

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF NORTHERN INDIANA)
PUBLIC SERVICE COMPANY FOR (1))
APPROVAL OF A TRANSMISSION,)
DISTRIBUTION AND STORAGE SYSTEM)
IMPROVEMENT CHARGE ("TDSIC"))
RATE SCHEDULE, (2) APPROVAL OF)
PETITIONER'S PROPOSED COST)
ALLOCATIONS, (3) APPROVAL OF THE)
TIMELY RECOVERY OF TDSIC COSTS)
THROUGH PETITIONER'S PROPOSED)
TDSIC RATE SCHEDULE, AND (4))
AUTHORITY TO DEFER APPROVED)
TDSIC COSTS, PURSUANT TO IND.)
CODE CH. 8-1-39.)

CAUSE NO. 44371

TESTIMONY OF

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

ON BEHALF OF THE

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

OCTOBER 11, 2013

Respectfully submitted,



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

CERTIFICATE OF SERVICE

This is to certify that a copy of the *OUCC Testimony of WES R. BLAKLEY* has been served upon the following parties of record in the captioned proceeding by electronic service on October 11, 2013.

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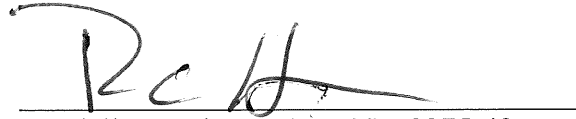
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**TESTIMONY OF OUCC WITNESS WES R. BLAKLEY
CAUSE NO. 44371
NORTHERN INDIANA PUBLIC SERVICE COMPANY**

I. INTRODUCTION

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

2 A: My name is Wes R. Blakley and my business address is 115 W. Washington St.,
3 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: Please describe your educational background and experience.**

8 A: I received a Bachelor of Science Degree in Business with a major in Accounting
9 from Eastern Illinois University in 1987 and worked for Illinois Consolidated
10 Telephone Company until joining the OUCC in April 1991 as a staff accountant.
11 Since that time, I have reviewed and testified in hundreds of tracker cases, rate
12 cases, and other proceedings before the Commission. I have attended the Annual
13 Regulatory Studies Program sponsored by NARUC at Michigan State University
14 in East Lansing, Michigan, as well as the Energy Basics Program offered by the
15 Wisconsin Public Utility Institute at the University of Wisconsin-Madison.

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

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

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

1 A: My testimony addresses and provides recommendations concerning Northern
2 Indiana Public Service Company's (NIPSCO or Petitioner or Company) request
3 for approval of a Transmission, Distribution, and Storage System Improvement
4 Charge (TDSIC) tracker. Specifically I will address: (1) NIPSCO's proposed
5 method of calculating its allowable return; (2) NIPSCO's request for approval of
6 the TDSIC costs through the proposed TDSIC tracker including its request for
7 authority to defer TDISC costs; and (3) NIPSCO's lack of recognition of
8 investment already existing in its base rates with regard to assets that will be
9 replaced under its 7-year plan while seeking to recover its new investment in
10 transmission distribution or storage improvements and other associated costs
11 through the TDSIC tracker.

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

14 A: I reviewed the petition, testimony, work papers, and exhibits filed in this Cause. I
15 reviewed NIPSCO's responses to OUCC data requests. I also reviewed pertinent
16 parts of the Indiana Code and Indiana Administrative Code. Finally, I participated in
17 discussions with OUCC staff members regarding issues identified in this Cause.

II. NIPSCO'S TDSIC WEIGHTED AVERAGE COST OF CAPITAL

18 **Q: Under NIPSCO's proposal, what is the weighted average cost of capital**
19 **(WACC) requested to be applied on the TDSIC investment?**

20 A: NIPSCO witness Derric J. Isensee calculated NIPSCO's requested WACC which
21 is shown on his Exhibit No. DJI-1. Mr. Isensee's calculation includes only the
22 equity and debt portions of NIPSCO's capital structure as of March 31, 2013.
23 The cost rate for the long-term debt as of March 31, 2013 was 6.07%. The cost

1 rate for equity is 10.20% which was the return approved in NIPSCO's last rate
2 case, Cause No. 43969, by Commission Order dated December 21, 2011. The
3 overall WACC proposed by NIPSCO to be applied to TDSIC investment before
4 tax gross-up is 8.59%.

