

Members

Sen. Brandt Hershman, Co-Chairperson  
Sen. Ryan Mishler  
Sen. Beverly Gard  
Sen. Ed Charbonneau  
Sen. Dennis Kruse  
Sen. Sue Landske  
Sen. James Merritt  
Sen. Sue Errington  
Sen. Jean Breaux  
Sen. Earline Rogers  
Sen. Karen Tallian  
Rep. David Crooks, Co-Chairperson  
Rep. Kreg Battles  
Rep. Jerry Denbo  
Rep. Chester Dobis  
Rep. Ryan Dvorak  
Rep. Paul Robertson  
Rep. Dan Stevenson  
Rep. Jack Lutz  
Rep. Robert Behning  
Rep. David Frizzell  
Rep. Timothy Neese  
Rep. Ed Soliday



## REGULATORY FLEXIBILITY COMMITTEE

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Authority: IC 8-1-2.5-9

### MEETING MINUTES<sup>1</sup>

Meeting Date: September 12, 2007  
Meeting Time: 10:00 A.M.  
Meeting Place: State House, 200 W. Washington St., Senate Chambers  
Meeting City: Indianapolis, Indiana  
Meeting Number: 1

**Members Present:** Sen. Brandt Hershman, Co-Chairperson; Sen. Ryan Mishler; Sen. Beverly Gard; Sen. Ed Charbonneau; Sen. Dennis Kruse; Sen. Sue Landske; Sen. James Merritt; Sen. Sue Errington; Sen. Jean Breaux; Sen. Earline Rogers; Sen. Karen Tallian; Rep. David Crooks, Co-Chairperson; Rep. Kreg Battles; Rep. Jerry Denbo; Rep. Chester Dobis; Rep. Ryan Dvorak; Rep. Jack Lutz; Rep. Robert Behning; Rep. David Frizzell; Rep. Ed Soliday.

**Members Absent:** Rep. Paul Robertson; Rep. Dan Stevenson; Rep. Timothy Neese.

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<sup>1</sup> Exhibits and other materials referenced in these minutes can be inspected and copied in the Legislative Information Center in Room 230 of the State House in Indianapolis, Indiana. Requests for copies may be mailed to the Legislative Information Center, Legislative Services Agency, 200 West Washington Street, Indianapolis, IN 46204-2789. A fee of \$0.15 per page and mailing costs will be charged for copies. These minutes are also available on the Internet at the General Assembly homepage. The URL address of the General Assembly homepage is <http://www.in.gov/legislative/>. No fee is charged for viewing, downloading, or printing minutes from the Internet.

Representative David Crooks and Senator Brandt Hershman, Co-Chairmen of the Regulatory Flexibility Committee, convened the meeting at 10:15 a.m. Representative Crooks announced that the meeting's agenda would include a discussion of the following: (1) options for funding the state's Emergency Alert System; (2) the annual reports presented by the Indiana Utility Regulatory Commission (IURC) and the State Utility Forecasting Group (SUFEG); and (3) the use of trackers in utility rate structures.

### **(1) Indiana's Emergency Alert System:**

#### Operation and structure of the Emergency Alert System:

Noting that the Legislative Council had directed the Committee to study the state's Emergency Alert System (EAS),<sup>2</sup> Representative Crooks asked for background on the system from Charlie Morgan, Vice Chair—Radio for the Indiana Broadcasters Association (IBA).<sup>3</sup> Mr. Morgan explained that the EAS is a network that connects emergency management personnel with radio stations, television stations, cable systems, and other public warning partners in order to communicate warnings of emergencies to the public. Created as part of a nationwide effort in 1951, during the height of the Cold War, the system was designed to allow the President to address the public during a national emergency. The current system was put into place in 1997, superseding the Emergency Broadcast System (EBS), and is implemented at the federal level by the Federal Communications Commission (FCC), the Federal Emergency Management Agency, and the National Oceanic and Atmospheric Administration's National Weather Service. The system may also be used by state and local authorities to deliver emergency information such as AMBER Alerts and weather information targeted to specific areas. Each state has its own EAS plan, which must conform with FCC regulations.

Mr. Morgan reported that several problems in the operation of the state's EAS system have been uncovered since 2002, when the system first started being used to broadcast AMBER Alerts for missing children. He noted five instances between 2003 and 2006 in which attempted AMBER Alerts failed. Additionally, signals for Required Monthly Testings (RMTs) consistently fail to reach participating broadcasters in the Evansville and Vincennes areas.

