analysis supported Vectren South's agreed upon contract pricing.

4. OUCC's Case-in-Chief. Mr. Eckert testified that Vectren South recently executed several long-term supply contracts with local Indiana producers to secure coal with specifications that meet its generation needs. He indicated Vectren South's coal procurement strategy is to purchase coal under multi-year contracts, with volume optionality, and supplements its long-term coal supply purchases with spot purchases that allow it to maintain a reliable source of coal. Vectren South believes that by staggering contract terms and price reopeners, it is able to obtain current market pricing for a portion of its contract supply to mitigate potential market volatility. He noted Sunrise Coal will be providing the majority of Vectren South's long-term coal supply needs, as Vectren Corporation has sold Vectren Fuels to Sunrise Coal. Mr. Eckert indicated that Vectren South has historically sole-sourced the majority, if not all, of its long-term coal supply.

Mr. Eckert testified that he reviewed the new long-term coal contracts and considers the pricing to be reasonable when compared to current and future market prices. The OUCC expressed

some concern that if a specific contract price re-opener occurred during a period when market prices were high, the arbitration of a pricing dispute could result in a high price for three years until the next re-opener under that contract. The OUCC recommended that future price re-opener outcomes be reviewed to assure reasonable market pricing. The OUCC also suggested that the price set in arbitration be subject to review and possible disallowance of such pricing.

5. Vectren South's Rebuttal Testimony. Vectren South filed rebuttal testimony to address the OUCC's concerns related to the future process that will be relied upon to periodically re-price coal at market prices. Mr. Games noted future contract price reopeners are staggered so that only a portion of the company's coal supply will be subject to negotiation in any given year, thereby mitigating market volatility. Any negotiated market price will only have a three year impact on costs related to that portion of the portfolio and then will be re-negotiated once again. He testified that Vectren South also has the ability to increase or decrease purchases under a given contract and can thereby assess prevailing market conditions and take the most favorably priced contract supply each year. Vectren South can also adjust purchases in order to use spot coal.

Mr. Games also addressed the OUCC's concern regarding the use of arbitration to resolve price negotiation disputes. He explained that arbitration is an industry accepted method of resolving coal contract price disputes. Under the Contracts, Sunrise Coal and Vectren South will only resort to arbitration if they cannot negotiate a new price for coal under a contract. He stated the process assures a market outcome and no other method would do a better job of assuring market pricing. He further indicated the entire purpose of a portfolio with staggered terms is to mitigate market volatility. This inherently recognizes that in any single year, the market may be up or down, and Vectren South will in each year have the opportunity to re-price some of its supply at a market price. He stated that while the OUCC has the right to review contract re-pricing processes and outcomes as part of its audits, Vectren South does not believe that the actual decision of an independent decision-maker based on its review of evidence of market pricing submitted by both parties, using a fair and impartial process, should be subject to second guessing. He concluded that contract disputes must be resolved by courts or arbitrators and those outcomes are determinative.

Ms. Medine provided testimony regarding the price re-opener clause and indicated that a contract cannot be reviewed in pieces as it is a package of related terms that is reasonable as a whole. Regarding the OUCC's suggested use of past and future prices to determine the reasonableness of a price resulting from a market reopener, she stated historic pricing is never a basis for determining contemporaneous market pricing. She explained the guiding principle is whether the pricing achieved at the time the contract price was set was done in a prudent manner. She opined that by staggering its portfolio of contracts and having significant volume optionality, Vectren South has done an excellent job of managing market volatility.

Ms. Medine also provided testimony regarding the OUCC's recommendation that the price set in arbitration be subject to review and possible disallowance. She opined that it is not appropriate for the OUCC to second guess the arbitrator's decision because although the OUCC has audit rights, this does include aspects of the arbitration process. She indicated the OUCC will have the opportunity to review each market reopener. This will include a review of the data submitted by

Vectren South to support its negotiation position and ultimately, if required, its arbitration position. She concluded that the ultimate outcome of the arbitration panel is independent and binding on both parties and therefore, cannot be subject to a prudency review by OUCC.

6. Discussion and Findings. As part of Vectren South's base rate case in Cause No. 43839, the Commission reviewed evidence related to Vectren South's 2008 request for proposal ("RFP") process and the resulting supply contracts. While we found there was no basis to order Vectren South to renegotiate the resulting contracts, we expressed concern that circumstances had led to the need to replace all of the utility's coal supply contracts at the same time. We recognized that Vectren South's new contracts contained staggered price terms designed to create a portfolio to avoid a reoccurrence of such circumstances. The Order in Cause No. 43839 directed Vectren South to prepare for and request the creation of a sub-docket in its first FAC filing following the effective date of the Order in Cause No. 43839 for the purpose of reviewing its coal supply activities on a going forward basis.

Vectren South requested the creation of a sub-docket in Cause No. 38708 FAC 91 and the going forward review was conducted in Cause No. 38708 FAC 91 S1. The review focused on Vectren South's 2011 competitive RFP process, bid evaluation and resulting supply arrangements. That process and the resulting contracts were found to be reasonable efforts to acquire fuel so as to provide electricity to retail customers at the lowest fuel cost reasonably possible. The Commission's May 7, 2012 Order in Cause No. 38708 FAC 91 S1 found that the OUCC recommendation to continue to monitor the procurement process had merit and directed Vectren South to provide in the testimony of its first quarter FAC filing each calendar year a detailed discussion of its coal procurement plan which provides enough data to enable the OUCC and the Commission to fully understand the coal supply picture for both the current calendar year and the following calendar year. The Commission noted that the directed filing was intended to be a supplement to the summary FAC proceedings and did not relieve Vectren South of its statutory obligations in each quarterly filing.

