STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

VERIFIED PETITION OF INDIANAPOLIS POWER & LIGHT COMPANY ("IPL"), AN INDIANA CORPORATION, FOR APPROVAL OF CLEAN ENERGY PROJECTS AND QUALIFIED POLLUTION CONTROL PROPERTY AND FOR ISSUANCE OF A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY FOR CONSTRUCTION AND USE OF CLEAN COAL TECHNOLOGY; FOR ONGOING REVIEW; FOR APPROVAL OF THE TIMELY RECOVERY OF COSTS INCURRED DURING CONSTRUCTION AND OPERATION OF SUCH PROJECTS THROUGH IPL'S ENVIRONMENTAL COMPLIANCE COST RECOVERY ADJUSTMENT ("ECCRA"); FOR APPROVAL OF DEPRECIATION PROPOSAL FOR SUCH PROJECT; FOR THE USE OF CONSTRUCTION WORK IN PROGRESS RATEMAKING; AND FOR AUTHORITY TO DEFER COSTS INCURRED DURING CONSTRUCTION AND OPERATION, INCLUDING CARRYING COSTS, DEPRECIATION, AND OPERATION AND MAINTENANCE COSTS, UNTIL SUCH COSTS ARE REFLECTED FOR RATEMAKING PURPOSES, ALL PURSUANT TO IND. CODE §§ 8-1-2-6.1, 8-1-2-6.7, 8-1-2-6.8, 8-1-2-42(a), 8-1-8.4, 8-1-8.7, 8-1-8.8 AND 170 IAC 4-6-1 ET SEQ.	)	**CAUSE NO. 44242**

PREFILED TESTIMONY OF

WES R. BLAKLEY – PUBLIC'S EXHIBIT #5

ON BEHALF OF THE

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

JANUARY 28, 2013

Respectfully Submitted,

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

Scott C. Franson, Atty. No. 27839-49
Deputy Consumer Counselor

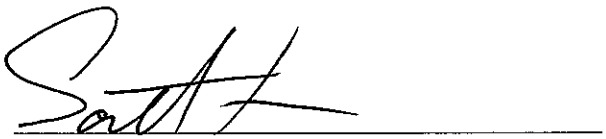
CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing ***Office of Utility Consumer Counselor Prefiled Testimony of Wes R. Blakley*** has been served upon the following counsel of record in the captioned proceeding by electronic service and/or by depositing a copy of same in the United States mail, first class postage prepaid, on January 28, 2013.

Teresa Nyhart
Nicholas K. Kile
Amy A. Davis
BARNES & THORNBURG LLP
11 South Meridian Street
Indianapolis, Indiana 46204
tnyhart@btlaw.com
nkile@btlaw.com
adavis@btlaw.com

Timothy L. Stewart
Anne Becker
Lewis & Kappes, P. C.
One American Square, Suite 2500
Indianapolis, Indiana 46282-0003
TStewart@Lewis-Kappes.com
abecker@Lewis-Kappes.com
atyler@Lewis-Kappes.com
etennant@Lewis-Kappes.com

Jennifer A. Washburn
Citizens Action Coalition
603 East Washington Street, Suite 502
Indianapolis, Indiana 46204
jwashburn@citact.org



Scott C. Franson
Deputy Consumer Counselor

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR
115 West Washington Street
Suite 1500 South
Indianapolis, IN 46204
infomgt@oucc.in.gov
317/232-2494 – Phone
317/232-5923 – Facsimile

TESTIMONY OF WES R. BLAKLEY
CAUSE NO. 44242
INDIANAPOLIS POWER AND LIGHT COMPANY

I. INTRODUCTION

Q: Please state your name and business address.

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

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

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

Q: Please describe your educational background and experience.

