

DIRECT TESTIMONY OF BARBARA A. SMITH

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

2 A: Barbara A. Smith, Indiana Office of Utility Consumer Counselor, 115 W. Washington
3 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 ("OUCC") as
6 the Director of the Resource Planning and Communications Division.

7 **Q: Are you the same Barbara A. Smith that filed testimony in Phase I of this sub-**
8 **docket, Cause No. 43114 IGCC4s-1?**

9 A: Yes.

10 **Q: What additional items have you done to prepare for your testimony in this Phase II**
11 **proceeding?**

12 A: In addition to all the documents I reviewed in preparation for my testimony in Phase I, I
13 reviewed numerous data responses from Duke, as well as emails from Duke and the
14 Commission. I had discussions with other OUCC personnel and our outside consultants
15 from Accumyn Consulting. I also reviewed pertinent portions of Intervenors' Phase I
16 testimony.

17 **Q: What is the scope and purpose of your testimony?**

18 A: The purpose of my testimony is (1) to introduce the other witnesses who are filing testimony
19 on behalf of the OUCC and provide a brief overview of their testimony, (2) to express the
20 OUCC's extreme disappointment about the previously undisclosed ex parte communications

1 between Duke executives and the former Chairman of the IURC; and (3) offer the OUCC's
2 recommendations in this proceeding.

3 **Q: In your Phase I testimony you stated that, despite growing concerns, the OUCC**
4 **continues to support the completion of the Edwardsport IGCC Project ('Project'). Is**
5 **that still the case?**

6 A: Yes. The reasons for supporting the Project are set forth in my Phase I testimony, and those
7 reasons remain unchanged. In fact, the OUCC's reasons for supporting the Project have
8 remained consistent since the filing of our testimony in the original CPCN case (Cause No.
9 43114). Those reasons include the fact that Indiana needs additional generation, the
10 prospects for realizing carbon capture and sequestration in a carbon-constrained world, and
11 the additional environmental benefits that IGCC technology affords. Additionally, it is my
12 understanding that the Project is approximately 90% complete, and Duke ratepayers have
13 already paid a significant amount of money towards completion of the plant. It makes no
14 sense to abandon the Project at this time.

15 **Q: In your Phase I testimony you identified the OUCC's primary concerns in regards to**
16 **the Project. Do those concerns remain?**

17 A: Yes. Again, the OUCC's concerns have been consistent and on record since Cause No.
18 43114 IGCC 1. The OUCC's major concerns continue to be the excessive Project costs and
19 the ongoing inaccurate cost estimates. Additional issues that have come to light include
20 Duke's lack of budgetary integrity and apparent lack of responsibility or accountability for
21 these multi-million dollar cost overruns.

22 **Q: In what way is this proceeding different than Phase I?**

23 A: In Phase I, the review was limited to an examination of the prudence of Duke's actions

1 regarding the increase in Project costs of \$530M for which Duke requested recovery in
2 Cause No. 43114 IGCC 4. Phase II is designed to examine issues of fraud, concealment
3 and/or gross mismanagement in the planning, design, engineering and construction of the
4 Project.

5 **Q: What is the significance of fraud, concealment, and/or gross mismanagement as it**
6 **relates to this Project?**

7 A: As the Commission stated, “[p]ursuant to Indiana Code 8-1-8.5-6.5, allegations of fraud,
8 concealment or gross mismanagement may be examined in every proceeding involving a
9 facility being constructed pursuant to a CPCN and a Clean Coal Technology certificate.”¹ In
10 fact, Ind. Code 8-1-8.8-6.5 states that, “[a]bsent fraud, concealment or gross
11 mismanagement, a utility shall recover through rates the actual costs the utility has incurred
12 in reliance on a certificate issued under this chapter...”. In my opinion, this language
13 suggests that if fraud, concealment or gross mismanagement exists, the utility may not be
14 permitted to recover costs for the facility through rates, even if those costs have already been
15 incurred by the utility.

16 **Q: How does the OUCC testimony in Phase II address the concerns you have identified?**

17 A: Mr. Robert James and Mr. Scott Bayley from Accumyn Consulting provide their analysis in
18 a Report and supporting testimony in this proceeding. The OUCC concurs with their
19 conclusion that, from the beginning, Duke grossly mismanaged the Project and attempted to
20 conceal mistakes caused by its mismanagement from the IURC and other interested

1 Cause No. 43114 IGCC 4S-1, Commission docket entry dated February 25, 2011.

1 stakeholders. OUCC utility analyst Ms. Cindy Armstrong will supplement Accumyn's
2 findings as they relate to Duke's gross mismanagement of its grey water problem.²

3 **GROSS MISMANAGEMENT**

4 **Q: What is the OUCC's definition of gross mismanagement?**

5 A: As defined by Messrs. Bayley and James, gross mismanagement as a set of circumstances
6 resulting from management ineptitude or oversight that severely hampers accomplishment of
7 Project goals.