In explaining how these operating failures occur, Mr. Morgan described the technical structure of the system within the state. He indicated that WFBQ (FM) in Indianapolis serves as the State Primary (SP) source for Indiana, meaning that it is responsible for issuing state-level alerts to Local Primary (LP) sources and State Relay (SR) sources in each of Indiana's ten EAS Local Areas. A state-level alert is activated by a request from an authorized official, such as the Governor or Lieutenant Governor, to the State Primary (SP) source. All LPs and SRs continuously monitor signals from both the SP and each other, and in turn disseminate state-level emergency information to other stations, cable systems, and the public. For reliability, each participating broadcast or cable system is required to continuously monitor at least two other source stations (LP-1 and LP-2) for emergency information. For emergency situations not involving the entire state, authorities may request EAS activation through the LP source serving the affected EAS Local Area.

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<sup>2</sup>Pursuant to SR 57 (2007), the Legislative Council directed the Committee to study "[o]ptions for funding, upgrading, and coordinating the state's Emergency Alert System (EAS)." Legislative Council Resolution 07-01.

<sup>3</sup>See Exhibit 1.

Despite the system redundancies sought to be achieved through multiple-source monitoring, Mr. Morgan explained that system reliability and efficiency is compromised by what he described as the "daisy chain" phenomenon. Because the system relies on LP and SR sources receiving and then disseminating alerts to other stations within the distribution "chain," there are inherent delays from the time an alert is first issued by state or local authorities to the time the information eventually reaches stations farther down in the distribution network. Mr. Morgan reported that in some parts of the state, it can take up to 30 minutes from the time an alert is issued to the time it is received by a non-LP station. Additionally, if one source or "link" in the chain fails, the stations monitoring that source will not receive the alert.

Mr. Morgan stressed that the system was designed using the technology available in 1951. As a result, Indiana's EAS is in need of significant upgrades to improve its reliability and efficiency. However, he conceded that the problem is not unique to Indiana, noting that other states face the same challenges with their systems. Mr. Morgan then introduced R. Dale Gehman to discuss how other states are using new technologies to address these reliability challenges.<sup>4</sup>

EMnet technology:

By way of introduction, Mr. Gehman explained that as Chairman of the Pennsylvania State Emergency Communications Committee, he spearheaded the development of an enhanced EAS satellite-based network as a solution to the "Cold War era," daisy-chain relay system. Known as the Emergency Management Network (EMnet), the system involves sending satellite signals to a statewide network of terminals, which in turn convey the signals directly to participating broadcast stations and cable headends. The system allows full-text and audio alerts to be sent and features secure, two-way messaging and paging capabilities. The communications are encrypted and time- and date-stamped. Mr. Gehman reported that Pennsylvania's network includes 408 terminals, which provide signals to 213 broadcast stations and 62 cable headends.

Since its inception in Pennsylvania in 2002, EMnet has been adopted by other jurisdictions and is now operational in 13 states. Mr. Gehman encouraged Indiana to become part of the network, noting that the IBA has determined that it would require a \$294,170 minimum investment to implement EMnet in the state. That level of investment would link every LP-1 and LP-2 source to the network. Installing the technology at additional stations would require additional funding. However, Mr. Gehman noted that just by providing the technology to Indiana's LP sources, the state would largely eliminate the daisy-chain inefficiencies. According to Mr. Gehman, each station linked to the network would receive alerts within seven seconds.

Mr. Gehman suggested that possible partners in the development and deployment of EMnet in Indiana could include the Indiana State Police, the State Department of Health, the Indiana Department of Homeland Security, local emergency management agencies, the National Weather Service, and television and radio broadcasters. He further recommended the establishment of an oversight panel, similar to the state committee that oversees the AMBER Alert program.

Noting that signals from satellite dishes can be subject to interference and are unreliable during certain weather conditions, Representative Crooks asked whether the EMnet system had experienced reliability problems in using satellite technology. Mr. Gehman

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<sup>4</sup>See Exhibit 2.

indicated that in case of any failure in satellite communications, the system features automatic-switching Internet backup as a redundancy. When asked by Representative Crooks why the Internet isn't used as the primary method for communicating alerts, Mr. Gehman responded that Internet broadcasting is too unreliable to serve as the primary technology at this point.

#### Public health emergencies:

Turning to the types of emergencies for which Indiana's EAS can be used, Representative Crooks invited comments from Bob Clifford, Deputy Director for Operations for the Public Health Preparedness and Emergency Response division (PHPER) at the Indiana State Department of Health (ISDH). Mr. Clifford reported that earlier in the year the ISDH had received a score of 91 out of 100 in the Strategic National Stockpile assessment conducted by the federal Centers for Disease Control and Prevention (CDC). According to Mr. Clifford, this score places Indiana among the "Level 3" states, which rank highest in the nation for their ability to respond to a large natural disaster or terrorist attack. He noted that among the measures evaluated by the CDC was the state's ability to disseminate information in a time of emergency.