5 **Q: What was the WACC in NIPSCO's last rate case and the WACC in its most**
6 **current pollution control tracker in Cause No. 42150, Environmental Cost**
7 **Recovery (ECR) mechanism 22 (ECR-22)?**

8 A: The approved WACC in NIPSCO's last rate case was 6.98% which included zero
9 cost capital. The WACC in NIPSCO's ECR-22, which was calculated as of June
10 30, 2013, and also included zero cost capital, was 6.61%.

11 **Q: What is the effect on NIPSCO's Return on Equity (ROE) of excluding zero**
12 **cost capital that had been included in NIPSCO's ECR-22 capital structure?**

13 A: My exhibit WRB-1 demonstrates the effect on ROE if NIPSCO receives a WACC
14 of 8.59% on its TDSIC investments. I have included all sources of capital in my
15 calculation which is an approved practice by the Commission in setting utility
16 rates in Indiana. These are the same sources of capital used in construction work
17 in progress (CWIP) trackers pursuant to 170 IAC 4-6-1 and are the same rules that
18 NIPSCO applies in its ECR tracker. "Capital Structure I" in Exhibit WRB-1
19 shows the actual capital structure as of June 30, 2013 filed by NIPSCO in ECR-
20 22. The WACC in ECR-22, using all sources of capital, was 6.61%. NIPSCO, in
21 its request for a WACC to apply to TDSIC investments, is asking to exclude all
22 zero cost capital in the calculation. This produces an 8.59% WACC that results in
23 a 1.98% or 198 basis point increase in the overall WACC calculated in ECR-22.
24 "Capital Structure II" in Exhibit WRB-1 depicts the same capital structure that
25 NIPSCO filed in ECR-22 but with the 8.59% plugged into the WACC total. This

1 level of WACC would have the effect of awarding NIPSCO the equivalent of a
2 14.48% ROE. This is 4.28% or 428 basis points above its currently approved
3 ROE of 10.20%. This enhanced return would be applied to all of NIPSCO's
4 TDSIC investments.

5 **Q: Did NIPSCO ask for an incentive return on the TDSIC projects?**

6 A: No, it did not. When asked by the OUCC if Petitioner was requesting an
7 incentive return in this Cause, NIPSCO responded that it was only seeking a ROE
8 of 10.2% consistent with NIPSCO's last rate case Order in Cause No. 43969.

9 **Q: Why does NIPSCO think it can exclude zero cost capital from its calculation**
10 **of WACC in TDSIC cases?**

11 A: NIPSCO witness Frank A. Shambo addresses the provisions of IC § 8-1-39-13(a)
12 which pertains to the calculation of TDSIC costs. That statute states as follows:

13 For purposes of calculating the TDSIC costs of a public utility, the
14 commission shall determine an appropriate pretax return for the public
15 utility. In determining the appropriate pretax return, the commission **may**
16 **consider** the following factors: (1) The current state and federal income
17 tax rates. (2) The public utility's capital structure. (3) The actual cost
18 rates for the public utility's long term debt and preferred stock. (4) The
19 public utility's cost of common equity determined by the commission in
20 the public utility's most recent general rate proceeding. (5) **Other**
21 **information that the commission determines is necessary. (emphasis**
22 **added)**

23 NIPSCO witness Shambo states that the capital structure for TDSIC investment
24 should be consistent with how NIPSCO actually finances new investments, that
25 is, with long-term debt and equity. He states that the proposed project cannot be
26 funded with zero cost capital items like deferred income taxes and customer
27 deposits or pension deferrals. He stated that over time the difference between
28 income tax depreciation and book depreciation may create deferred income taxes.

1 He believes that it is appropriate to consider all sources of financing inside of a
2 general rate proceeding, but not when considering the appropriate capital structure
3 and return on these incremental TDISC investments.

4 **Q: Does the statute that Mr. Shambo cites support the exclusion of zero cost**
5 **capital or any deviation from the traditional method of calculating the**
6 **appropriate WACC to be used?**

7 A: No, it does not. The statute does say that the Commission "may consider" factors
8 which include the public utility's capital structure, the actual cost rates for the
9 public utility's long-term debt and preferred stock, the public utility's cost of
10 common equity determined by the commission in the public utility's most recent
11 general rate proceeding and other information that the commission determines is
12 necessary. There is no mention of incentives or premiums on ROE that would
13 permit a radical departure from the traditional way of calculating WACC in the
14 TDSIC tracker.

