

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

VERIFIED PETITION OF DUKE ENERGY INDIANA, INC.)
SEEKING (1) APPROVAL OF AN ONGOING REVIEW)
PROGRESS REPORT PURSUANT TO I.C. 8-1-8.5 AND 8-1-)
8.7; (2) AUTHORITY TO REFLECT COSTS INCURRED FOR)
THE EDWARDSPOINT INTEGRATED GASIFICATION)
COMBINED CYCLE GENERATING FACILITY ("IGCC)
PROJECT"))
PROPERTY UNDER CONSTRUCTION IN ITS RATES AND)
AUTHORITY TO RECOVER APPLICABLE RELATED)
COSTS THROUGH ITS INTEGRATED COAL)
GASIFICATION COMBINED CYCLE GENERATING)
FACILITY COST RECOVERY ADJUSTMENT, STANDARD)
CONTRACT RIDER NO. 61 PURSUANT TO I.C. 8-1-8.8-11)
AND -12; AND (3) ESTABLISHMENT OF A SUBDOCKET)
PROCEEDING TO REVIEW THE COST ESTIMATE FOR)
THE IGCC PROJECT; AND (4) APPROVAL OF A REQUEST)
TO UPDATE ITS DEPRECIATION RATES FOR)
PRODUCTION TRANSMISSION, DISTRIBUTION AND)
GENERAL PLANT AND EQUIPMENT)

CAUSE NO. 43114
IGCC 4 S1

SETTLEMENT TESTIMONY OF

BARBARA A. SMITH – PUBLIC’S EXHIBIT NO. 1S

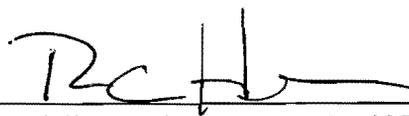
AND

WES R. BLAKLEY – PUBLIC’S EXHIBIT NO. 2S

ON BEHALF OF THE

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

MAY 16, 2012



Randall C. Helmen, Atty. No. 8275-49
Chief Deputy Consumer Counselor

CERTIFICATE OF SERVICE

This is to certify that a copy of the **OUCS SETTLEMENT TESTIMONY OF BARBARA A. SMITH and WES R. BLAKLEY** has been served upon the following parties of record in the captioned proceeding by electronic service on May 16, 2012.

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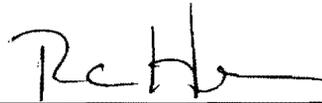
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**SETTLEMENT TESTIMONY OF BARBARA A. SMITH
CAUSE NO. 43114 IGCC 4 S1 PHASE I AND PHASE II
DUKE ENERGY INDIANA**

1 **Q: Please state your name and business address.**

2 A: Barbara A. Smith, Indiana Office of Utility Consumer Counselor, 115 W.
3 Washington St., Suite 1500 South, Indianapolis, IN 46204.

4 **Q: By whom are you employed and in what capacity?**

5 A: I am employed by the Indiana Office of the Utility Consumer Counselor
6 (“OUCC”) as the Director of the Resource Planning and Communications
7 Division.

8 **Q: Did you previously submit verified testimony in this Cause?**

9 A: Yes. I have submitted testimony in every IGCC 4S1 proceeding including, most
10 recently, responsive testimony in Phase I and direct and rebuttal testimony in
11 Phase II.

12 **Q: What is the purpose of your testimony?**

13 A: The purpose of my testimony is to support and recommend approval for the
14 Settlement Agreement IURC Cause No. 43114-IGCC4S1 Phase I and Phase II
15 (“Agreement”) entered into by and between Duke Energy Indiana, Inc. (“DEI” or
16 “Petitioner”), the OUCC, the Duke Energy Indiana Industrial Group (“Duke IG”) and
17 Nucor Steel – Indiana (“Nucor”) (collectively “the Settling Parties”) that was
18 filed with the Commission on April 30, 2012. The Agreement provides a
19 reasonable resolution of all issues in Phase I and Phase II of this proceeding
20 regarding the Edwardsport project (“the Project”). Specifically, my settlement

1 testimony addresses the unique circumstances which led to the Agreement and the
2 regulatory policy that supports the conclusion that the Agreement is in the public
3 interest.