Mr. Clifford explained that in Indiana, PHPER is responsible for all medical preparedness and response efforts related to terrorist attacks, pandemic influenza, and large natural disasters. In the event of any such incident, PHPER would need to provide crucial information to people in a manner that does not create panic. He noted that from the time the federal or state government declares an emergency, PHPER has 48 hours to deliver needed medicines to affected populations. The state's EAS could be used to convey information on where or how such medicines would be distributed. He pointed to an anthrax attack or an influenza pandemic as two emergencies for which the EAS could be used to communicate critical instructions to citizens.

#### Weather emergencies:

Next, the Committee heard from David Tucek from the National Weather Service in Indianapolis. Mr. Tucek stressed the importance of getting information to residents quickly during severe weather events. Like Mr. Gehman, he emphasized that whatever technologies are used to deliver this information, it is important to have redundancies in the system to ensure reliability if one or more parts of the system should fail. He pointed out that EAS warnings do not replace the need for weather sirens in communities. Mr. Tucek reported that Marion County is in the process of replacing all of its existing tornado sirens with new sirens that will be able to target specific areas of the county. When the installation is complete, the county will have complete siren coverage, with each new siren covering greater distances.

After Mr. Tucek had concluded his remarks, Senator Kruse commented that the amount of money needed to upgrade the state's system with the EMnet technology is minimal. He suggested that lawmakers should provide funding for the necessary installations.

#### **(2) Annual IURC Reports:**

Following the testimony on Indiana's EAS, Representative Crooks asked Chairman David Lott Hardy of the IURC to present the agency's annual industry reports.<sup>5</sup> Chariman Hardy began by introducing his fellow Commissioners and acknowledging their work and that of

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<sup>5</sup>See Exhibit 3.

the IURC staff. He then expressed the IURC's willingness to communicate openly with legislators, whenever such communication is permitted by the IURC's rules. He explained that the IURC would assume responsibility for knowing its own rules governing ex parte communications. Given the IURC's commitment to knowing and observing these rules, Chairman Hardy told legislators they should feel comfortable asking questions when they arise.

#### Electric industry report:

Chairman Hardy then presented the IURC's annual report on the electric industry. Noting that Indiana has consistently ranked among the lowest cost states with respect to retail electric rates, Chairman Hardy reported that as of April 2007, Indiana's average residential electric rates were the eleventh lowest in the nation. However, he indicated that the overall cost of electricity is likely to rise in both Indiana and the rest of the nation as consumer demand for electricity continues to increase. He reported that the state will need to increase its generation capacity by 29% by 2015, in order to meet increased demand. While 70% of Indiana's existing generating facilities are fueled by coal, Chairman Hardy suggested that utilities will have to meet the need for increased capacity through a diverse portfolio of options, including renewable resources, coal gasification, and demand side management programs.

In highlighting the regulatory issues confronting the industry in the near future, Chairman Hardy mentioned the potential for federal regulation of carbon dioxide emissions from electric power plants. In light of this possibility, Chairman Hardy suggested that more research and development efforts should be directed to carbon sequestration and storage technologies. He also predicted that electric rates will be affected by utilities' increasing costs to construct new generation facilities and install environmental compliance equipment. He pointed out that these capital costs have been rising due to increasing national and global demand for such inputs as labor, materials, equipment, and financing. Finally, Chairman Hardy suggested that utilities' requests for adjustable rate mechanisms, or "trackers," will continue to generate concern among ratepayers. He explained that these mechanisms allow a utility's rates to "track" or reflect certain expenses that are largely outside the utility's control, such as fuel costs, without the utility having to bring a formal rate case. Chairman Hardy assured the Committee that the IURC would continue to provide appropriate oversight of utilities' requests for trackers, while recognizing the need for utilities to remain financially stable.

#### Natural gas industry report:

Chairman Hardy next turned to the IURC's natural gas report. He reported that Indiana's 22 regulated natural gas utilities had operating revenues totaling \$2.4 billion in the past year. Still, the residential rates for natural gas utility service in Indiana are among the lowest in the nation, with Indiana having the nineteenth lowest rates in the country.

While Indiana customers have historically enjoyed relatively low natural gas rates, Chairman Hardy predicted that market conditions would likely result in increasing natural gas prices and price volatility. While demand for natural gas during the 2006-2007 winter heating season was lower than during the previous winter due to warmer weather, this was offset by higher demand for natural gas during the summer of 2007, when high temperatures increased the demand for gas-fired electricity generation. Chairman Hardy reported that this increased summer demand led to the first net withdrawals of natural gas from storage during the summer months. With less gas in storage, customers could face higher natural gas costs during the 2007-2008 heating season.

