

ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

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IN THE MATTER OF THE VERIFIED PETITION)
OF INDIANA MICHIGAN POWER COMPANY) CAUSE NO. 44696
FOR AUTHORITY TO RECOVER COSTS OF A)
GENERATION HEDGING PLAN THROUGH)
FUEL ADJUSTMENT CLAUSE AND IND. CODE) APPROVED: APR 20 2016
§ 8-1-2-42.)

ORDER OF THE COMMISSION

Presiding Officers:
Angela Rapp Weber, Commissioner
Loraine L. Seyfried, Chief Administrative Law Judge

On October 22, 2015, Indiana Michigan Power Petitioner (“I&M” or “Petitioner”) filed its Verified Petition with the Indiana Utility Regulatory Commission (“Commission”) for authority to recover gains or losses, including any associated transactional costs, associated with a generation hedging plan (“Hedging Plan”) applicable to its electric utility service through I&M’s fuel adjustment clause (“FAC”) proceedings.

On October 22, 2015, I&M also filed its direct testimony and exhibits. On February 11, 2016, the Indiana Office of Utility Consumer Counselor (“OUCC”) filed its case-in-chief. And, I&M filed its rebuttal evidence on March 4, 2016.

An evidentiary hearing in this Cause was held on March 31, 2016, at 9:30 a.m. in Room 224, PNC Center, 101 W. Washington Street, Indianapolis, Indiana. Counsel for I&M and the OUCC appeared and participated at the hearing. At the hearing, I&M and the OUCC presented their respective evidence without objection. No member of the public appeared or participated at the hearing.

Based upon applicable law and the evidence presented, the Commission finds:

1. Notice and Jurisdiction. Due, legal, and timely notice of the evidentiary hearing in this Cause was given and published by the Commission as required by law. Petitioner is a “public utility” under Ind. Code § 8-1-2-1. Under Ind. Code § 8-1-2-42, the Commission has jurisdiction over changes to Petitioner’s rates and charges, including tracking provisions approved by the Commission. Accordingly, the Commission has jurisdiction over Petitioner and the subject matter of this proceeding.

2. Petitioner’s Characteristics and Business. I&M, a wholly-owned subsidiary of American Electric Power (“AEP”), is a corporation organized and existing under the laws of the State of Indiana, with its principal office at Indiana Michigan Power Center, Fort Wayne, Indiana. I&M is a member of the East Zone of the AEP System. I&M is engaged in, among other things, rendering electric service in the States of Indiana and Michigan. In Indiana, I&M provides retail electric service to approximately 458,000 customers in the following counties: Adams, Allen,

Blackford, DeKalb, Delaware, Elkhart, Grant, Hamilton, Henry, Howard, Huntington, Jay, LaPorte, Madison, Marshall, Miami, Noble, Randolph, St. Joseph, Steuben, Tipton, Wabash, Wells, and Whitley.

3. **Relief Requested.** I&M requests approval that gains or losses, including any associated transactional costs, from the Hedging Plan be credited or recovered through the FAC in accordance with Ind. Code § 8-1-2-42(d). I&M proposes that the transactions be subject to review based upon analysis of the facts and circumstances as they existed at the time the transactions at issue were entered into. I&M also proposes that the costs, gains, or losses, including any associated transactional costs, be recoverable through the FAC upon a finding that the transactions were reasonable.

4. **I&M's Direct Evidence.**

A. **I&M's Generation Resources.** Andrew J. Williamson, Director of Regulatory Services for I&M, described I&M's generation resources consisting of the coal-fired Rockport Plant Units 1 and 2, Cook Nuclear Plant Units 1 and 2, run-of-river hydroelectric dams, purchased wind generation, and development of utility scale solar. He explained that in addition to these resources, as part of the AEP System, I&M is entitled to a portion of the Ohio Valley Electric Corporation's generating capacity and associated energy. He stated that the sum of these resources, along with I&M's current interruptible demand customers, approximates I&M's net PJM Interconnection¹ ("PJM") peak load obligation.

Mr. Williamson testified that I&M's generation resources have been impacted by the termination of the AEP System Interconnection Agreement and the retirement of the I&M Tanners Creek plant. He stated that as a result of these changes, I&M's available generation resources are closely aligned with its peak load and energy requirements. Mr. Williamson explained that while I&M's portfolio of resources is normally sufficient to meet I&M's customer needs, it is heavily dependent on the availability of I&M's Rockport and Cook plants. He stated that these plants consist of four units in total and represent approximately 90 percent of I&M's generating capability. He explained this presents a risk that if one or more of these units is not available because of a planned or unplanned outage, I&M may have to purchase energy, subject to market price risk, to meet its load obligation.