8 **Q: Please summarize the OUCC testimony regarding Duke's gross mismanagement of the**
9 **Project.**

10 A: After reviewing thousands of pages of construction-related documents, it was readily
11 apparent to Messrs. James and Bayley that Duke personnel were (and are) woefully
12 unqualified to manage the construction of this extremely complex multi-billion dollar
13 Project, which is the largest IGCC facility ever built in the world. Duke personnel may have
14 the expertise to operate complex power plants, but they have demonstrated that they are ill-
15 equipped to manage the construction of one of this scale. Since Duke had managed the
16 construction of pollution control projects, it apparently believed that it could manage the
17 construction of this multi-billion dollar Project. That assumption was short-sighted and
18 resulted in excessive cost overruns that have plagued this Project. According to Messrs.
19 Bayley and James, Duke's gross mismanagement can be summarized as follows:

2 Mr. James offered testimony in Phase I regarding the grey water issue (Public's Ex. 4-R). The OUCC is not refiling that testimony in Phase II, but the issue is addressed in the Accumyn Report which is filed in this

1 **Duke selected an unproven mix of Project Delivery Methods.** Duke
2 unilaterally implemented unconventional management methods, despite
3 having experienced construction partners in Bechtel and GE. Duke's
4 decisions resulted in unnecessarily complicated, detailed engineering and
5 construction execution, burdening the Project with extraordinary quantity
6 increases, escalating costs and extended schedule baselines.

7 **Duke failed to achieve primary objectives of its FEED Study.** Duke
8 expressed high confidence in its original Project cost estimate of \$1.985B
9 based on its FEED Study, which cost ratepayers approximately \$15-17M.
10 Ironically, Duke's errors and omissions made in the course of the FEED Study
11 ultimately led to massive increases to the Project's scope and cost,
12 unnecessarily transferring risk to Duke's ratepayers. Most significantly, Duke
13 failed to fully complete its basic design package at the end of the Study. This
14 failure may have been Duke's single biggest mistake, leading to multiple
15 problems on this Project that persist to this day. Duke also failed to obtain a
16 Lump Sum Turnkey ("LSTK") contract, which would have limited the cost
17 exposure of its ratepayers.

18 **Duke Mismanaged its Flexible Contracting Approach.** By taking
19 management control of this project, Duke voluntarily assumed all the risk,
20 knowing that it could transfer that risk to its ratepayers. Duke's unpredictable,
21 ever-changing management approach led to a number of problems, including

1 the following:

- 2 • Failure to develop a fully integrated master schedule until long after
- 3 commencing engineering, procurement and construction (“EPC”);
- 4 • Mismanagement of fast-tracked design and construction;
- 5 • Extraordinary quantity growth in Project commodities due to
- 6 incomplete basic design; and
- 7 • Inefficiencies and internal conflict in Duke’s shared management
- 8 approach.

9 **Failed Management of Project Controls.** Duke was incapable of controlling
10 quantities, cost estimates and scheduling functions, which led to enormous
11 cost increases and schedule delays.

12 **Failure to Manage Development of the Project’s Grey Water Disposal**
13 **Method.** Both Mr. James and Ms. Armstrong testify regarding Duke’s failure
14 to properly manage development of its grey water disposal system. The
15 Company rejected the plan proposed by its experienced contractor and instead
16 believed it could self-manage a design based on deep well injection. Its
17 management decision was based on insufficient research, leading to disastrous
18 delays and cost overruns.

19 **CONCEALMENT**

20 **Q: What is concealment?**

1 A: The American Heritage Dictionary defines “conceal” as “[t]o hide or keep from observation,
2 discovery, or understanding; keep secret[.]”

3 **Q: In your opinion, can the Commission find Duke guilty of concealment if Duke**
4 **concealed pertinent information only from the Commission?**

5 A: No.

6 **Q: Please explain.**

7 A: If Duke concealed information from the OUCC and Intervenors (“Interested Parties”), it
8 should be considered an act of concealment for purposes of this proceeding, whether or not
9 the Company provided some information to the Commission.