15 **Q: Why do you call exclusion of zero cost capital "radical"?**

16 A: In ECR-22, NIPSCO filed its capital structure including all of its zero cost capital.
17 This produces a WACC of 6.61%. NIPSCO now wants to exclude all of its zero
18 cost capital in calculating the TDSIC tracker. The total amount of all sources of
19 zero cost capital in its capital structure as of June 30, 2013, was \$830 million,
20 which represents over 22% (see WRB-1) of total company capital. NIPSCO
21 wants to ignore over \$800 million of zero cost capital, thereby awarding itself
22 with a very large imputed 428 basis point premium in its ROE for its TDSIC
23 investments. This is a radical departure from traditional rate making in Indiana

1 and will lead to excessive returns and unreasonably higher rates charged to
2 customers required to pay for these investments.

3 **Q: Do you agree with Mr. Shambo's claim that the TDSIC projects cannot be**
4 **funded by zero cost capital?**

5 A: No. The claim that zero cost capital cannot help fund the TDSIC projects is
6 incorrect. NIPSCO's capital structure at June 30, 2013, is approximately \$3.7
7 billion which includes \$830 million of zero cost capital. Approximately \$682
8 million of the zero cost capital amount is deferred income tax. These funds are
9 not restricted in use and are available for the Company to finance capital projects.

10 **Q: Has there been an increase in zero cost capital in NIPSCO's capital structure**
11 **over time?**

12 A: Yes. For example, NIPSCO's deferred income taxes had a balance of \$426
13 million as of June 30, 2010 which was the test year cut-off in NIPSCO's last base
14 rate case. As I previously testified, the current deferred income tax balance as of
15 June 30, 2013 is \$682 million which is a 60% increase of \$256 million from the
16 2010 balance. NIPSCO will continue to grow its deferred income tax balance as
17 it increases its pollution control construction projects tracked through its ECR and
18 the TDSIC projects tracked through its proposed tracker in this proceeding.
19 Again, there is no restriction against NIPSCO using these funds to finance any of
20 these projects.

21 **Q: How should the WACC be calculated in the TDSIC tracker?**

22 A: The OUCC believes that the Commission should require that the calculation of
23 WACC be calculated in a manner consistent with NIPSCO's last rate case and
24 NIPSCO's ECR proceedings. This means that all zero cost capital should be
25 included in the capital structure. This has been the standard practice followed by

1 the Commission in hundreds of Indiana ratemaking proceedings, including
2 NIPSCO's last base rate case and its ECR cases.

3 **Q: Are there other issues relating to the use of WACC in this Cause?**

4 A: Yes. NIPSCO wants to apply the WACC, which is used to calculate earnings, to
5 all deferred costs including deferred depreciation expense and property tax
6 expense, which then would be grossed up for taxes again by NIPSCO. When
7 granting post-in-service AFUDC/carrying charges and deferred depreciation, the
8 ultimate purpose is to grant financial statement relief, not to create earnings that
9 are grossed up for taxes. This will happen when the deferred costs are included in
10 rates.

III. REPLACEMENT OF TRANSMISSION AND DISTRIBUTION
FACILITIES

11 **Q: Does NIPSCO propose removing from rate base any transmission and**
12 **distribution plant that will be replaced by new investment and tracked in the**
13 **TDSIC?**

14 A: No. When asked in OUCC Data Request Set 2-002,

15 Will NIPSCO remove replaced transmission and distribution assets at
16 original cost in NIPSCO's proposed TDISC tracking mechanism? If not,
17 please explain why not.

18 NIPSCO responded:

19 No. It would not be appropriate for NIPSCO to remove any replaced
20 asset costs or expenses from rates. Ind. Code § 8-1-39-2 states:

21 As used in this chapter, "eligible transmission, distribution, and
22 storage system improvements" means new **or replacement**
23 electric or gas transmission, distribution, or storage utility
24 projects ... (emphasis added)

25 Ind. Code § 8-1-39-2 does not distinguish between new or replacement
26 projects. Also, Ind. Code § 8-1-39-9(a) states:

1 ...a TDSIC will allow the periodic automatic adjustment of the
2 public utility's basic rates and charges to provide for timely
3 recovery of eighty percent (80%) of **approved capital**
4 **expenditures and TDSIC costs**(emphasis added)

5 Sec. 9(a) explicitly states the recovery afforded in the TDSIC must be
6 the approved expenditures and costs. No portion of Ind. Code Ch. 8-1-39
7 provides for or requires a utility to remove replaced transmission and
8 distribution assets at original cost in the utility's proposed TDSIC
9 tracking mechanism.