A: I received a Bachelor of Science Degree in Business with a major in Accounting from Eastern Illinois University in 1987. Upon graduation, I worked as a Revenue Accountant and later as a Billing Supervisor for Illinois Consolidated Telephone Company. My primary duties included supervising the audit of the billing system, analyzing and recording revenues and filing related sales and excise tax returns. I continued in that capacity until April 1991, when I accepted a staff accountant position with the OUCC. I have attended the Annual Regulatory Studies Program sponsored by NARUC at Michigan State University in East Lansing, Michigan.

Q: Have you previously testified before the Indiana Utility Regulatory Commission ("Commission")?

A: Yes. I have testified in water, sewer, electric and gas rate case proceedings.

Q: Please describe your duties and responsibilities at the OUCC.

A: I review Indiana utilities' requests for regulatory relief filed with the Commission. I also prepare and present testimony based on my analyses, and make recommendations to the Commission on behalf of Indiana utility consumers.

Q: What is the purpose of your testimony?

A: The purpose of my testimony is to provide an opinion and recommendations concerning Indianapolis Power and Light Company's ("IPL" or "Petitioner") requested ratemaking treatment for its proposed Mercury and Air Toxics Standards ("MATS") Compliance Plan.

Q: Please summarize your recommendations to the Commission.

A: Should the Commission approve the CPCN, the OUCC recommends:

1. During the construction phase, the construction work in progress ("CWIP") and allowance for funds used during construction ("AFUDC") requested by IPL be approved;

2. Extension of the depreciation of the projects over a 20 year period instead of the 18 years requested by Petitioner;

3. Denial of Petitioner's request to defer and record as a regulatory asset the post-in-service depreciation, AFUDC and operations and maintenance ("O&M") expense; and

4. In its environmental tracker, IPL should specifically identify pollution control investment included in base rates in Petitioner's last rate case in Cause No. 33938 that is now being replaced or upgraded. Ratepayers should receive a reasonable credit in the ECCRA to reflect the revenue requirements embedded in base rates for equipment being replaced or upgraded.

Q: Please describe the review and analysis you conducted in order to prepare your testimony.

A: I reviewed the petition, testimony, workpapers, and exhibits filed in this Cause. I reviewed Petitioner's responses to OUCC data requests. I also reviewed pertinent parts of the Indiana Code and Indiana Administrative Code.. Finally, I participated

in discussions with Petitioner and other OUCC staff members regarding issues in this Cause.

II. REQUESTED RATE RELIEF

Q: What does Petitioner propose regarding rate relief in this Cause?

A: Petitioner seeks authority for the following:

1. To recognize all costs incurred in the construction and operation of the MATS compliance project, including capital costs, investments, and expenses including consumables using IPL's existing Environmental Compliance Cost Recovery Adjustment (ECCRA);

2. To record AFUDC in accordance with the procedures outlined in 170 IAC 4-6, the "Ratemaking Treatment of QPCP";

3. To depreciate the MATS compliance project over an eighteen (18) year period once the assets are in service; and

4. After project completion, defer and record as a regulatory asset the post-in-service depreciation, carrying costs and O&M expense, until such time these costs receive ratemaking treatment through the Environmental Compliance Cost Recovery Adjustment (ECCRA) or are otherwise reflected in basic rates.[1]

Q: If the CPCN is granted, does the OUCC have any concerns regarding the CWIP and AFUDC treatment requested in this Cause during the construction phase?

A: No. The ECCRA is a CWIP tracker, and the AFUDC treatments during construction proposed by IPL are provided to utilities by statute, and in concept, the OUCC has no issue with these items during the construction phase.[2] However, I will express my concerns regarding Petitioner's proposals for special post-in-service accounting treatments. Also, I will explain the need to provide

[1] Testimony of Petitioner's Witness Cutshaw, .Page 5, Lines 7-21, Page 6, Lines 1-5.

[2] See 170 I.A.C. 4-6-1 *et* seq.

ratepayers a reasonable credit in the ECCRA to reflect the revenue requirements embedded in base rates for equipment being replaced or upgraded.