Mr. Williamson identified the steps I&M takes to manage purchased power costs. He stated that from an operational perspective, I&M manages purchased power costs through maintenance of its owned generating resources as well as strategic planning and timing of maintenance and refueling outages. Mr. Williamson testified that the Hedging Plan will allow I&M to better manage purchased power costs because it is effectively another tool that allows I&M to diversify its energy portfolio. In particular, the Hedging Plan will provide an additional option that can provide price stability and protection against upward purchased power price risk when one or more of I&M's large baseload units is unavailable.

B. **I&M's Hedging Plan.** Thomas D. Presthus, Director of Energy Trading for American Electric Power Service Corporation ("AEPSC"), and Mr. Williamson jointly sponsored

¹ PJM Interconnection is a regional transmission organization that coordinates the movement of wholesale electricity in certain states, including portions of Indiana.

I&M's Hedging Plan. Mr. Presthus explained that hedging is the practice of entering into one or more transactions for the purpose of limiting exposure to one or more variables in a particular market. He stated that a financial transaction is a purchased power transaction that settles financially, meaning it does not result in physical delivery of energy. He said these transactions settle after the date they are entered into, according to various lengths of time. He added that the transaction itself is a fixed price contract for a certain volume of energy to be delivered on a certain date(s) and period of time. And, when the transaction is settled, the difference between the fixed price and actual market price generates a gain or loss and results in either cash received or cash paid, with no physical delivery of energy.

Mr. Williamson testified that I&M's Hedging Plan would allow for financial purchased power transactions to hedge I&M's expected net-energy requirements for a pre-determined period of time. He said I&M plans to use financial transactions (or hedges) to limit the customer impact of purchased power costs without unreasonably increasing costs or jeopardizing Petitioner's ability to meet its customer needs.

Mr. Williamson explained that the Hedging Plan will be jointly executed by the AEPSC Commercial Operations ("ComOps") group and I&M. Mr. Presthus stated that the ComOps group has significant experience in most major Regional Transmission Organization markets and has responsibility for fuel procurement, unit dispatch, operations, and outage coordination of AEP's owned generation. He testified that ComOps also participates in markets to secure economic purchased power to help provide the lowest reasonable fuel costs for AEP's operating companies.

Mr. Williamson testified that the ComOps group will evaluate I&M's hedging opportunities and notify I&M management when an opportunity is available. I&M will work with the ComOps group to understand and evaluate these hedging opportunities. He said facts and circumstances unique to each period when an energy shortfall is forecasted to occur will ultimately determine whether a hedge is made and to what extent. I&M's approval is required for a hedge transaction to be executed.

Mr. Williamson stated that I&M will not hedge its purchased power exposure every time I&M is forecasted to have insufficient generation to meet customer needs. He explained that the Hedging Plan allows for flexibility to evaluate opportunities to mitigate upward purchased power price risk due to market pricing, but does not require hedging that exposure. I&M will execute a hedge when the facts and circumstances are such that ComOps and I&M believe a customer's exposure to upward purchased power price risk can be mitigated.

Mr. Presthus provided an overview of the type of trading instruments I&M would use in the implementation of the Hedging Plan and how the financial transactions will be executed. Mr. Presthus explained how a gain or loss from a hedge transaction occurs and how transaction costs or fees are determined. He indicated that ComOps will maintain documentation to support the hedging decision made, whether or not a hedge is executed. The types of documentation that will be available include: The Triggering Event, Impact Analysis, Recommendations, Consensus Decision, Hedge Execution, and Hedge Exit.

C. I&M's Hedge Accounting and Ratemaking Treatment. Mr. Williamson explained that I&M is requesting that all reasonably incurred gains or losses, including any associated transactional costs, arising from the Hedging Plan be eligible for recovery in I&M's

semi-annual FAC filings, subject to Commission review, approval, and audit. He testified it is appropriate that the costs incurred to achieve this benefit be recognized as a cost or credit to the cost of purchased power because such transactions will be made to address native load purchased power cost price exposure. Mr. Williamson stated that I&M's intent in undertaking the Hedging Plan is to mitigate the upward price risk associated with market purchased power costs. And, I&M's Hedging Plan may result in either higher or lower costs in any given year when compared to not hedging against upward purchased power price risk.

