**STATE OF INDIANA**

**INDIANA UTILITY REGULATORY COMMISSION**

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|---|---|---|
| **VERIFIED PETITION OF INDIANAPOLIS POWER & LIGHT COMPANY, AN INDIANA CORPORATION, FOR APPROVAL OF ALTERNATIVE REGULATION PLAN FOR EXTENSION OF DISTRIBUTION AND SERVICE LINES, INSTALLATION OF FACILITIES AND ACCOUNTING AND RATEMAKING OF COSTS THEREOF FOR PURPOSES OF THE CITY OF INDIANAPOLIS' AND BLUEINDY'S ELECTRIC VEHICLE SHARING PROGRAM PURSUANT TO IND. CODE 8-1-2.5-1 ET SEQ.** | ) ) ) ) ) ) ) ) ) ) | **CAUSE NO. 44478** |

**OUCC PREFILED TESTIMONY**

**OF**

**STACIE R. GRUCA - PUBLIC EXHIBIT #3**

**ON BEHALF OF THE**

**INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR**

**June 20, 2014**

Respectfully Submitted,

INDIANA OFFICE OF UTILITY CONSUMER

Tiffany T. Murray, Atty. No. 28916-49
Deputy Consumer Counselor

## CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing ***Office of Utility Consumer Counselor Prefiled Testimony of Stacie R. Gruca*** 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 June 20, 2014.

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# OUCC DIRECT TESTIMONY OF STACIE R. GRUCA
# CAUSE NO. 44478
# INDIANAPOLIS POWER & LIGHT COMPANY

## I. INTRODUCTION

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

A: My name is Stacie R. Gruca, and my business address is 115 West Washington St., Suite 1500 South, Indianapolis, Indiana 46204.

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

A: I am employed by the Indiana Office of Utility Consumer Counselor (OUCC) as a Senior Utility Analyst in the Electric Division.

**Q: Please summarize your professional background and experience.**

A: I graduated from Indiana University, Indianapolis, with a Bachelor of Science degree in Business, majoring in Accounting, Finance, and International Studies. I joined the OUCC in 2003. Since then, I have attended seminars on demand-side management and energy efficiency issues. I attended "Practical Skills for the Changing Electric and Gas Industries," sponsored by the National Association of Regulatory Utility Commissioners (NARUC) and the New Mexico State University Center for Public Utilities, in Albuquerque, New Mexico. I also attended the 2003 Annual Regulatory Studies Program sponsored by NARUC and the Institute of Public Utilities at Michigan State University in East Lansing, Michigan, and the 37th Annual Eastern NARUC Utility Rate School sponsored by NARUC and the Institute of Public Utilities at Michigan State University in Clearwater, Florida. I have attended various Market Subcommittee, Market

Settlements Work Group, and Revenue Sufficiency Guarantee (RSG) Task Force meetings of the Midcontinent Independent System Operator, Inc. (MISO).

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

A: I review Indiana electric utilities' requests for regulatory relief filed with the Indiana Utility Regulatory Commission (Commission). I also prepare and present testimony based on the results of my analysis and make recommendations to the Commission on behalf of Indiana electric utility consumers.

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

A: Notwithstanding the OUCC's opposition to the proposal filed by Indianapolis Power & Light (IPL), my testimony articulates two accounting measures to be implemented by IPL, in the event the Commission approves the proposed Alternative Regulatory Plan (ARP). First, I recommend changes to the manner in which IPL seeks to calculate carrying charges on its proposed regulatory asset. Second, I recommend an amortization period greater than five (5) years for the recovery of IPL's proposed regulatory asset. IPL's recovery of the regulatory asset would begin with the establishment of new IPL base rates.

OUCC Witnesses Mr. A. David Stippler and Mr. Edward T. Rutter both recommend that the Commission deny IPL's proposed ARP.

**Q: Have you previously testified before the Indiana Utility Regulatory Commission?**

A: Yes.