In Cause No. 38708 FAC 98, the Commission found that Vectren South's coal procurement plan for 2013 through 2014 satisfied the requirements of the Order in Cause No. 38708 FAC 91 S1. However, the Commission also noted that the FAC summary proceeding statutory timeframes were not well suited for the significant cross-examination and extensive discovery requirements that occurred in Cause No. 38708 FAC 98. Accordingly, the Commission found that going forward Vectren South would be required to file coal procurement plans in a separate annual sub-docketed proceeding. This sub-docket proceeding meets the directive set out in Cause No. 38708 FAC 98 and is the review vehicle for the coal procurement plans of 2014 and 2015.

The evidence of record demonstrates that during this proceeding Vectren Fuels sold its coal mines to Sunrise Coal, in effect, eliminating what had been an affiliate relationship with Vectren South. Vectren South now has long-term coal procurement contracts in place whereby Sunrise Coal supplies the majority of Vectren South's coal supply. The contracts have periodic price re-opener clauses which serve to adjust their price to the market. More importantly in light of our past concerns, the contracts re-open for adjustment to market based pricing at staggered intervals. Upon

review, the Commission finds the initial price of the contracts to be reasonable in light of market prices and price expectations.

In its Case-in-Chief, the OUCC expressed concerns over the potential process applied when re-opening of the contracts for market based price adjustment to be agreed upon by Sunrise Coal and Vectren South. While Vectren South and the OUCC agree that such outcomes may be reviewed to assure the process resulted in a reasonable market price, the OUCC's primary concern pertains to the arbitration process should Sunrise Coal and Vectren South not agree. Vectren South argues that contract disputes must be resolved by courts or arbitrators and those outcomes are determinative. The Commission notes the question before us is the recoverability of fuel costs that may flow from the coal supply contracts, not the resolution of specific disputes in the contracts that may or may not occur. Ind. Code § 8-1-2-42(d)(1) requires that before the Commission grants the electric utility the requested fuel cost charge it must determine whether the electric utility has made every reasonable effort to acquire fuel and generate or purchase power or both so as to provide electricity to its retail customers at the lowest fuel cost reasonably possible. Here our review of Vectren South's coal procurement plan/strategy and the evidence of record leads us to conclude the contract arrangements as presented, including the arbitration process, are reasonable and serve both to assure long-term supply security for Vectren South and a touch point with market pricing. Notwithstanding this general finding, the specific actions undertaken by Vectren South in applying the terms of the arrangements will be subject to review when such actions are undertaken and presented in future FAC proceedings.¹ Based on the evidence presented, we find that Vectren South has met the requirement to present its 2014-2015 coal supply plan and demonstrated that its plan is a reasonable effort to procure coal at the lowest cost reasonably possible.²

The Commission notes the annual sub-docket proceedings were initiated to allow for scrutiny of coal supply procurement planning without the time limitations inherent in the quarterly FAC proceedings. The fact that some of the supply arrangements were between affiliates added a layer of complexity to the reviews. While no specific request has been made to alter the process used for review of Vectren South's future coal procurement plans, we find that because Vectren South's coal procurement plan contains new purchasing conditions due to the sale of Vectren Fuels to Sunrise Coal, an independent Illinois Basin coal producer, the annual review of Vectren South's coal procurement strategy may be sufficiently reviewed within time constraints of the standard FAC proceeding. Therefore, the creation of an annual sub-docket proceeding to review Vectren South's coal procurement is no longer necessary. Vectren South is directed to file, in first quarter FAC filing of each calendar year, a detailed discussion of its coal procurement plan for both the current calendar year and the following calendar year.

7. Confidential Information. Vectren South sought a determination that Confidential Information involved in this proceeding be exempt from public disclosure under Ind. Code § 8-1-2-29 and Ind. Code ch. 5-14-3. The request was supported by the affidavit of Mr. Games. By the

¹ Such actions include, but are not limited to, the use of any volume flexibility or the actions taken during price re-opening processes.

² We further note that from an expansive public interest perspective the long-term coal supply contracts serve to provide a measure of security for the Southern Indiana coal mines and the miners that they employ.

Commission's June 19, 2014 docket entry, the Presiding Officers granted Vectren South's request, finding the Confidential Information to be preliminarily confidential after which such information was submitted under seal. After reviewing the Confidential Information, we find all such information qualifies as confidential trade secret information pursuant to Ind. Code § 5-14-3-4 and Ind. Code § 24-2-3-2. This information has independent economic value from not being generally known or readily ascertainable by proper means. Vectren South takes reasonable steps to maintain the secrecy of the information and disclosure of such information would cause harm to Vectren South. Therefore, we affirm the preliminary ruling and find this information should be exempted from the public access requirements contained in Ind. Code ch. 5-14-3 and Ind. Code § 8-1-2-29, and held confidential and protected from public disclosure by this Commission.

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

1. Vectren South's coal procurement plan for 2014 and 2015 has met the requirements of Ind. Code § 8-1-2-42 and is approved in accordance with all of the Findings above.
2. Since the creation of an annual sub-docket proceeding to review Vectren South's coal procurement is no longer necessary, Vectren South shall file a detailed coal procurement plan as set forth in Paragraph 6.
3. The material submitted to the Commission under seal is declared to contain trade secret information as defined in Ind. Code § 24-2-3-2 and therefore is exempted from the public access requirements contained in Ind. Code ch. 5-14-3 and Ind. Code § 8-1-2-29.
4. This Order shall be effective on and after the date of its approval.

STEPHAN, HUSTON, AND ZIEGNER CONCUR; WEBER NOT PARTICIPATING; MAYS-MEDLEY ABSENT:

APPROVED: DEC 03 2014

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


Brenda A. Howe
Secretary to the Commission