Q: What concerns does the OUCC have regarding IPL's proposed 18 year depreciation life in this Cause?

A: Indiana Code § 8-1-2-6.7 allows a utility to depreciate its clean coal technology project over a range of ten (10) to twenty (20) years. IPL's proposal to depreciate the MATS compliance project over an eighteen (18) year period will result in IPL's depreciation expense to be approximately $28.38million per year. If the project is depreciated over twenty (20) years, the depreciation expense associated with the project will be approximately $25.55 million per year. The change to a twenty (20) year accelerated depreciation will help reduce IPL's revenue requirement by approximately $2.83 million annually.[3] Considering the magnitude of the projects' estimated cost plus costs associated with other projects, the OUCC recommends depreciating the assets over twenty (20) years. This provides Petitioner full recovery of its depreciation and mitigates the rate impact to Petitioner's customers.

III. POST- IN- SERVICE ACCOUNTING TREATMENT

Q: Please discuss Petitioner's request to defer and record post-in-service depreciation, carrying costs and O&M expense.

A: After construction is complete, Petitioner requests authority to defer post-in service depreciation, carrying costs, and O&M expense for the MATS compliance projects. Petitioner requests this treatment because it anticipates a delay between

[3] $511 million / 18 = $28.38 million, $511 million / 20= $25.55 million ($28.38 million-$25.55 million = $2.83 million)

the in-service date and inclusion of the MATS compliance projects in Petitioner's rate base for ratemaking purposes.

Q: Why do utilities request post-in-service accounting treatment of these types of costs until they are included in base rates?

A: When a project like this is complete and the asset becomes used and useful, the utility must start recording depreciation expense. It also incurs AFUDC costs on the investment. Utilities typically plan rate cases so that when a project is complete, or a purchased asset is placed in service, the asset can be put into base rates. However, there may be a delay between when a project is completed or purchased and when it is included in base rates, which may reduce earnings. If certain criteria are met, utilities may seek special authorization from the Commission to accrue AFUDC and defer depreciation. These adjustments benefit the utility's financial reporting. The utility's accrual of AFUDC reduces its interest expense and the deferral of depreciation delays depreciation expense from hitting the utility's income statement. Thus, the accrual provides financial statement relief until the time the assets can be included in base rates and begin recovering a return on the asset and a return of the asset through depreciation recovery.

Q: What does the Commission consider when examining a request for post-in-service accounting treatment?

A: The Commission examines the amount of earnings erosion a utility would suffer if the special accounting treatment is not granted.

Q: Did Petitioner estimate the earnings erosion impact if post-in-service accounting treatment is not granted?

A: No.

Q: Has the Commission previously denied a request for post-in-service accounting treatment where significant earnings erosion has not been demonstrated?

A: Yes, it has. In the Final Order in Cause No. 43874, Utility Center Inc., the Commission stated that "[u]tilities request and receive post-in-service rate making treatment to avoid earnings erosion that may result from significant and new interest and depreciation expenses. The evidence presented to justify post-in-service AFUDC does not allow us to determine whether and to what extent Petitioner's earnings will be eroded." *In Re Utility Ctr*., Cause No. 43874 at 44 (Ind. Util. Regulatory Comm'n Apr. 13, 2011). The Commission stated in *Utility Center* that "[w]hat is necessary to show in addition to such facts is that the utility will suffer earnings erosion without the requested post-in-service AFUDC. This carries with it some obligation to quantify the level of earnings erosion. Also earnings erosion should be viewed in the context of the utility's operations as a whole." *Id*. The Commission concluded that the evidence did not show material erosion in earnings, and denied Utility Center's request for post-in-service AFUDC and deferred depreciation.

Q: Has the Commission denied a request for post-in-service accounting treatment in any other Causes?