4 **Q: Is the Agreement a product of serious bargaining among capable and**
5 **knowledgeable parties?**

6 A: Yes. The Settling Parties represent a diverse group of constituents with differing
7 views on the complicated issues raised in this proceeding. The Agreement is the
8 result of substantial negotiations and investigation of the concerns raised in this
9 proceeding. While the Agreement is straight forward and non-complicated, it is
10 the result of very tedious and time-consuming work. Experts were involved with
11 legal counsel in the development of both the conceptual framework and the details
12 of the proposed settlement. Many hours were devoted by all Settling Parties to
13 settlement negotiations both before and after the Agreement in principle was
14 reached. The process and the results reflected in the Agreement, when taken as a
15 whole, produce a fair result that balances the interests of the various stakeholders
16 and the overall public interest.

17 **Q: Did the Joint Intervenors participate in the settlement negotiations that led**
18 **to the Agreement?**

19 A: It is my understanding that there were numerous conversations between counsel
20 for the Settling Parties and counsel for the Joint Intervenors during these
21 negotiations to determine Joint Intervenors' interest in joining in the negotiations.
22 Although Joint Intervenors ultimately did not join in the negotiations or the
23 Agreement, they were kept generally apprised of the status of the settlement
24 negotiations.

1 **Q: What concerns did the OUCC raise in its case-in-chief testimony in this**
2 **subdocket?**

3 A: The OUCC raised concerns about the excessive project cost increases and the
4 recurring inaccurate project cost estimates. Additionally, the OUCC asserted that
5 DEI failed to demonstrate that it exercised budgetary constraints or conducted
6 prudence reviews regarding the cost overruns. DEI's conduct, we asserted,
7 constituted imprudence and, in some cases, gross mismanagement. The OUCC
8 contended that since DEI was receiving an enhanced return on its project
9 investment, it had little incentive to manage the Project costs prudently. DEI
10 ratepayers were bearing total responsibility for these escalating costs while DEI
11 shareholders faced no risks, only increasing profits.

12 **Q: Were the concerns of the OUCC addressed in the Agreement?**

13 A: Yes. The terms of the Agreement address the issues the OUCC raised in both
14 Phase I and Phase II of this proceeding. I will cover terms of the Agreement and
15 explain how this settlement is a major accomplishment for the DEI ratepayers.

16 **Q: Please describe the hard cost component of the Agreement.**

17 A: The Settling Parties agreed to a Hard Cost Cap of \$2.595 billion.¹ To lend this
18 figure some perspective, the Project's estimated construction costs were originally
19 approved by the IURC at \$1.985 billion. In over four years since the Commission
20 approved the Project, the estimated costs increased first to \$2.35 billion, then to
21 \$2.88 billion and finally to DEI's current estimate, provided in this proceeding, of

¹ This cap includes approximately \$2.319 billion of actual construction cost for the total company. This number is approximately \$2.129 billion for DEI jurisdictional retail customers. The total construction cost of \$2.595 billion includes approximately \$2.319 billion plus an estimated \$276 million in Allowance for Funds Used During Construction ("AFUDC").

1 \$3.3 billion (\$2.98 billion construction cost plus \$302 million AFUDC). The
2 Commission issued an order on January 7, 2009 in IGCC 1 approving the
3 recovery of DEI's estimated cost of \$2.35 billion. This amount was comprised of
4 \$2.225 billion in construction costs and \$125 million of AFUDC. The negotiated
5 \$2.319 billion hard cap limits DEI's recovery of construction costs to an
6 additional \$94 million over and above the already approved amount of \$2.225
7 billion. Compared to DEI's current construction cost estimate of \$2.98 billion,
8 this settlement outcome results in a savings to DEI ratepayers of \$661 million in
9 direct construction costs. Once the statutorily prescribed AFUDC is included, the
10 savings are even greater, because DEI can only recover AFUDC on the \$2.319
11 billion under the terms of the Agreement. If DEI's latest estimate of \$3.3 billion
12 total project costs is accurate, DEI ratepayers will not be burdened with over \$700
13 million in construction costs. Instead, these costs will be absorbed by DEI
14 shareholders. If the costs of the Project continue to escalate, as some have
15 predicted, the savings to ratepayers will continue to grow even more.