Mr. Williamson testified it is reasonable for the Commission to approve recovery of the gains and losses realized as a result of the Hedging Plan as part of I&M's FAC proceedings because the financial results of the hedge itself must be combined with the cost of the physical energy purchase to achieve the intended fixed price results. Customers can only benefit from limited upward purchased power price risk if the two transactions are combined within the same rate mechanism. He stated that since the purpose of the hedge transaction is to lock into a certain cost for a pre-determined volume of physical purchased power energy, it is reasonable to allow inclusion of such costs in the FAC proceedings. Mr. Williamson explained how the Commission will be able to audit hedging transactions as part of I&M's FAC proceedings.

Mr. Williamson also explained the accounting treatment associated with the hedging transactions. He stated I&M will account for the hedging transactions in accordance with Generally Accepted Accounting Principles ("GAAP") and the Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts. He stated that all hedge transactions must be accounted for in accordance with GAAP and the Accounting Standards Codification 815—Derivatives and Hedging ("ASC-815"). He testified that if a hedge qualifies as a derivative, ASC 815 generally classifies these as mark-to-market or a cash flow hedge, which each have their own unique accounting rules. He added that if a hedge does not qualify as a derivative it will be accounted for on an accrual basis, where the gain or loss is recorded in the period the contract settles. Mr. Williamson explained that when the hedge qualifying as a derivative settles and the gain or loss is realized, it is recorded to either FERC Account 447—Sales for Resale or 555—Purchased Power. He stated that the FERC account designation depends on whether the hedge is designated as mark-to-market or a cash flow hedge for accounting purposes.

5. OUC's Evidence. Senior Utility Analyst Michael D. Eckert discussed I&M's request and the review that he conducted. He summarized I&M's Hedging Plan and identified the factors I&M will analyze when making a decision to hedge. Mr. Eckert recommended that I&M's Hedging Plan be limited to financial hedges and that any hedging policy changes be filed with the Commission prior to implementation. He further recommended that the OUC's FAC filing deadline be extended to 35 days after I&M files its testimony and petition. Last, Mr. Eckert provided the OUC's recommendation that I&M provide certain documentation as part of the FAC audit process in order for the OUC to timely review hedging related requests.

6. I&M's Rebuttal Evidence. Mr. Williamson testified that after reviewing the OUC's testimony, I&M reached out to the OUC to discuss their concerns and look for ways to work collaboratively. He stated that I&M worked with the OUC to understand and clarify the information sought by Mr. Eckert and the parties agreed that when an FAC filing includes a hedging transaction according to I&M's Hedging Plan, I&M will include in the standard FAC audit package: (1) The Triggering Event (includes unit availability data), (2) Impact Analysis, (3) Recommendations, (4) Consensus Decision, (5) Hedge Execution (includes transactional costs

details), and (6) Hedge Exit (includes profit and loss information). Mr. Williamson further testified that I&M and the OUCC reached agreement on how to address the OUCC's concerns regarding the timeline for FAC filings. More specifically, he said I&M agreed that for FAC filings that include Hedging Plan activity, I&M will respond to all OUCC data requests specific to Hedging Plan activity in the FAC within five days. Finally, Mr. Williamson agreed with Mr. Eckert's recommendations that I&M's Hedging Plan be limited to financial hedges and that any hedging policy changes be filed with the Commission prior to implementation.

7. Commission Discussion and Findings. We have consistently encouraged the use of appropriate risk management techniques for electric and gas utilities to address exposure to market price volatility. *E.g.*, *Indiana Utilities Corp.*, Cause No. 37357 GCA 61 at 2 (IURC 1/25/2006), *Duke Energy Indiana, Inc.*, Cause No. 38707 FAC 68 S1 at 7 (IURC 6/25/2008), and *Northern Indiana Public Service Co.*, Cause No. 43849 at 10 (IURC 7/13/2011). We find that the mitigation of price risk in fuel procurement is consistent with the provisions of Ind. Code § 8-1-2-42(d), and that implementation of a process to address purchased power price risk through a well-developed hedging plan is a reasonable action to provide electricity to customers at the lowest fuel cost reasonably possible. As discussed below, we find I&M's Hedging Plan to be reasonable and should be approved.