**Q: Please describe the examination and analysis you conducted in order to prepare your testimony in this Cause.**

A: I reviewed Petitioner's verified petition, pre-filed testimony, exhibits, and work papers, and I reviewed the testimony of Intervenor, the City of Indianapolis. I also reviewed IPL's and the City of Indianapolis' responses to various OUCC data requests.

## II. BLUEINDY PROJECT COSTS

**Q: Please describe how IPL proposes to recover BlueIndy Project costs.**

A: IPL proposes to establish a "regulatory asset" to defer the costs associated with installation of customer-owned charging station equipment for BlueIndy (installation costs), costs associated with extending IPL's electric facilities to BlueIndy charging stations (line extension costs), and carrying charges associated with the deferred installation and line extension costs (collectively "BlueIndy Project costs"); and recover those costs in IPL's next base rate case.[1] Importantly, the majority of the BlueIndy Project costs relate to IPL paying for the installation of customer-owned electrical equipment, including BlueIndy charging stations. Through the ARP, IPL seeks a guaranteed return of and return on the costs to install customer-owned equipment, as well as recovery of costs related to extending IPL's distribution lines to serve BlueIndy. The cost associated with installing the customer-owned equipment is over three times greater than the cost of IPL's distribution line extensions to serve BlueIndy. As a result of IPL's proposal, the rate impact calculated by IPL is 44 cents per month for a typical residential customer using 1,000 kWh per month, as shown on Petitioner's

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[1] IPL Witness Kimberly Berry, page 4, lines 12-14. Line extension costs to be included as part of the regulatory asset are those that exceed the 30 month revenue test. As indicated on page 2, footnote 1, of Ms. Berry's testimony, "The costs up to the amount of 30 months of revenue will be recorded as a fixed asset in Utility Plant in Service."

Exhibit KB-2.[2] This assumes a base rate order reflecting the regulatory asset in rate base and amortization of the regulatory asset beginning January 1, 2018.[3]

## III. CARRYING CHARGE RATE

**Q: Does IPL propose to earn carrying charges on deferred costs accumulated in the regulatory asset?**

A: Yes. IPL's proposal includes carrying charges on amounts deferred and accumulated in the regulatory asset.

**Q: Under IPL's proposed ARP, is there any risk associated with IPL's eventual return of and return on the BlueIndy Project costs?**

A: IPL's ARP is designed to provide a very high level of assurance for recovery of BlueIndy Project costs. Consequently, IPL's risk is exceptionally low, and this lack of risk should be considered by the Commission when establishing an appropriate carrying charge rate.

**Q: What carrying charge rate does IPL propose?**

A: IPL proposes a carrying charge rate based on its overall weighted average cost of capital (WACC) rate, which would be recalculated on a quarterly basis. As illustrated on Petitioner's Workpaper KB-1, the carrying charge rate based on Petitioner's WACC rate,[4] as of September 30, 2013, would equal 7.40%, including a cost of long-term debt of 5.80% and a return on equity (ROE) of 12.1%. When this rate is applied to the deferred line extension costs[5] and installation costs during the deferral period, the result is estimated carrying

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[2] IPL's calculated 44 cent rate impact, which provides for the projected recovery of approximately $19.4 million, is based on a rate impact of 43 cents resulting from recovery of its estimated $18.7 million regulatory asset and 1 cent resulting from recovery of its $700,000 utility plant in service.

[3] IPL Witness Kimberly Berry, page 8, lines 1-3.

[4] *See* Attachment SRG-1; Petitioner's Weighted Average Cost of Capital, as of September 30, 2013, included in Cause No. 42170 ECR-22.