16 **Q: How does the hard cap address OUCC's concern that there has been a lack**
17 **of accountability or responsibility on the part of those who have caused or**
18 **allowed these cost overruns?**

19 **A:** The hard cap addresses this OUCC concern because, absent extraordinary
20 circumstances, DEI will not be able to recover any construction costs that exceed
21 approximately \$2.319 billion in any future proceeding at any time. The
22 responsibility to keep costs in check will be placed squarely on the shoulders of
23 DEI's shareholders as to all additional costs to complete the Project.

24 **Q: Does the Agreement include a cap on AFUDC?**

1 A: Yes. As OUCC Witness Mr. Wes Blakley will explain in greater detail, the
2 Settling Parties agreed that DEI should be allowed to recover AFUDC only on the
3 reduced construction cost amount of approximately \$2.319 billion.

4 **Q: By entering into this Agreement, is the OUCC conceding that DEI's conduct**
5 **was not imprudent or that it was not guilty of concealment or gross**
6 **mismanagement?**

7 A: No. We stand by our testimony. The OUCC believes the significant financial
8 concessions made by DEI's shareholders validate our claims. We also believe that
9 the Agreement reasonably resolves those claims. The nature of settlements is for
10 parties to weigh their respective risks and rewards in an effort to find a confluence
11 of reasonable outcomes. In my opinion, the OUCC and other Intervenors
12 presented compelling cases. However, we also acknowledge that DEI devoted
13 considerable time and resources to put on a vigorous defense as to these claims.
14 This Agreement serves to put our claims to rest by providing substantial benefits
15 to ratepayers.

16 **Q: What was the basis for setting the hard cap at the level described above?**

17 A: The setting of the hard cap amount was the result of extensive arms-length
18 negotiations. The Settling Parties did not attempt to agree upon precisely what
19 individual costs were prudently incurred. Instead, the cap reflects the Settling
20 Parties' assessment of their respective risks faced in the litigation. For example,
21 the hard cap was set at an amount above DEI's currently approved project costs
22 addressed in the Commission's 2008 Order. This increase is a reflection of the
23 fact that there are certain legitimate cost escalations that have occurred and may
24 continue to occur in the future. The hard cap is an amount that the Settling Parties

1 agreed was reasonable, supported by the evidence of record and will provide
2 certainty, with regard to costs, for the remainder of the life of this Project.

3 **Q: Why is it important to the OUCC to have “certainty” regarding the costs of**
4 **the Project?**

5 A: The OUCC has supported the construction of this Project since 2007 and
6 continues to support its completion and utilization of the energy produced. This
7 Project allows Indiana to use a local resource to address the state’s future energy
8 needs. As I stated in my Phase I testimony, Indiana remains a coal-rich state and
9 the Governor’s Homegrown Energy Strategy places an emphasis on clean coal as
10 part of the future solution to Indiana’s energy needs.² The Agreement provides
11 certainty for ratepayers and will allow DEI to complete and place in service this
12 additional generation with its promise of clean coal technology.

13 **Q: Are there other components to the Agreement that have a positive impact on**
14 **DEI retail rates for ratepayers?**

15 A: Yes. Section 4 of the Agreement provides for a base rate moratorium whereby
16 DEI may not file for an increase to its base rates and charges prior to March 2013.
17 Increases to rates and services resulting from a final order in a retail electric base
18 rate case filing cannot be implemented prior to April 1, 2014.

19 **Q: Why does the OUCC consider a rate moratorium a benefit to ratepayers?**

20 A: The rate moratorium is a benefit to ratepayers for at least two reasons. First, DEI
21 has publically stated that it was planning to file a base rate case in 2012 and that it
22 is under-earning by approximately \$100 million per year Although we would not

² See IURC Cause No. 43114 IGCC 4 S1, Public’s Exhibit No. 1R, page 3, lines 20 – 23.