It is clear from the record that I&M's electric operations could be exposed to upward purchased power price risk if one or more of its four base load units is unavailable. Mr. Presthus explained that I&M's portfolio of generation resources and load obligations generally leave it with more energy supply than demand. Yet, the loss of one or more of I&M's base load generating units could leave I&M in a position of being a significant net energy buyer. The evidence shows the Hedging Plan will be implemented through market-based financial transactions that hedge I&M's purchased power risk exposure in PJM. Accordingly, we find I&M's Hedging Plan is reasonably designed to address upward purchased power price risk in the event one or more of I&M's base load units is unavailable.

The record shows that I&M proposes to execute hedges using financial products (or hedging instruments) that historical data supports as effective hedging of I&M's actual purchased power exposure in PJM. The record further reflects that when I&M has insufficient generating resources to meet its internal energy needs, I&M will be required to purchase power for physical delivery to meet its customer needs, regardless of whether I&M hedges that purchase. The financial hedge transaction, with the associated gain or loss, is used to hedge the actual purchase and allows I&M to lock into a certain price for a predetermined amount of energy over a predetermined period of time. The evidence presented supports our conclusion that I&M's Hedging Plan is reasonable because it seeks to mitigate a customer's exposure to upward purchased power price risk associated with market prices. Accordingly, I&M's financial Hedging Plan may mitigate the impact to customers of higher purchased power costs.

We further find that I&M's Hedging Plan appropriately balances the need for flexibility with the need for transparency. Specifically, I&M's Hedging Plan identifies the factors I&M will analyze when making a decision to hedge and that these factors represent a reasonable balance between the mitigation of upward purchased power price risk and the exposure to gains or losses, including any associated transactional costs, associated with hedging activity. The record reflects that I&M worked collaboratively with the OUCC to address the OUCC's desire to have supporting documentation for Hedging Plan transactions readily available for review as part of the FAC audit

process. I&M will provide the OUCC with the documentation identified by Mr. Williamson's rebuttal testimony as part of the standard FAC audit package. I&M will further respond to the OUCC's Hedging Plan related discovery in FAC proceedings that include Hedging Plan activity within five days. In addition, I&M's Hedging Plan will be limited to financial hedges and any hedging policy changes will be filed with the Commission for consideration and approval in I&M's FAC, or other separate proceeding, prior to implementation. We find these agreed-upon terms are reasonable and adequately address the OUCC's recommendations.

Given that the financial hedging transactions will be made to address native load purchased power cost price exposure, we find I&M may request recovery of both incurred gains or losses, including any associated transactional costs from hedging transactions, through I&M's semi-annual FAC and, to the extent deemed reasonable, those costs will be recoverable through I&M's semi-annual FAC. Approval of I&M's financial Hedging Plan does not mean the Commission is providing pre-approval of the financial transactions made pursuant to that Plan. Rather, any recovery of the hedging gains or losses, including any associated transactional costs, will be subject to review for reasonableness as are all of I&M's fuel costs to be recovered through the FAC process. Petitioner's proposed hedging methodology "is consistent with the Commission's often-stated principle that hind-sight review should not be used when reviewing hedging activities." *Duke Energy Indiana*, Cause No. 38707 FAC 68 S1 at 8 (IURC 6/25/2008). Accordingly, any such review will be made based upon an analysis of the facts and circumstances as they existed at the time the transactions at issue were entered into and, upon a finding that the transactions were reasonable, incurred gains or losses, including any associated transactional costs, shall be recoverable through the semi-annual FAC.

IT IS THEREFORE ORDERED BY THE INDIANA UTILITY REGULATORY COMMISSION that:

1. I&M's Hedging Plan is approved as set forth in this Order.
2. I&M is authorized to request recovery of the gains or losses, including any associated transactional costs, arising from its Hedging Plan as a fuel cost through its semi-annual FAC. Such gains or losses, including any associated transactional costs, should be separately identified in the schedules supporting each such filing, and upon a finding of reasonableness shall be recoverable through I&M's semi-annual FAC.
3. This Order shall be effective on and after the date of its approval.

STEPHAN, HUSTON, WEBER, AND ZIEGNER CONCUR:

APPROVED:

I hereby certify that the above is a true and correct copy of the Order as approved.



Mary Becerra
Secretary of the Commission