A: Yes. The Commission also denied a request for post-in-service accounting treatment in the Final Order in Cause No. 43956. In that case, Duke Energy Indiana ("Duke") requested authority to record a deferral for post-in-service and depreciation costs associated with purchasing the Vermillion II Generating

Facility ("Vermillion"). The OUCC recommended that the Commission deny the request on the grounds that Duke did not provide sufficient evidence showing that material earnings erosion would occur. The Commission concurred in its final order stating:

> The Commission therefore finds that any earnings erosion due to the purchase of Vermillion are not significant enough to warrant the requested accounting treatment in relation to Vermillion, and denies Duke Indiana's request to defer for subsequent recovery the depreciation and post in service carrying costs for the Vermillion plant and transaction related costs.[4]

Q: Do the *Utility Center* and *Duke* orders set the basic rules on earnings erosion with regards to post-in-service accounting treatment for carrying charges and deferred depreciation?

A: Yes. Even when utilities have costs that may be eligible for capitalization as a regulatory asset for future recovery in rates per Generally Accepted Accounting Principles ("GAAP"), there must still be evidence that without this special authorization, the utility would incur *material* earnings erosion. The Commission has also made it clear that earnings erosion should be viewed in the context of the utility's operations as a whole.

Q: Has Petitioner provided any evidence of material earnings erosion?

A: No. Petitioner did not submit any estimates or projections regarding earnings erosion in this Cause. Petitioner did not estimate the impact or attempt to prove how Petitioner would be harmed without the requested relief in this Cause.

[4] See 43956 Order dated December 28, 2011.

Petitioner also made no attempt to estimate how long the earnings erosion would last.

Q: What is your conclusion on Petitioner's request for post-in-service accounting treatment for the MATS compliance projects?

A: When a utility requests post-in-service accounting treatment, it must (1) demonstrate that it will experience material earnings erosion, (2) quantify this erosion as a percentage of total company earnings and (3) display the cost of the project or purchase as a percentage of net utility plant. It is within the purview of the Commission to decide whether the evidence indicates material earnings erosion that will negatively impact Petitioner financially. In this case, Petitioner provided no evidence of the potential for, or amount projected of, material earnings erosion. The Commission should therefore deny Petitioner's request to record a deferral for post-in service depreciation, AFUDC/ carrying costs, and O&M expense for the MATS compliance projects.

Q**: Does Petitioner believe that post-in-service accounting treatment is automatic under the rules and statute?**

A: Yes. Petitioner's witness Kevin W. Crawford states in his testimony that the inclusion of post-in-service costs of the projects, including AFUDC, depreciation, and O&M costs is consistent with 170 I.A.C. 4-6-1 *et seq*. Petitioner's witness James L. Cutshaw states in his testimony that "the accrual of post-in-service AFUDC is automatic under the rule until the issuance of an order affording ratemaking treatment of the remaining costs."[5]

[5] Testimony of Petitioner's Witness Cutshaw,.Page 8, Lines 21-22

1 **Q Do you believe that accrual of post-in-service AFUDC is automatic?**

2 A: No. Post-in-service accounting treatment is not specifically mentioned as a
3 financial incentive in the rules. Petitioner may request a financial incentive that is
4 not delineated in the rules, but the Commission requires evidence to determine if
5 the incentive is warranted. In the case of post-in-service accounting treatment,
6 material earnings erosion must be demonstrated. The Commission can review the
7 evidence presented and determine whether earnings erosion is material. The
8 earnings erosion should be viewed in the context of the utility's operations as a
9 whole.

IV. OTHER ISSUES

10 **Q: Do you have other concerns about Petitioner's ECCRA proposal?**

11 A: Yes. The ECCRA tracks CWIP and allows a cash return to be calculated on
12 QPCP projects. This return is grossed-up for taxes and is converted to an actual
13 revenue requirement billed to customers every six (6) months, which is permitted
14 by Commission rules[6] even though the project is not yet used and useful. This
15 continues throughout the life of the construction project. When the project is
16 complete, the tracker continues, except that depreciation and O&M expenses
17 associated with the completed project can be billed to customers. The tracker
18 continues until a utility files a request for new base rates. At that time, capital
19 investment and expenses associated with all ECCRA projects will be rolled into
20 base rates, and the ECCRA tracker will cease to exist. In the future, if new

[6] 170 I.A.C. 4-6-1

pollution control equipment is required, Petitioner can request to start the ECCRA tracker again.