1 place the same value as DEI does on the moratorium, a two-year rate moratorium,
2 will result in lower rates than DEI's ratepayers might otherwise pay without this
3 limitation and thus the moratorium provides real value to DEI ratepayers.
4 Second, since the Settling Parties have agreed to modify depreciation rates on all
5 non-IGCC production plant, this provision will serve to reduce retail rates by
6 approximately \$35 million per year for approximately three years, remaining in
7 effect until an order in DEI's second base rate case, filed after the 2013 rate case.
8 Normally, depreciation rates are only changed in base rate proceedings, but this
9 modification will provide such benefits immediately upon approval of this
10 Agreement. In addition, DEI has agreed that in its next base rate case it will
11 change the method used to calculate depreciation on its qualified pollution control
12 property, which will result in approximately a \$32 million decrease in annual
13 retail depreciation.

14 **Q: What other terms of the Agreement have a direct effect on DEI's retail**
15 **consumers' rates?**

16 A: As Mr. Blakley will describe in greater detail, DEI has agreed to reflect deferred
17 taxes in its capital structure in the IGCC tracking mechanism. This action will
18 reduce retail rates by approximately \$22 million annually.

19 **Q. What other consumer benefits are found in the Agreement?**

20 A: There are three important terms that the Settling Parties included in this
21 Agreement.

22 1. DEI shareholders will establish a fund to effect a collaborative development
23 of a clean energy initiative by OUCC and DEI. This initiative will be

1 administered by an independent third party. Although the details have not yet
2 been defined, the OUCC will ensure the resulting project(s) will have a
3 positive impact on Indiana ratepayers and the Indiana economy as well as help
4 push market transformation in the clean energy arena. .

5 2. DEI shareholders will contribute \$3.5 million to the Indiana Low Income
6 Home Energy Assistance Program (“LIHEAP”) over a five-year period.
7 These funds will be used solely to assist DEI retail customers.

8 3. DEI retail customers will receive 100% of the applicable retail jurisdictional
9 share of any net byproduct or co-product revenue from the Project. Although
10 the dollar amount of this income stream is not yet known, it gives this
11 potentially significant benefit back to the ratepayers

12 **Q: Realizing the three items above are indeed important, please focus now on**
13 **the material financial concessions mentioned earlier in this testimony and**
14 **summarize the rate impact to be realized by DEI retail customers.**

15 A: I will. Below is a summary of the approximate financial benefits to DEI retail
16 customers as a direct result of this Agreement:

- | | | |
|----|---------------------------------|--|
| 17 | • Hard cap | \$700 million - \$900 million ³ |
| 18 | • Deferred taxes | \$22 million annually (initially) |
| 19 | • Depreciation adjustment | \$35 million annually |
| 20 | • Accelerated pollution control | \$32 million annually |
| 21 | equipment depreciation | |

³ This is the amount upon which ratepayers will not pay a return on or a return of to DEI. According to Mr. Blakley, this will result in nearly \$2 billion in reduced rates over the life of the plant.

1 **Q: Do you believe the Agreement is in the public interest?**

2 A: Yes. It provides material financial concessions to DEI ratepayers that significantly
3 reduce the rate impact of this Project. It provides assurances that, absent
4 extraordinary circumstances outside of DEI's control, ratepayers will pay only for
5 the \$2.595 billion hard cap of direct project costs and additional AFUDC for the
6 completion of this Project.

7 **Q: Does this conclude your testimony?**

8 A: Yes it does.

AFFIRMATION

I affirm, under the penalties for perjury, that the foregoing representations are true.

Barbara A. Smith

By: Barbara A. Smith
Indiana Office of
Utility Consumer Counselor

5-16-12

Date

Cause No. 43114 IGCC 4S1

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

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SETTLEMENT TESTIMONY OF

WES R. BLAKLEY – PUBLIC’S EXHIBIT NO. 2S

ON BEHALF OF THE

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

MAY 16, 2012

SETTLEMENT TESTIMONY OF WES R. BLAKLEY
Cause No. 43114 IGCC 4 S1
DUKE ENERGY INDIANA

1 **Q: Please state your name and business address.**

2 A: My name is Wes R. Blakley, and my business address is 115 W.
3 Washington St., Suite 1500 South, Indianapolis, Indiana 46204.