The volatility inherent in the natural gas commodities market has led natural gas utilities to seek alternative rate structures to ensure the recovery of their fixed costs. Chairman Hardy explained that a utility's fixed costs are non-commodity costs, such as operational costs, that do not vary with the amount of gas sold. Under traditional ratemaking, a utility recovers some of its fixed costs through the volume of gas sold to retail customers. Under an alternative rate structure known as "decoupling," the recovery of a utility's fixed costs is separated from the volume of natural gas sold. Decoupling allows utilities to recover fixed costs even when retail customers consume less gas, due to rising costs, weather conditions, or conservation efforts. Chairman Hardy reported that the IURC has approved decoupling mechanisms for several gas utilities.

In addition to decoupling, trackers are also used in natural gas rate structures. As in the electric industry, the use of trackers by natural gas utilities has been a source of growing concern among ratepayers. Chairman Hardy noted that a less controversial tracker is the statutorily authorized "gas cost adjustment," which allows a utility to recover the commodity cost of natural gas. According to Chairman Hardy, the gas cost portion of a customer's bill is approximately 75% of the total.

Finally, Chairman Hardy indicated that the IURC's Pipeline Safety Division recently adopted guidelines for the construction of interstate pipelines through Indiana, as required by SEA 529 (2007). Enacted in response to the construction of the interstate Rockies Express Pipeline (REX) through nine Indiana counties, SEA 529 required the Division to adopt voluntary guidelines focusing on land reclamation and soil conservation. Chairman Hardy noted that the guidelines were established as a way to simplify easement negotiations between Indiana landowners and interstate pipeline developers. He reported that the Division adopted the guidelines ahead of the statutory deadline of September 1, 2007.

#### Communications industry report:

In reporting on the communications industry, Chairman Hardy indicated that much of the IURC's work over the past year has involved implementing HEA 1279 (2006), which largely deregulated the telecommunications industry in Indiana and created state-level video franchising. Chairman Hardy explained that with the enactment of both HEA 1279 and the federal Telecommunications Act of 1996, the work of the IURC's Communications Division is no longer driven by traditional rate regulation, but instead involves evaluating the level of competition within and across various communications modalities. This evaluation involves significant data gathering and analysis.

In order to meet its reporting requirements under HEA 1279, the IURC has attempted to gather information by surveying providers concerning: (1) basic telecommunications service; (2) video service; and (3) broadband deployment. Chairman Hardy reported that the IURC has encountered difficulty in obtaining the requested data. For example, when asked for data concerning broadband availability, several providers referred the IURC to data maintained by the FCC. According to Chairman Hardy, the FCC data does not provide sufficient detail and is only current through June 2006. In addition, the FCC's threshold for what qualifies as a broadband connection to the Internet involves slower connection speeds (at least 200 kbps in one direction) than does the standard specified in HEA 1279 (at least 1.5 Mbps downstream and at least 384 kbps upstream). Thus, what qualifies as a broadband connection under the FCC's definition does not necessarily qualify as such under the standard adopted in Indiana.

Despite the IURC's inability to collect more extensive data, Chairman Hardy updated the Committee on the status of broadband deployment based on the FCC data. He reported that while Indiana has consistently lagged behind the national average in the number of

broadband lines per capita, the state has a higher percentage (53.01%) of its total lines operating at higher speeds (200 kbps in one direction and 2.5 Mbps to 10 Mbps in the other direction) than does the nation as a whole (45.67%). The FCC data further revealed that in 87% of Indiana's zip codes, consumers have a choice of more than one broadband provider.

Turning to the availability of video service, Chairman Hardy reported that the IURC has approved 16 state-level video franchises since assuming its role as the sole franchising authority in Indiana on July 1, 2006. He indicated that of the 16 video service providers (VSPs) with state-issued franchises, only six are new entrants into the market. The rest of the franchises were issued to existing VSPs that chose to terminate their existing local franchises or to provide service in a new area in Indiana. Because new competitors have been slow to emerge, Chairman Hardy concluded that state-issued franchises have not yet resulted in an increase in video competition since HEA 1279 took effect. However, noting that it takes time for VSPs to upgrade and build the necessary infrastructure, he predicted that VSPs will eventually expand their coverage areas.

With respect to basic telecommunications service, Chairman Hardy reported that the IURC has initiated a formal rulemaking procedure to adopt rules to establish the Indiana Lifeline Assistance Program, as mandated by HEA 1279. He explained that the state program, like its federal counterpart, will enable qualifying low-income households to receive discounted basic telecommunications service. The IURC must complete its rulemaking by July 1, 2008, and the rules must take effect by July 1, 2009. According to Chairman Hardy, the Lifeline Assistance Program is meant to advance the goal of universal service by increasing the percentage of the population with access to basic telecommunications service. Another program designed to increase Indiana's telephone penetration rate is the Indiana Universal Service Fund (IUSF). Like the federal Universal Service Fund, the IUSF will allow customers in high cost areas, including many rural areas, to receive comparable telecommunications services at rates comparable to those available in high-density areas. Beginning in October 2007, providers will collect from all retail customers a surcharge to fund the IUSF.