Q: Does Petitioner currently have other QPCP programs receiving rate recovery treatment in its ECCRA?

A: Yes. Petitioner's ECCRA tracker has existed for approximately ten (10) years, and no costs from it have ever been rolled into base rates. The MATS Rule request is the fourth construction program to be added to the ECCRA tracker; the first pollution control program tracked in the ECCRA was the NOx Program, which had most of the major construction completed by 2004 and 2005. The total cost of the NOx program was approximately $231 million including AFUDC, and the current cost is $124 million net of depreciation according to its recent ECR-20 filing. The second program included in the ECCRA was the Multi Pollutant Program (MPP), which had its projects completed in 2006 and 2007. The total cost of this program was approximately $254 million including AFUDC and currently is valued at $174 million net of depreciation in its recent ECR-20 filing. The third program included in the ECCRA is the Multi Pollutant Program 2 (MPP 2) which had its one main project completed in 2011. The total cost of this program is approximately $133 million including AFUDC and is currently $126 million net of depreciation in its recent ECR-20 filing. The total construction investment included in the ECCRA is approximately $618 million. Since Petitioner's ECCRA tracker has been in operation for 10 years, the pollution investments that are tracked have been depreciated between one (1) and nine (9) years. The total net investment that a return is calculated on in Petitioner's

ECCRA tracker is approximately $424 million in the current ECR-20. Petitioner has requested in its current ECR-20 filing total revenue requirements for all three programs including return, depreciation, and operation and maintenance expenses in the amount of $50.150 million. This will be billed to customers over a six (6) month period. Petitioner wants to add the MATS compliance projects onto the ECCRA, which represents approximately $511 million of projects that will start receiving a return during construction, and depreciation and O&M will be added when the project is complete. The total of all four (4) projects is over $1 billion of investment that will have received a return, accelerated depreciation and O&M in the ECCRA. While other utilities have had multiple pollution control programs in ECR filings, Petitioner has not had its rates adjusted since the final order in 1995 in Cause No. 39938. In the interim, Petitioner has added hundreds of millions of dollars of investment in environmental controls. Petitioner is now requesting approval to replace worn out equipment in the form of capital maintenance on its pollution control property currently included in its ECCRA.

Q: What makes Petitioner's ECCRA request different than the usual request?

A: In addition to new investment, Petitioner is also requesting approval to track replacement of, and upgrades to, pollution control investments that are decades old and included in existing base rates. These include:

- Petersburg Unit 1 ESP — Original Construction 1967
  Precipitator Replaced 1973
- Petersburg Unit 2 ESP — Original Construction 1969
  Second Precipitator 1980

- Petersburg Unit 3 ESP Original Construction 1977
- Petersburg Unit 4 ESP Original Construction 1986
- Harding Street 7 ESP Original Construction 1973[7]

All of these pollution control investments were included in base rates in the final order in Cause No. 39938 dated August 24, 1995. The test year of that case was June 30, 1994.

Q: In this Cause, did the OUCC attempt to determine the net book value of the listed Electrostatic Static Precipitators ("ESP's") at the time of Petitioner's last rate case?

A: Yes. OUCC Data Request No. 6-17 requested information relating to the net book value of the replaced or upgraded ESPs at the time of Petitioner's last general rate case. Petitioner was unable to provide the information.[8] However, there is no doubt that Petitioner is earning a return on the net plant investment, depreciation and operating expenses on the ESPs included in the 1995 rate case. Petitioner now wants to include the ESP replacements and upgrades in its ECCRA tracker. This results in a high risk of double recovery.

Q: What is your recommendation as it pertains to the MATS Compliance Project costs?