10 Unlike the Commission, the Interested Parties are advocates who have the right and,
11 in fact, the responsibility to investigate the significance of the actions and conduct by Duke
12 while it is seeking to recover billions of dollars from its ratepayers.

13 **Q: Why do you raise this point?**

14 A: Duke has made it clear in other filings in this and related dockets that it intends to claim that
15 because it provided information to the Commission via the Commission’s consultant on the
16 job site, Black & Veatch (B&V), it did not engage in concealment.

17 **Q: Does that seem reasonable to you?**

18 A: No. We have no way of knowing what information Duke provided to B&V or what
19 information B&V provided to the Commission, since we have not seen the B&V progress
20 reports. Further, Duke provided information to B&V that Duke intended the Commission to
21 know. That is quite different than what the Interested Parties have discovered in this case.

1 The Interested Parties have had the ability to look behind the curtain of Duke-controlled
2 information contained in monthly progress reports. In fact, it appears that B&V may not
3 even have had access to the most significant documents, letters and emails demonstrating
4 gross mismanagement and concealment. The Commission, as the decision maker, should
5 expect the Interested Parties to provide the most persuasive and relevant evidence available.
6 The Commission should not have to read between the lines of the B&V reports and discern
7 the significance of particular actions on the Project job site. The Interested Parties have done
8 so here.

9 **Q: Please summarize the OUCC's evidence pertaining to concealment.**

10 A: First, I must point out that there is not a bright line that distinguishes evidence that
11 demonstrates gross mismanagement or concealment. Many of the events outlined in our
12 gross mismanagement section may, in fact, also constitute concealment. Duke's mishandling
13 of the FEED Study and the events surrounding the Study were not adequately disclosed to
14 the Commission or the Interested Parties. It is an example of both gross mismanagement and
15 concealment. Additional evidence of concealment is discussed by Messrs. Bayley and James
16 in the Project Budget Manipulation section of the Report.³ Messrs. Bayley and James testify
17 that the information Duke provided to the IURC lacked transparency with respect to changes
18 in project scope, design, schedule or cost implications. As the scope of the Project and its
19 estimated costs escalated, Duke altered its budget presentation, making it impossible to track
20 and understand the change in budgeted line items. Finally, Duke engaged in concealment by

³ OUCC Analyst Anthony Alvarez also addressed this issue in his Phase I testimony which was marked as Public's Exhibit 2-R. Contemporaneously with this filing, the OUCC is moving to incorporate Mr. Alvarez's Phase I testimony

1 having ex parte communications with Mr. David Hardy, former Chairman of the
2 Commission.

3 **IMPROPER COMMUNICATIONS BETWEEN DUKE EXECUTIVES AND FORMER**
4 **IURC CHAIRMAN HARDY**

5 **Q: Do you believe that Duke participated in ex parte communications with the former**
6 **chairman of the Commission?**

7 A: Yes. Like everyone else at the OUCC, I was deeply troubled by the disclosure of numerous
8 emails reflecting inappropriate communication between high-level Duke executives and
9 former Chairman Hardy.

10 **Q: Why is this troubling?**

11 A: Most of the email correspondence is between Mr. Hardy and Duke's second-highest
12 executive Jim Turner, who was responsible for Duke's regulatory business. There is also
13 evidence of inappropriate communications between Mr. Hardy and James Rogers, Duke
14 Chairman of the Board, President and CEO. Based on email correspondence produced by
15 Duke and the Commission in this matter, Duke executives and Mr. Hardy had ongoing
16 communications from the inception of the Edwardsport Project that were in violation of
17 Indiana's code of ethics.⁴ According to the State ethics rules, state employees must conduct
18 themselves in such a manner that the general public will have confidence that their
19 performance is always for the public good. State employees are to be impartial in the
20 discharge of their duties; their decisions and policies must not be made outside the proper

into this phase as if fully set forth herein.

⁴ Indiana State Ethics Commission, February 2006 (<http://www.in.gov/>).

1 channels of state government; and public office.⁵ In addition, I understand that Executive
2 Order 93-12 places additional ethical responsibilities on IURC Commissioners.

3 Finally, the disclosed documents exhibit a disturbing pattern of continued improper ex parte
4 communication between Duke and Mr. Hardy.

5 **Q: What is ex parte communication?**

6 A: It is my understanding that ex parte communication is communication between an interested
7 party and Commission personnel, of a substantive nature, about a pending matter or a matter
8 that will be pending before the Commission within 30 days of the communication.