[5] Line extension costs that exceed 30-month revenues.

charges of $672,513 and $2,742,922 respectively, or total estimated carrying charges of approximately $3.4 million until IPL's next base rate case. Per Petitioner's Exhibit KB-2, IPL estimates the amount of its regulatory asset to be $18.7 million ($3.0 million line extension costs plus $12.3 million installation costs plus $3.4 million estimated carrying charges).[6] As mentioned above, IPL will seek to include the regulatory asset in rate base in its next base rate case.

Q: **Is Petitioner's method of calculating a carrying charge rate reasonable in these circumstances?**

A: No. The majority of IPL's regulatory asset is costs for the installation of customer-owned equipment rather than investment in electric utility plant. Furthermore, IPL has practically eliminated any risk of recovery through the design of its proposed ARP. Therefore, any carrying charge rate approved by the Commission should more reasonably reflect the exceptionally low risk inherent in IPL's ARP. IPL's proposed 12.1% ROE compares to recent 10-year U.S. Treasury bond yields of approximately 2.6%.[7] U.S. Treasury bond yields are often used as a proxy for the return on risk free investments.

Q: **What carrying charge rate would be more reasonable under the circumstances?**

A: The OUCC proposes the Commission order IPL to use its current cost of long-term debt as the carrying charge rate for Petitioner's regulatory asset.[8]

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[6] At the time of IPL's next base rate case, IPL will then calculate a return on and, in the form of depreciation, a return of its BlueIndy Project regulatory asset in the amount of $18.7 million (in which estimated carrying charges are included) before amortizing the regulatory asset over a five year period.

[7] *See* www.money.cnn.com/data/bonds and www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yield. Last accessed on June 18, 2014.

[8] The OUCC would not object to periodic or quarterly revisions of this rate, as long as it is limited to the use of IPL's cost of long-term debt.

Petitioner's cost of long-term debt is 5.80% as of March 31, 2014.[9] If IPL's proposed ARP in this Cause is approved by the Commission, then IPL will be guaranteed recovery of 100% of its BlueIndy Project costs. The use of a 5.80% carrying charge rate would more reasonably reflect the low risk inherent in IPL's ARP, but would still provide a substantial premium over current risk free rates.

**Q: If the Commission decides to approve a carrying charge rate based on IPL's WACC, then should the return on equity be adjusted downward from IPL's proposed 12.1%?**

A: Yes. If IPL's proposed WACC rate is used, then a ROE of 10.2% or less in its calculation of carrying charges should be used. In the Commission's Order in Cause No. 44242, the Commission indicated that it agreed with the OUCC's and Industrial Group's concern that "the 12.1 percent ROE used by IPL no longer reflects current capital costs."[10] The Commission further stated in its Order:

> Each of Indiana's four other investor-owned electric utilities have undergone base rate cases since IPL's rate case in Cause No. 39938. Our February 13, 2013 Order in Cause No. 44075 represents our most recent rate decision, in which the Commission determined that 10.2 percent represented an appropriate ROE for Indiana Michigan Power. On average, Indiana's investor-owned electric utilities, excluding IPL, have a Commission approved equity return of 10.325 percent.[11]

Based on the finding that on average Indiana's IOUs, excluding IPL, have a Commission approved equity return of 10.325%, and the recognition that IPL's 12.1% ROE no longer reflects current capital costs, the Commission decided to increase a credit to ratepayers in Cause No. 44242.[12]

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[9] *See* Attachment SRG-2; Petitioner's Weighted Average Cost of Capital, as of March 31, 2014, provided as Petitioner's Attachment 1 in response to the OUCC's Data Request Set No. 7, Question 5.
[10] IURC Cause No. 44242, Order dated August 14, 2013, Page 34.
[11] IURC Cause No. 44242, Order dated August 14, 2013, Pages 34-35.
[12] *Id.*