10 NIPSCO's response aside, IC 8-1-39 does not prohibit recognizing that there are
11 items in base rates that are being replaced by new equipment whose costs will be
12 tracked in the TDSIC tracker. Equity and fairness dictate that NIPSCO recognize
13 that this replaced investment is in base rates, while still allowing NIPSCO to
14 recover its true incremental transmission and distribution cost increases.

15 OUCC witness Tyler Bolinger addresses this important flaw in NIPSCO's
16 case and proposes an equitable approach based on sound regulatory principles and
17 accurate measurement of rate base growth, which is fair to both the customer and
18 NIPSCO.

IV. RECOMMENDATIONS

19 **Q: What are the OUCC's recommendations?**

20 **A:** The OUCC recommends the Commission deny the TDSIC capital expenditure
21 (CapEx) tracker proposed by NIPSCO in this proceeding. Should the
22 Commission approve a CapEx tracker, as proposed by NIPSCO, the OUCC
23 recommends the following modifications be made including, but not limited to:
24 (1) a requirement that NIPSCO calculate WACC in a manner consistent with its
25 last rate case and ECR proceedings, which includes zero cost capital in the capital

1 structure; (2) the disallowance of a carrying cost applied to deferred depreciation
2 expense and property tax expense after a project is placed in-service. Again, the
3 OUCC recommends denial of NIPSCO's proposed TDSIC CapEx tracker. As
4 discussed by OUCC Witness Tyler E. Bolinger, transmission and distribution
5 (T&D) investment tracking should be based on accurate measurement of the net
6 utility plant rate base growth, and NIPSCO's proposal makes no serious attempt
7 to accurately measure T&D rate base growth since NIPSCO's last base rate case.

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

9 A: Yes.

AFFIRMATION

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

Wes R. Blakley

Wes R. Blakley, Utility Analyst
Indiana Office of Utility Consumer Counselor

10/11/13

Date

Cause No. 44371
NIPSCO

Northern Indiana Public Service Company
42150 ECR-22
Capital Structure
6/30/2013

Capital Structure I

	Capitalization	Weighting %	Cost Rate	Pet W/A
Common Equity	1,724,664	46.33%	10.20%	4.73%
Preferred Stock	0	0.00%	0.00%	0.00%
Long-Term Debt	1,093,827	29.38%	6.07%	1.78%
Total Financial Cap.	2,818,491	75.71%		
Deferred Income Taxes	682,046	18.32%	0.00%	0.00%
Unamortized ITC - Pre 1971	0	0.00%	0.00%	0.00%
Unamortized ITC - Pre 1970	8,426	0.23%	8.60%	0.02%
Post Retirement Benefits	148,070	3.98%	0.00%	0.00%
Customer Deposits	65,645	1.76%	4.43%	0.08%
Total Zero Cost Capital	830,116	22.30%		
Total Regulatory Capitalization	3,722,678	100.00%		6.61%

Northern Indiana Public Service Company
TDSIC 44371
Capital Structure
6/30/2013

Capital Structure II

	Capitalization	Weighting %	Cost Rate	Pet W/A
Common Equity	1,724,664	46.33%	14.48%	6.71%
Preferred Stock	0	0.00%	0.00%	0.00%
Long-Term Debt	1,093,827	29.38%	6.07%	1.78%
Total Financial Cap.	2,818,491	75.71%		
Deferred Income Taxes	682,046	18.32%	0.00%	0.00%
Unamortized ITC - Pre 1971	0	0.00%	0.00%	0.00%
Unamortized ITC - Pre 1970	8,426	0.23%	8.60%	0.02%
Post Retirement Benefits	148,070	3.98%	0.00%	0.00%
Customer Deposits	65,645	1.76%	4.43%	0.08%
Total Zero Cost Capital	830,116	22.30%		
Total Regulatory Capitalization	3,722,678	100.00%		8.59%