#### Water and wastewater industry reports:

Noting that the IURC is not required to report on the water and wastewater industries, Chairman Hardy told the Committee that his agency had determined that it was important to keep lawmakers informed of a number of issues confronting the industry, including aging infrastructure, the need for long-term supply planning, and financially troubled utilities. He thus proceeded to deliver the IURC's inaugural water and sewer report.

First, Chairman Hardy explained that the water and wastewater industry is fragmented, with different state agencies providing oversight for different types of utilities. According to Chairman Hardy, the legal form of the utility determines whether and to what extent a water or sewer utility is subject to the IURC's jurisdiction. For example, while the IURC regulates the rates and service terms for investor-owned water utilities, municipal water utilities can "opt out" of the IURC's jurisdiction. Thus, of the 835 water systems identified by the Indiana Department of Environmental Management, only 125 are regulated by the IURC. While small investor-owned and not-for-profit sewer utilities are regulated by the IURC, municipal wastewater providers are not. Of the 541 identified sewer utilities in the state, the IURC regulates just 55.

Chairman Hardy then highlighted a number of issues that the IURC would be monitoring in both the water and sewer industries. Like electric utilities, water and sewer utilities will need to make significant investments in infrastructure in the years ahead. Aging facilities

will require repair or replacement, and new real estate developments will require water and sewer extensions. Noting that the water industry is the most capital intensive of all utilities, investing more capital per dollar of revenue earned than any other sector, Chairman Hardy cautioned that these needed capital investments could significantly affect service rates.

In addition to infrastructure concerns, water supply and access issues will continue to affect the industry. Chairman Hardy pointed to the recent dispute over the Indianapolis Department of Waterworks' proposed construction of a pipeline that would carry water from Lake Monroe to Indianapolis. He noted that the dispute led to the passage of HEA 1738 (2007), which requires public hearings and notice to affected communities before water can be diverted from certain reservoirs.

Finally, Chairman Hardy reported that a small group of "troubled utilities" continues to consume a great deal of the IURC's time and effort. He explained that these utilities are typically small utilities established by housing developers, who then turn ownership over to residents of the development. Over time, many of these utilities deteriorate, providing inadequate service and posing environmental hazards. Under IC 8-1-30, the IURC may appoint a receiver and direct the sale of a utility's assets at fair market value, if the IURC finds that the utility has severe deficiencies that it has failed to remedy. According to Chairman Hardy, while the "receivership statute" has been a useful tool for the IURC, the receivership process can be lengthy and result in significant costs, which are ultimately borne by utility customers. He suggested that more stringent requirements for establishing a new utility or operating an existing utility may reduce the proliferation of small systems owned or initiated by developers.

#### SUFG report:

At the conclusion of his reports, Chairman Hardy introduced Doug Gotham, Director of the SUFG, to present the 2007 Indiana Renewable Energy Resources Study.<sup>6</sup> Mr. Gotham began by comparing statistics on U.S. energy consumption versus Indiana energy consumption, based on the energy source used. In 2006, 40% of the total energy consumed in the United States came from petroleum sources, followed by natural gas (23%), coal (23%), and nuclear energy (8%). Renewable resources comprised just 7% of the nation's total energy consumption. In Indiana, in the year 2004, coal accounted for 55% of the state's total energy consumption, followed by petroleum sources (30%) and natural gas (18%). Renewable resources represented only 1.5% of the energy consumed in Indiana.<sup>7</sup>

Turning from energy consumption to electricity production, Mr. Gotham presented data on U.S. electricity generation by energy source during 2006. Coal was the primary fuel source used, accounting for 49% of the electricity generated in the United States. This was followed by natural gas (20%), nuclear power (19%), and petroleum (2%). Renewable sources were used to generate 10% of the country's electricity. Mr. Gotham noted that hydropower was the renewable source used most often to generate electricity, comprising 76% of the renewables used in the United States.

Having observed that renewables were responsible for a small percentage of both the energy consumed and the electricity produced in the United States, Mr. Gotham described

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<sup>6</sup>See Exhibit 4.

<sup>7</sup>Percentages for Indiana energy consumption by energy source do not total 100%, because the state experienced a 5% net loss of electricity flow to other states.

some of the barriers to more widespread use of these alternative energy sources. First, he stressed that cost is the major barrier, with most renewable technologies having high capital costs for needed infrastructure and equipment. In Indiana, which had the fifth lowest electricity rates in the country in 2004, there has been little incentive to make these significant capital investments. According to Mr. Gotham, in this low cost environment, utilities and developers may forego making significant investments in renewable generation, concluding that consumers would not be willing to pay a premium for renewables-based electricity. In Indiana, a second barrier to the implementation of alternative sources is the intermittent nature of sources such as wind and solar power.