Additionally, in Cause No. 44339, the Commission required IPL to utilize a cost of equity of 10.2% in its AFUDC calculation for construction approved in that Order. IPL's rebuttal testimony in Cause No. 44339 explained, "IPL's 12.1% cost rate comports with the FERC USOA adopted by the Commission," and, "the fact that IPL's AFUDC inputs differ from other utilities' inputs does not demonstrate that the Commission should depart from the FERC USOA methodology for calculating AFUDC on the proposed Projects."[13] The Commission's discussion and findings section of the Order in Cause No. 44339 included the IPL argument, "that since the Commission and the OUCC have utilized a 12.1% equity rate for the calculation of AFUDC by IPL in some prior cases, and since no party has previously contested use of that rate, it is appropriate to utilize the rate until a new determination is made by this Commission."[14] In dismissing IPL's arguments on this issue, the Commission responded to IPL in its Order stating:

> We are not convinced that continued use of the previously imputed ROE was appropriate. The argument that the USOA provides that the ROE should be that determined in the last rate proceeding is of no assistance to IPL because no ROE was determined in its last rate case. …that case was resolved with a "black box" settlement and there was no finding by this Commission of the allowed ROE.
>
> Petitioner's argument that we have approved the use of a 12.1% ROE in other situations is not compelling. It certainly does not prevent us from making another decision in a later case…[15]

The Commission further stated in its Order in Cause No. 44339 that:

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[13] IURC Cause No. 44339, Order dated May 14, 2014, Page 32.
[14] IURC Cause No. 44339, Order dated May 14, 2014, Page 33.
[15] *Id.*

> Allowing IPL to use a 12.1% ROE would mean, for example, that the amount of AFUDC that eventually becomes part of rate base would be higher. Deferral of a larger dollar amount would effectively cause ratepayers to pay higher rates for the life of the asset. We do not find this to be a reasonable circumstance based on the prevailing authorized ROE of other Indiana electric investor owned utilities ("IOUs").[16]

If the Commission approves the use of WACC, the OUCC recommends IPL include a ROE of no more than 10.2%. The Commission has recognized that IPL's proposed 12.1% ROE no longer reflects IPL's current capital costs. Based on IPL's current capital structure as of March 31, 2014, the utilization of a 10.2% ROE would provide a WACC rate of 6.68%.[17]

## IV. AMORTIZATION OF REGULATORY ASSET

**Q: What amortization period does Petitioner propose to use in recovery of its proposed regulatory asset once its BlueIndy Project costs are included in rate base?**

A: As shown in Petitioner's Exhibit KB-2, Petitioner proposes to amortize its proposed regulatory asset, which includes carrying charges, over a five year period once a rate order reflects the regulatory asset in rate base.

**Q: Does the OUCC agree with a five year amortization of Petitioner's proposed regulatory asset?**

A: No. The OUCC recommends amortization of Petitioner's proposed regulatory asset over a longer period of time, 10 to 20 years, as explained below. A five-year amortization period is unreasonably short, and Petitioner's evidence in this Cause does not justify using such a brief period over which Petitioner's proposed regulatory asset would be amortized and paid for by its ratepayers.

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[16] IURC Cause No. 44339, Order dated May 14, 2014, Page 34.

[17] *See* Attachment SRG-3. The OUCC would not object to a periodic or quarterly recalculation of IPL's WACC rate, as long as it includes a ROE of no more than 10.2%, or ROE determined at the time of IPL's next base rate case.

**Q: Please explain why a five year amortization period is unreasonably short.**

A: The City of Indianapolis indicates in testimony that the BlueIndy Project is designed to bring about long-term and "transformational" changes for transportation in the City. The proposed five year amortization period does not correspond to the long-term vision behind the proposal. Additionally, through formal discovery, the OUCC asked about the useful life of the distribution and service line extensions to the BlueIndy Project (i.e. the estimated amount of time over which distribution and service line extensions to the BlueIndy Project will be depreciated). IPL responded that depreciation was calculated using the Commission-approved composite depreciation rate for IPL's transmission and distribution equipment of 5.11%.[18] Petitioner further indicated that this equates to a useful life of approximately 20 years. Petitioner used this 5.11% depreciation rate in its calculation of the 30-month revenue portion of the line extension costs to be included in utility plant in service. The OUCC recognizes that the majority of IPL's BlueIndy Project costs relate to installing customer-owned electrical equipment rather than electric utility plant for the delivery of electric service to customers. Nevertheless, the approximate 20-year life of the distribution line extensions for BlueIndy should receive significant weight when considering the proper amortization period.