4 **Q: By whom are you employed and in what capacity?**

5 A: I am a Senior Utility Analyst for the Office of Utility Consumer Counselor
6 (OUCC).

7 **Q: Are you the same Wes Blakley that has previously testified in this sub-**
8 **docket?**

9 A: Yes. In fact, I have testified in every IGCC docketed proceeding.

10 **Q: What is the purpose of your settlement testimony in this Cause?**

11 A: My testimony provides a review of the rate-making treatment of items in
12 the Settlement Agreement (“Agreement”) entered into between Duke
13 Energy Indiana Inc. (“DEI” or “Petitioner”), the OUCC, Duke Energy
14 Industrial Group (“Duke IG”) and Nucor Steel – Indiana (“Nucor”) that
15 was filed in this sub-docket with the Commission on April 30, 2012. The
16 nature of the Agreement and the revenue requirement items in it are
17 sensitive to time. Therefore, all revenue requirement and rate reduction
18 estimates are approximations and are not intended to be exact. Items that
19 would directly impact rates as a result of approving the Agreement
20 include: 1) establishing a hard cost cap for the project; 2) passing through

1 a depreciation rate reduction; and 3) including zero cost deferred income
2 taxes in the capital structure.

3 Other items in the Agreement do not directly affect the IGCC
4 tracker but give benefits to ratepayers. This includes a contribution to the
5 Indiana Utility Ratepayer Trust, a contribution to the Indiana Low Income
6 Home Energy Assistance Program, as well as payments for certain legal
7 and consulting fees for services vital to the presentation of the non-Duke
8 settling parties evidentiary cases. Also, the Agreement provides a change
9 in depreciation rates applied to DEI's qualified pollution control property
10 (QPCP). This reduction in depreciation expense for accounting purposes
11 will initially benefit DEI because the accelerated rates will continue to be
12 used in its QPCP tracker, but will subsequently result in an approximately
13 \$32 million annual reduction to DEI customer rates in Petitioner's next
14 base rate case because the non-accelerated rates will be proposed for
15 ratemaking in that case for the QPCP property at issue. Finally, the
16 Agreement contains a rate case moratorium, whereby DEI agrees not to
17 file a new retail electric base rate case prior to March 2013, and that no
18 increase to its base rates will be implemented prior to April 1, 2014.

19 **I. Hard Cost Cap**

20 **Q: Please describe your understanding of the Hard Cost Cap Proposal in**
21 **the Agreement.**

1 A: The Agreement creates a "Hard Cost Cap" of \$2.595 billion. According to
2 DEI, the current cost of the IGCC plant is approximately \$3.3 billion.
3 Under the Agreement, the construction cost and investment will be frozen
4 at \$2.595 billion as of June 30, 2012, which is approximately \$700 million
5 less than the actual cost.

6 **Q: Will the Hard Cost Cap result in a savings to ratepayers over the**
7 **lifetime of the Plant?**

8 A: Yes. The Hard Cost Cap will result in a reduction to the annual revenue
9 requirement paid by DEI ratepayers.

10 **Q: Can you calculate an approximate annual revenue requirement**
11 **reduction attributable to the Hard Cost Cap?**

12 A: Yes. The approximate annual revenue requirement reduction can be
13 calculated. Assuming a weighted average rate of return from the latest
14 capital structure known, which is from IGCC-8 of 6.99%, we can
15 calculate basic revenue requirement reductions for the return component.
16 Applying this 6.99% return to the \$700 million reduction in construction
17 investment gives you the reduction of return (net operating income)
18 requirements of \$48.9 million on an annual basis. Grossing this number
19 up for income taxes, using the gross up factor from IGCC-8, results in a
20 total revenue requirement reduction of approximately \$73.4 million

1 annually in year one.¹ This is the return on the disallowed construction
2 expressed on a revenue requirements basis. These savings will be higher
3 if the total cost of the Project exceeds the current \$3.3 billion estimate.

4 **Q: Are there additional savings attributable to the Hard Cost Cap, in**
5 **addition to the reduced revenue requirements related to return on**
6 **investment?**

7 A: Yes. There will also be savings in depreciation expenses, often referred to
8 as “return of” investment. Assuming a 30 year depreciation period, a
9 \$23.3 million² reduction in annual revenue requirement can be calculated
10 for depreciation. Thus, a total reduction of revenue requirement of
11 approximately \$96.7 million on an annual basis can be achieved as a result
12 of the adoption of the Hard Cost Cap proposal as of June 30, 2012. This
13 assumes the total cost invested by Duke in the IGCC project is \$3.3
14 billion, and reflected in rates of the Hard Cost Cap by June 30, 2012.