Mr. Gotham then discussed a number of specific renewable energy sources and their current and potential uses in Indiana. He reported that the U.S. Department of Energy's most recent wind map indicates that some northern areas of the state are potentially favorable to wind power. In fact, two wind projects in Benton County are expected to come online in late 2007: the 130 MW Benton County Wind Farm and the 200 MW Fowler Ridge Wind Farm.

He also noted the recent attention given to ethanol and soy diesel, which are produced from corn and soybeans, respectively, and used as transportation fuels. Other energy crops that could be used in Indiana include fast growing hardwood trees and switchgrass. However, there are a number of economic hurdles to the use of energy crops, including harvesting and transportation costs, other high-value uses for land, and lower prices for competing fossil fuels.

According to Mr. Gotham, organic waste biomass (primarily in the form of wood waste) represents Indiana's single largest source of renewable energy in terms of overall consumption. With respect to electricity production, organic waste biomass represents the second largest renewable source of electricity generation in Indiana, behind only hydropower. Such generation is mainly fueled by landfill gas, municipal solid waste, animal waste biogas, and byproducts from wastewater treatment.

While fuel cells have received much attention in recent years, the cells currently available cost about \$3,000/kW, which is roughly twice the cost for a large coal-fired plant and about ten times the cost for a natural gas-fired turbine. Still, Mr. Gotham acknowledged that considerable research has been devoted to the challenges associated with the technology, including cost barriers and concerns about hydrogen production and storage.

Although fuel cells may be viable in the future, hydropower is the renewable source used most often to generate electricity, both nationally and in Indiana. Indiana has about 60 MW of hydroelectric generating capacity, and the U.S. Department of Energy has identified another 66 MW of potential hydropower at existing dams. However, because this potential hydropower is spread out over 27 sites, only about 42 MW of this potential hydropower is considered viable.

Mr. Gotham concluded his presentation by announcing that the SUFG was working to complete its 2007 electricity forecast, which would provide comprehensive information on Indiana's actual and predicted consumption patterns, electricity prices, and resource requirements. He indicated that the forecast would be available later in the year.

With the annual reports having been presented, Representative Crooks announced at 12:40 p.m. that the Committee would recess until 2:00 p.m.

### **(3) Use of Trackers in Utility Rates:**

Regulatory overview:

Representative Crooks called the meeting back to order at 2:05 p.m. He then asked Chairman Hardy to provide an overview of the IURC's use of trackers in its ratemaking procedures.<sup>8</sup> As he explained before, Chairman Hardy noted that automatic adjustment clauses, or "trackers," allow a utility to recover through its rates certain expenses that are largely outside the utility's control, such as fuel costs, without the utility having to bring a formal rate case. According to Chairman Hardy, trackers are designed to reduce the frequency of expensive and time-consuming rate cases. He noted that trackers do not enable utilities to earn a profit on their expenses, but rather make them whole for costs incurred. In addition, trackers tend to have a positive effect on utilities' financial ratings by assuring Wall Street that utilities will be able to earn their authorized return on investment.

Despite the benefits that trackers can afford by providing financial stability for utilities, Chairman Hardy acknowledged that use of these mechanisms has raised legitimate concerns among customers. He explained that in a rate case, the IURC weighs various factors in authorizing a utility's rates. For example, the IURC considers whether a utility's costs are "prudently incurred," and whether they have been offset by any decreases in the utility's other operating expenses. With trackers, however, the IURC has no opportunity to balance these considerations. As a result, utilities may have less incentive to keep all costs as low as possible. According to Chairman Hardy, opponents of trackers have argued that trackers violate the principle that regulatory commissions should not act to guarantee a utility's profitability.

Having described both the benefits and disadvantages of trackers, Chairman Hardy explained that the IURC's primary source of authority for using trackers emanates from the legislature. Two of the most commonly used trackers, the fuel adjustment clause (FAC) and the gas cost adjustment (GCA) (IC 8-1-2-42), which allow electric and gas utilities to recover their costs for purchased fuel and gas, were enacted by the General Assembly in 1975 and 1983, respectively, in response to oil embargoes and extreme price volatility for commodities. Since that time, the legislature has authorized additional trackers that allow utilities to recover costs incurred for power plant construction (IC 8-1-8.8) and the installation of clean coal technologies (IC 8-1-8.8 and IC 8-1-2-6.6). A more general source of authority for trackers can be found in the alternative regulatory statute (IC 8-1-2.5), which was enacted in 1995 and allows the IURC to adopt alternative regulatory practices and rate mechanisms. Chairman Hardy explained that the various statutes require the IURC to approve a utility's request for a tracker if the IURC determines that the request is "in the public interest" or if the utility's costs are "reasonable and necessary."