As a result, the OUCC believes that an amortization period that is closer to the actual useful life of the distribution and service line extensions, 10 to 20 years, should be used.

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[18] *See* Attachment SRG-4; Petitioner's response to the OUCC's Data Request Set No. 7, Question 2.

**Q: Does the Commission need to make a determination regarding the amortization period of IPL's proposed regulatory asset for its BlueIndy Project costs in this Cause?**

A: No. A final determination of the amortization period could wait until Petitioner's next base rate case so that it can be done within the context of a comprehensive review of all of Petitioner's revenues, expenses, investments, and cost of capital. The OUCC is concerned about the impact of all of IPL's regulatory assets on its ratepayers, including the BlueIndy Project costs. In Cause No. 38703 FAC-103, OUCC Witness Michael D. Eckert reported that IPL already has accumulated regulatory assets of nearly $100 million dollars not related to the BlueIndy Project.[19] This large accumulation stems in part from IPL's decision to avoid a base rate case for two decades. The amortization period for any BlueIndy regulatory asset could be considered as part of a comprehensive review of IPL's cost of service in a future rate case; however, if the Commission determines that an amortization period must be established in the current proceeding, then the OUCC recommends that an amortization period of 10 to 20 years be used.

## V. OUCC RECOMMENDATIONS

**Q: What does the OUCC recommend regarding the accounting and ratemaking treatment of BlueIndy Project costs in this proceeding?**

A: Consistent with the testimony of Messrs. A. David Stippler and Edward T. Rutter, the OUCC recommends the Commission deny IPL's proposed ARP, including the proposed deferred accounting for IPL's BlueIndy Project costs. However, in the event the Commission approves deferred accounting for some or all of IPL's BlueIndy Project costs, then the OUCC recommends changes to the deferred

[19] "Nearly $100 million" refers to the amount of MISO charges IPL has deferred as of January 31, 2014. *See* IURC Cause No. 38703 FAC-103, Public's Exhibit No. 2, Page 3, Lines 10-13.

accounting and ratemaking treatment to reduce the impact on ratepayers. The OUCC recommends the following:

1) The Commission require IPL to use its long-term debt rate, currently 5.80%, as the carrying charge rate on its regulatory asset resulting from the BlueIndy Project. Alternatively, the OUCC recommends the Commission require IPL to use a ROE of no more than 10.2% if IPL's overall WACC rate is used in the calculation of carrying charges.[20]
2) The Commission determine the amortization period for IPL's regulatory asset resulting from the BlueIndy Project, in context of a comprehensive review, in IPL's next rate case. If the Commission requires an amortization period for the regulatory asset be determined in the current proceeding, then the OUCC recommends the Commission require IPL to amortize its regulatory asset over a 10 to 20 year period.

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

A: Yes.

[20] Using a ROE of 10.2%, the current WACC rate that would be used to calculate carrying charges would be 6.68%.