15 **Q: What happens after June 30, 2012?**

16 A: After June 30, 2012, if the Hard Cost Cap is not fully reflected in rates,
17 DEI can continue to accrue allowance for funds used during construction
18 (AFUDC) on the portion of the \$2.595 that has not been reflected in rates.
19 I believe this means that the construction costs and AFUDC, which has
20 been included as a result of the last tracker approved by the Commission

¹ \$48.9 million x 1.50067 = \$73.4 million. This amount will decline over time as accumulated depreciation increases reducing the amount of plant upon which a return can be earned.
² \$700 million / 30 years = \$23.3 million.

1 in IGCC-4 of approximately \$887 million, is excluded from further
2 AFUDC, but the difference up to the hard cap amount of \$2.595 billion
3 will be eligible for AFUDC accruals. According to the Agreement, this
4 would add approximately \$9 million per month to the cost of the plant
5 through November of 2012. If there is no approval by the end of
6 November 2012, then 85% of the calculated AFUDC will be accrued to
7 the plant. This will add to the overall cost of the plant. Estimates of
8 actual reductions in revenue requirements as a result of the hard cap
9 proposal after June 30, 2012, are less certain, but should not be
10 substantially different if delays are not lengthy.

11 **II. Depreciation Rates**

12 **Q: What is the impact of allowing DEI to update its depreciation rates**
13 **and passing the resulting reduction through as a credit to customers**
14 **in the IGCC tracker?**

15 A: It is my understanding that DEI has performed a new depreciation study
16 that reduces depreciation rates. Normally, new depreciation rates can only
17 be instituted at the time of a rate case. The Settling Parties have agreed to
18 allow DEI to implement the new lower total company depreciation rates
19 and pass on the reduction as a credit to customers in the IGCC tracker.
20 This reduction amounts to approximately \$35 million annually according
21 to DEI.

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III. Deferred Income Taxes

Q: Does the Agreement discuss the inclusion of zero cost deferred income taxes in the capital structure?

A: Yes. DEI has agreed on a prospective basis to include zero cost deferred taxes in the capital structure, which effectively reduces the weighted cost of capital. Exclusion of zero cost capital from the capital structure had been granted in the original CPCN order in Cause No. 43114 as a form of incentive to DEI and was capped at \$1.985 billion of IGCC investment. The actual impact that the exclusion of deferred income taxes has on the capital structure varies with the weighting of deferred income taxes as well as the weighting of other elements in the capital structure. The incentive provided about a 100 basis point increase in the weighted cost of capital. This increase in the weighted cost of capital, when applied to the amount of IGCC investment eligible for the incentive, equates to about \$22 million of additional revenue requirement on an annual basis. By removing this incentive, ratepayers would immediately benefit from the reduced weighted average rate of return in the initial amount of approximately \$22 million annually.

Q: Please summarize the approximate revenue requirement impact of the items discussed above.

A: If the settlement is approved by June 30, 2012, the revenue requirement impact would be an approximate \$120 million dollar reduction on an

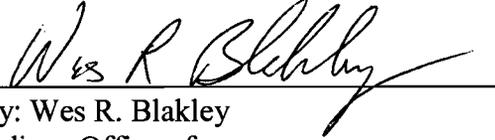
1 annual basis. This assumes a 6.99% rate of return and a tax gross up
2 factor of approximately 1.50 applied to the difference between the plant
3 investment of \$3.3 billion and the Hard Cost Cap of \$2.595 billion at June
4 30, 2012. In addition there will be a \$35 million credit from a reduction of
5 depreciation rates passed through as a credit in the IGCC tracker.

6 **Q: Does this conclude your testimony?**

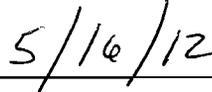
7 **A: Yes, it does.**

AFFIRMATION

I affirm, under the penalties for perjury, that the foregoing representations are true.



By: Wes R. Blakley
Indiana Office of
Utility Consumer Counselor



Date

Cause No. 43114 IGCC 4S1