Chairman Hardy reported that the IURC has authorized a number of trackers under the alternative regulatory statute, including trackers that allow utilities to recover demand-side management costs, regional transmission organization (RTO) expenses, purchased power costs, and various environmental compliance costs. He then described the trackers in effect for each of Indiana's five investor owned electric utilities (Indiana Michigan Power, Indianapolis Power & Light, Duke Energy, NIPSCO, and SIGECO) and the four largest natural gas utilities (Citizens Gas, NIPSCO, Indiana Gas, and SIGECO).

Turning to the water industry, Chairman Hardy reminded the Committee that in 2000, the General Assembly enacted IC 8-1-31 to authorize the distribution system improvement charge (DSIC). Designed to allow water utilities to recover the costs of investments in their distribution systems, the DSIC is meant to encourage utilities to replace aging

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<sup>8</sup>See Exhibit 5.

infrastructure and pipes. Chairman Hardy noted that the tracker is not available to wastewater utilities. Since its legislative creation, the DSIC has been used by four water utilities, ranging in size from the large Indiana American Water Company (serving nearly 250,000 customers) to the considerably smaller Water Service Company of Indiana (serving less than 2,000 customers). In addition to the DSIC, the IURC has established "purchased water" trackers for small water utilities that purchase their water from another utility. Unlike the DSIC, the purchased water tracker does not derive from any specific enabling legislation. Rather, it was developed after an IURC investigation and adopted as a rule (170 IAC 6-5) in 1990.

In concluding his presentation, Chairman Hardy predicted that additional trackers will be proposed as utilities face new environmental and regulatory requirements. He suggested that utilities may seek to recover investments in transmission facilities, the costs of complying with renewable portfolio standards, or revenue losses stemming from conservation programs. Chairman Hardy observed that when properly designed, trackers can be a useful tool in achieving regulatory balance. He urged legislators to give the IURC sufficient latitude to shape the mechanisms for, and monitor the effects of, any future legislatively authorized trackers.

#### Industry perspective:

Following Chairman Hardy's overview of tracker mechanisms, the Committee received the industry perspective from Stan Pinegar, Vice President of the Indiana Energy Association (IEA).<sup>9</sup> While acknowledging the importance of rate cases, Mr. Pinegar pointed out that such proceedings are both time consuming and costly. He noted that the significant costs incurred by utilities during rate case proceedings are ultimately reflected in the rates paid by customers. Furthermore, because a rate case can take a year or more to complete, by the time the IURC issues its final order approving a utility's rates and charges, the historical data on which the authorized rates are based are already outdated. According to Mr. Pinegar, trackers alleviate this problem by using current data. This, in turn, results in rates that more accurately reflect a utility's actual costs, with customers paying no more or no less than that amount.

Mr. Pinegar then set forth three scenarios in which the industry views trackers as appropriate regulatory tools. First, trackers are appropriate mechanisms for allowing utilities to recover costs that are volatile and outside utilities' control. He pointed to the FAC and the GCA as two examples of existing trackers that serve that purpose. Second, the legislature, in setting policy for the state, may authorize trackers to encourage utilities to pursue certain initiatives or programs. He reminded the Committee that Senator Hershman had included trackers in SB 410 (2007), which would have provided incentives for utilities to invest in advanced metering infrastructure and certain conservation programs by allowing utilities to recover the costs of such investments. Finally, Mr. Pinegar argued that trackers may be appropriately used to allow utilities to recover mandated costs, or those costs incurred in complying with state and federal regulations. In the near future utilities may face increased costs to comply with federal regulations concerning greenhouse gas emissions. A state or federally mandated renewable portfolio standard could impose additional costs. Mr. Pinegar maintained that utilities should be able to track such expenses in their rates.

In concluding, Mr. Pinegar stressed that consumers are still afforded protections when trackers are used. He noted that the IURC considers the evidence presented for each

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<sup>9</sup>See Exhibit 6.

requested tracker and only approves the tracking of costs that are reasonable and prudently incurred. He argued that trackers cause a utility's rates to be reviewed by the IURC more frequently than would occur if a utility could only present its costs in a formal rate case. Finally, he pointed out that trackers are not automatic rate increases but can, and often do, reflect falling prices, depending on market forces and the timing of incurred costs.