**AFFIRMATION**

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

Stacie R. Gruca

By: Stacie R. Gruca
Indiana Office of
Utility Consumer Counselor

6/20/2014

Date:

INDIANAPOLIS POWER & LIGHT COMPANY
Weighted Average Cost of Capital
September 30, 2013
(Thousands of Dollars)

| Line No. | | Total Company Capitalization | Capitalization Ratio | Total Cost of Capital | Weighted Cost of Capital |
|---|---|---|---|---|---|
| 1 | Long-Term Debt | 1,018,055 | 45.46% | 5.80% | 2.64% |
| 2 | Preferred Equity | 59,784 | 2.67% | 5.37% | 0.14% |
| 3 | Common Equity | 835,732 | 37.32% | 12.10% | 4.52% |
| 4 | Post-1970 Investment Tax Credit | 7,036 | 0.31% | 8.54% | 0.03% |
| 5 | Deferred Taxes and Pre-1971 Investment Tax Credit | 293,013 | 13.08% | 0.00% | 0.00% |
| 6 | Customer Deposits | 25,872 | 1.16% | 6.00% | 0.07% |
| 7 | Total | 2,239,492 | 100.00% | | 7.40% |

IPL's last general rate case was concluded with the Commission's approval of a Settlement Agreement. The Settlement Agreement was silent on the issue of rate of return. The Commission's Order approving the Settlement Agreement made no specific finding regarding the cost of common equity or its application in a book weighted or market weighted capital structure. Consequently, IPL and the OUCC have for many years utilized the rate of 12.1% for purposes of IPL's calculation of its AFUDC rate.

IURC Cause No. 44478
OUCC DR 7-5 Attachment 1

INDIANAPOLIS POWER & LIGHT COMPANY
Weighted Average Cost of Capital
March 31, 2014
(Thousands of Dollars)

| | Total Company Capitalization | Capitalization Ratio | Total Cost of Capital | Weighted Cost of Capital |
|---|---|---|---|---|
| Long-Term Debt | 1,018,254 | 45.52% | 5.80% | 2.64% |
| Preferred Equity | 59,784 | 2.67% | 5.37% | 0.14% |
| Common Equity | 835,500 | 37.35% | 12.10% | 4.52% |
| Post-1970 Investment Tax Credit | 6,303 | 0.28% | 8.54% | 0.02% |
| Deferred Taxes and Pre-1971 Investment Tax Credit | 290,487 | 12.99% | - | - |
| Customer Deposits | 26,587 | 1.19% | 6.00% | 0.07% |
| Total | 2,236,915 | 100.00% | | 7.39% |

# INDIANAPOLIS POWER & LIGHT COMPANY
Weighted Average Cost of Capital
March 31, 2014
(Thousands of Dollars)

| Line No. | | Total Company Capitalization | Capitalization Ratio | Total Cost of Capital | Weighted Cost of Capital |
|---|---|---|---|---|---|
| 1 | Long-Term Debt | 1,018,254 | 45.52% | 5.80% | 2.64% |
| 2 | Preferred Equity | 59,784 | 2.67% | 5.37% | 0.14% |
| 3 | Common Equity | 835,500 | 37.35% | 10.20% (1) | 3.81% (2) |
| 4 | Post-1970 Investment Tax Credit | 6,303 | 0.28% | 8.54% | 0.02% |
| 5 | Deferred Taxes and Pre-1971 Investment Tax Credit | 290,487 | 12.99% | - | - |
| 6 | Customer Deposits | 26,587 | 1.19% | 6.00% | 0.07% |
| 7 | Total | 2,236,915 | 100.00% | | 6.68% (2) |

(1) Per the OUCC's recommendation of a 10.20% ROE used in the calculation of WACC. All other numbers included are Petitioner's numbers used in its calculation of WACC as of March 31, 2014.

(2) Percentage change resulting from the OUCC's recommendation of a 10.20% ROE used in the calculation of WACC. All other numbers included are Petitioner's numbers used in its calculation of WACC as of March 31, 2014.

**Data Request** OUCC 7-2

What is the useful life of the distribution and service line extensions to the BlueIndy Project, or what is the estimated amount of time over which distribution and service line extensions to the BlueIndy Project will be depreciated?

**Objection:**

**Response:**

Depreciation was calculated using the Commission approved composite depreciation rate for IPL's transmission and distribution equipment of 5.11%. This equates to a useful life of approximately 20 years.