I recommend that the Commission not include the MATS compliance projects in the ECCRA tracker until Petitioner can demonstrate that ratepayers are not paying for replaced or upgraded pollution control investment in current base rates.

Q: Please summarize your recommendations to the Commission.

A: The OUCC recommends:

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[7]See Attachment WRB-1 and WRB-2, IPL Data Response to OUCC Data Request 6-15 and 6-16.

[8] See Attachment WRB-3, IPL Data Response to OUCC Data Request 6-17.

1. During the construction phase, the CWIP and AFUDC requested by Petitioner be approved;

2. The MATS compliance projects be depreciated over a 20 year period;

3. The denial of Petitioner's request to defer and record as a regulatory asset the post-in-service depreciation, AFUDC/carrying costs and O&M expense; and

4. Denial of recovery of the MATS compliance projects in the ECCRA until Petitioner demonstrates that replaced or upgraded pollution control equipment is not included in base rates. Ratepayers should receive a reasonable credit in the ECCRA to reflect the revenue requirements embedded in base rates for equipment being replaced or upgraded.

Q: Does this conclude your testimony?

A: Yes.

AFFIRMATION

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

Wes R. Blakley

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

Date: 1/28/13

Request No. 6-15 When did each of the ESPs on Petersburg Units 1-4 and Harding Street Unit 7 go into service?

Objection:

Response: Subject to and without waiver of the foregoing objections, IPL provides the following response:

Petersburg Unit 1	Original Construction	1967
	Precipitator Replaced	1973
Petersburg Unit 2	Original Construction	1969
	Second Precipitator	1980
Petersburg Unit 3	Original Construction	1977
Petersburg Unit 4	Original Construction	1986
Harding Street 7	Original Construction	1973

Request No. 6-16 Please provide the remaining expected useful life of each of the ESPs on Petersburg Units 1-4 estimated in IPL's last depreciation study.

Objection: IPL objects to OUCC DR Request 6-16 to the extent that the Request is vague and ambiguous. IPL further objects on the separate and independent grounds and to the extent that the Request seeks a compilation, analysis or study that IPL has not performed and to which IPL objects to performing. IPL further objects to the Request on the grounds and to the extent it solicits information that exceeds the scope of this proceeding and is not reasonably calculated to lead to the discovery of relevant or admissible evidence.

Response: Subject to and without waiver of the foregoing objections, IPL provides the following response:

The depreciation study which was the basis for IPL's current depreciation rates does not specifically identify the expected useful life of each of the ESPs on Petersburg Units 1-4. The costs for the ESPs are recorded in Account 312 Boiler Plant Equipment. Per that depreciation study (and page 337 of IPL's FERC Form 1 - Factors Used in Estimating Depreciation Charges), the Estimated Avg. Service Life for Petersburg Plant Account 312 was 35 years.

Request No. 6-17 Please indicate if the Petersburg Units 1-4 ESPs are included in rate base, and the net book value of those units at the time of IPL's last general rate case. Please also provide the original cost and accumulated depreciation of each of the ESPs at the time of IPL's last general rate case.

Objection: IPL objects to OUCC DR Request 6-17 on the grounds and to the extent that the Request seeks a compilation, analysis or study that IPL has not performed and to which IPL objects to performing. IPL further objects to the Request on the grounds and to the extent it solicits information that exceeds the scope of this proceeding and is not reasonably calculated to lead to the discovery of relevant or admissible evidence.

Response: Subject to and without waiver of the foregoing objections, IPL provides the following response:

The order in IPL's last rate case approved a "black box" settlement which did not specifically identify the components of rate base utilized in determining the approved revenue requirement underlying IPL's current basic rates and charges.

IPL does not currently have a detail listing of original cost by asset included in its filing in the last rate case.

IPL does not currently maintain records of undepreciated book value at an individual asset level. IPL maintains records of undepreciated book value at a functional level and at the plant site level.