Mr. Pinegar then introduced Steven Fetter, President of Regulation UnFettered, to provide additional testimony on behalf of the IEA.<sup>8</sup> By way of introduction, Mr. Fetter announced that he is familiar with trackers as former Chairman of the Michigan Public Service Commission and as head of the utility ratings practice at Fitch Ratings. He reported that the use of trackers is common throughout the United States: 42 states have trackers in place for electric utilities, and 49 jurisdictions have GCA mechanisms for gas utilities. According to Mr. Fetter, this widespread use of trackers is a testament to their ability to benefit both utilities and consumers. He noted that both sides benefit from avoiding the costs of a rate case. Additionally, by ensuring that utilities are able to earn their authorized return, trackers reduce the regulatory uncertainty that is a major concern of both equity and debt investors. As regulatory uncertainty decreases, investors are more willing to commit funds to a utility at a reasonable cost, which in turn translates to lower rates for customers.

Mr. Fetter then highlighted a number of statements made in support of trackers by the major rating agencies, including Moody's Investors Service, Standard & Poors, and Fitch. He also noted that a number of states, including Indiana, have authorized the use of trackers beyond the sphere of fuel or gas cost recovery. In describing some of these mechanisms, he distributed a chart listing the various trackers adopted by the states.<sup>9</sup> Mr. Fetter then concluded his remarks by noting that in Indiana trackers are kept in check by Indiana's unique "earnings cap," a legislatively established mechanism that involves a comparison of a utility's current earnings with the utility's authorized earnings. He explained that the earnings cap ensures that trackers do not enable "over earning" by utilities. According to Mr. Fetter, Indiana has emerged as a leading jurisdiction in the use of trackers to follow actual costs both upward and downward.

#### Consumer perspective:

Representative Crooks then asked to hear from consumers regarding the use of trackers. He invited Jack Wickes to speak on behalf of the Indiana Industrial Energy Consumers, Inc. (INDIEC).<sup>10</sup> Mr. Wickes explained that INDIEC is an organization of manufacturers and other large-volume users of energy. Mr. Wickes reported that in any given year, INDIEC members consume 30%-40% of the energy used in Indiana. Given their demand for electricity, these consumers are concerned about the increasing number of trackers that have been approved in recent years. Mr. Wickes pointed out that there is little opposition to the well-established FAC and GCA, which track commodity costs as they both rise and fall. Rather, it is the "proliferation" of trackers that have followed, including trackers for demand side management, purchased power, clean coal technology, and RTO expenses.

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<sup>8</sup>See Exhibit 7.

<sup>9</sup>See Exhibit 8.

<sup>10</sup>See Exhibit 9.

Mr. Wickes reported that since the enactment of SB 29 (2002), which authorized new clean coal trackers, over \$2 billion in cumulative capital expenditures for environmental compliance has been passed through to customers through trackers. He noted that INDIEC had opposed SB 206 (2007), which would have authorized trackers for costs incurred by utilities in reducing emissions that the IURC "reasonably anticipates" will be regulated by federal, state, or local governments. Mr. Wickes argued that the risks associated with predicting what federal lawmakers might do should not be borne by consumers. In closing, he stressed that INDIEC is opposed to any legislation that would establish trackers without including an "offset provision" that would require the IURC to offset a utility's increased costs by any decreasing costs.

Also representing consumers, Jerry Polk spoke on behalf of the Citizens Action Coalition of Indiana.<sup>11</sup> While conceding that trackers have a place in the regulatory scheme, Mr. Polk maintained that recent utility tracking initiatives have amounted to "backdoor deregulation," by allowing utilities to bypass traditional rate cases. He noted that the regulatory review of tracked costs that occurs in a tracker proceeding is limited in scope and thoroughness, compared to the level of review that occurs in a general rate case. According to Mr. Polk, as more trackers are approved, utilities have less incentive to seek a general rate case, which in turn delays the opportunity for a comprehensive review of a utility's total costs of providing service. He further pointed out that even when trackers are in place, utilities still receive a "risk premium" for bearing the risk of cost increases in between rate cases. He argued that to the extent the utility no longer bears this risk when trackers are in place, the corresponding risk premium should be eliminated.

Mr. Polk maintained that trackers shift the risk of rising costs from the utility to consumers. With the risk of increased costs transferred to consumers, utilities have less incentive to control their costs. Mr. Polk argued that shifting the burden to ratepayers, who have no part in the management of the risk, violates the principle that the person who manages the risk should bear the risk.

Finally, Mr. Polk urged legislators not to "micro manage" the use of trackers. He suggested that the IURC has sufficient authority under the alternative regulatory statute (IC 8-1-2.5) to use trackers as part of its duty to ensure "reasonable and just" utility rates. He pointed to a number of existing trackers that have no explicit enabling legislation as evidence that the IURC has discretion to adopt rate adjustment mechanisms. He argued that this discretionary authority renders unnecessary legislation such as SB 206 (2007) and SB 410 (2007), which would have established new trackers for environmental compliance costs and conservation programs, respectively.

Following brief discussion by the Committee, the Co-Chairmen adjourned the meeting at 4:15 p.m.

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<sup>11</sup>See Exhibit 10.