9 **Q: Why are ex parte rules so important?**

10 A: The ex parte rules are designed to ensure that communications conducted off the record
11 between the Commission and interested persons do not influence Commission decisions.
12 Since it is difficult to say exactly what type of information might influence Commission
13 decisions, there is a blanket prohibition against all ex parte communication with
14 commissioners and all assigned staff.

15 **Q: Is this blanket prohibition against ex parte communication important to the regulatory
16 process?**

17 A: Absolutely. It is the most important tool in providing the public with sufficient assurance
18 that the Commission's findings are fair and balanced and that all interested stakeholders,
19 utilities and ratepayers had a fair opportunity to be heard.

20 **Q: How do the ex parte rules affect your work?**

⁵ See above Ethics Commission Opinion.

1 A: The OUCC not only shares a building, but is on the same floor as the Commission. Our
2 respective staffs frequently attend the same Commission proceedings and other meetings,
3 pass each other in the halls daily and often eat lunch in the same restaurants. Yet, it is
4 precisely because of this contact that we are constantly mindful of what we say within
5 earshot of Commission personnel. Although we consider ourselves an integral part of the
6 utility regulatory process, we recognize the importance of protecting the integrity of that
7 process and that requires us, as advocates, to stringently follow the rules. We assume
8 regulated entities will do so as well. This is why it is so discouraging to see evidence of
9 blatant ex parte communication between Duke and the Commission's former chairman,
10 especially on such a profoundly important project to the state of Indiana. As with all ex parte
11 communication, the biggest problem is that we don't know exactly what was shared or
12 discussed in those meetings. What we do know is that emails were exchanged, private
13 meetings were arranged and held, and mutual understandings may have been reached.

14 **Q: Have you reviewed all the emails disclosed by Duke or the Commission that pertain to**
15 **communication on this Project?**

16 A: I'm sure I haven't read all of them. I've read hundreds of emails, including those attached to
17 the testimony of the Industrial Group's witness Mr. D'Onofrio.

18 **Q: Are any of the emails you have reviewed especially disturbing to you?**

19 A: Yes. The emails reflecting direct contact between Duke personnel and Mr. Hardy in the fall
20 of 2010, during the height of settlement negotiations with the Interested Parties, are difficult
21 to read. This was especially disturbing with respect to emails involving Mr. Michael Reed,

1 newly appointed President of Duke Energy Indiana and a former IURC Executive Director
2 who worked intimately and socialized with Mr. Hardy. I believe the emails show that the
3 parties to the dispute were not playing on a level playing field, and that ratepayers were not
4 treated fairly.

5 **Q: How does evidence of this ex parte communication constitute concealment?**

6 A: Duke executives obviously thought the information was material and important enough to
7 share with the Commission, but Duke purposely did not share that information with the other
8 Interested Parties in this case. This seems to epitomize the definition of concealment. Since
9 we do not know precisely what was said in the meetings referenced in the emails, we cannot
10 know for sure whether the information given to Mr. Hardy was accurate, or spun in such a
11 manner that the significance of the problems with the Project was diminished.

12 **Q: Does the fact that many of the offending communicators are no longer with the**
13 **Commission or with Duke make these ex parte communications of no consequence?**

14 A: Absolutely not. The very public and pervasive nature of the ex parte communications has
15 caused many to lose confidence in the Indiana utility regulatory system. The OUCC believes
16 the newly constituted Commission needs to send a message consistent with Gov. Daniels'
17 emphatic statement that he "will not tolerate even the appearance of impropriety."⁶ We also
18 believe that conduct has consequences and Duke should not be able to escape those
19 consequences by firing a couple of employees.

20 RECOMMENDATIONS

⁶ "Governor terminates IURC chairman, issues ethics memo to agency heads", October 5, 2010, (Press release at <http://www.in.gov/gov/3515.htm>.)

1 **Q: What does the OUCC recommend in this case?**

2 A: After much thought and deliberation, the OUCC recommends that the Commission disallow
3 any cost recovery by Duke of any amount over \$1.98B. The evidence submitted by the
4 OUCC and other Interested Parties in this docket present a compelling case of a Company
5 that, through arrogance or incompetence, has unnecessarily cost ratepayers millions of
6 dollars and has set back the public's trust in our regulatory process.

7 The offenses committed don't lend themselves to easy quantification. There is no
8 mathematical formula to assess the damage. Therefore, returning to the language of Ind.
9 Code 8-1-8.5-6.5, since Duke is guilty of gross mismanagement and concealment, it should
10 not be allowed to recover all of the actual expenses it has incurred on this project.
11 Ratepayers should get the benefit of their original bargain: a fully functional IGCC facility
12 for \$1.985B.

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