STATE of INDIANA

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TO: Mr. Adam Horst, Director, State Budget Agency

FROM: Jim Atterholt, Chairman, Indiana Utility Regulatory Commission

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RE: Agency Overview for Biennial Budget Fiscal Years 2012 and 2013

Mission

The Indiana Utility Regulatory Commission (IURC) is charged with protecting the public interest by assuring that utilities and others provide safe and reliable service at a reasonable cost. It exercises, on a derivative basis, the legislature's authority to regulate public utilities by applying and implementing the statutes and regulations.

Description of the IURC and its Programs

The Commission is a fact-finding body that hears evidence in cases filed before it and makes decisions based on the evidence presented in those cases. The IURC, by law, is charged with balancing the interests of ratepayers and utilities to ensure reliable utility service at reasonable rates. The IURC has regulatory authority over more than 900 utilities providing electric, steam, water, natural gas, sewer, telecommunications, and video services. These utilities are investor-owned, not-for-profit, municipal, cooperative organizations, or water conservancy districts.

The IURC has 76 staff members that include experts in law, accounting, engineering, economics, finance, and public policy. The technical staff is responsible for scrutinizing information submitted by all parties that are seeking IURC action. Typical cases include: requests for rate adjustments, territorial changes, financing, environmental compliance, system interconnection, video franchising authority, and various consumer complaints. In 2009, the Commission issued 378 orders.

The IURC also has a Consumer Affairs Division that acts as a mediator between the utility and the consumer when customers have questions or complaints about billing, services, or other matters. The Consumer Affairs Division uses information gathered in the complaint handling process to alert the Commission to consumer issues that may require further attention. If the Division discovers a concern, it may request that an investigation be conducted by the Commission.

In addition to its traditional responsibilities as the economic regulator, the Commission has had an expanded role in a number of areas through Federal and Congressional mandates in recent years. For example, the passage of national energy legislation has required the Commission to conduct analysis and implement various initiatives. Increased activity by the Federal Energy Regulatory Commission (FERC) and the Federal Communications Commission (FCC) affecting regulated entities and issues related to IURC regulation has also markedly increased time demands on Commission staff. As the need for additional electric generation grows, new and updated transmission infrastructure must follow. Therefore, considerable investment in both generation and transmission will be necessary in the immediate future as well as over the long term. The Commission is required to respond to this very significant market need with additional resources, increased expertise and expanded involvement in regional planning through Regional Transmission Organization (RTO) entities such as the Midwest Independent System Operator (MISO) and PJM Interconnection (PJM).

Pursuant to the American Recovery and Reinvestment Act of 2009 (ARRA) funding awarded through the Department of Energy, the IURC will be able to supplement its staff with in-depth skill sets that are traditionally difficult to find and that are too expensive to be hired as staff. The Commission has designed three specific areas of concentration to address areas of high importance and concern: Integrated Resource Planning; Carbon Capture and Storage; and Energy Efficiency and Demand Side Management. The budget developed by the IURC for this grant allows for the hiring of three new full-time employees for a period of three years with benefits. The position of Director of Integrated Resource Planning has recently been filled.

A number of new Pipeline Safety laws have been passed by Congress in recent years as well as increased delegation to the Commission from the United States Department of Transportation (USDOT). Because of these expanded responsibilities, our staff is required to spend additional time in the field for site inspections related to pipeline integrity, damage prevention and risk mitigation. We expect the area of Pipeline Safety to continue its recent expansion for the foreseeable future.

Agency Achievements

The utility industry as a whole continues to be in a period of profound transformation, making it increasingly challenging for the Commission to adapt and be responsive within appropriate timeframes that avoid unreasonable levels of regulatory lag. This task is complicated by the fact that all industry sectors seem to be, not only changing rapidly, but also simultaneously. Key issues confronting Indiana electric, natural gas, communications and water/wastewater utility sectors are also beginning to apply to multiple segments on a more consistent and regular basis than in the past, which has altered how the Commission allocates its time and resources. However, the Commission continues to monitor statewide and national efforts to address these issues in addition to remaining at the forefront of discussions with legislators, other state regulators and commissions.

With the economic downturn, the Commission's docket rapidly filled with rate cases. From 1990 to 2005, very few major rate cases were filed. However, since 2009, virtually every large jurisdictional utility has filed a rate case with the Commission; has a rate case pending before the Commission; or is preparing a rate filing to be made with the Commission. Rate cases take an enormous amount of staff resources and every division is affected. Based on its current and anticipated caseload for the next two years, the Commission will see demands at a level never before experienced.

In 2009, the Commission successfully handled several high-profile cases, including: an emergency rate case filed by Indianapolis Water Company (IWC), the demand-side management investigation, the review of the Universal Service Program for natural gas utilities, and the ongoing construction of Duke Energy Indiana's Integrated Gasification Combined Cycle Project (IGCC Project) in Edwardsport.

In the IWC case, the Commission moved swiftly and decisively in order to avert potentially disastrous consequences, which resulted in a stable condition conducive to resolution. The base rate case is still undergoing review and an order is expected this fall. With regard to demand-side management, the Commission's final decision allowed for targeted development on an integrated program that is designed to be cost-effective and verifiable; this is the first program of its scope in Indiana. Another case that received a considerable amount of attention involved the Universal Service Program. In its final order, the Commission allowed the natural gas utilities to reinstate their respective bill assistance programs until each one provides the Commission with a more complete record that can be comprehensively reviewed in a base rate case. Lastly, the Commission has stayed involved with oversight of the IGCC Project by holding regular hearings and engaging its own engineering firm to assist in oversight.

In order to improve transparency and allow for more executive level input into the budgeting process, the IURC created a finance and budget committee. The committee has oversight responsibility for all of the agency's budgetary and financial matters, including preparation and presentation of monthly expenditures, reports/analysis, and a biennial budget. The Commission also continues to support its financial taskforce that is developing a more formalized and systematic monitoring plan to identify "trip wires" or signals of impending financial issues for Indiana utilities. Developing these two internal groups has allowed the Commission to take a more holistic approach to finance, exploring its impact at an agency, state, and national level.

Division Caseload & Overview

As previously noted, each division has been affected by a larger than normal caseload and a significant number of high-profile cases. Therefore, a more comprehensive review of the challenges and accomplishments faced by each division is provided below.

Electric

In 2009, Indiana's average retail rates were the 15th lowest in the nation, as compared to the 12th lowest for 2008. Consequently, Indiana's electric rates continue to remain attractive, primarily due to its reliance on coal. However, the general trend of increased coal prices observed since 2002 has eroded Indiana's competitive price advantage. Staff analysis shows some Indiana utilities have seen coal prices increase more than 75% since 2002. Neighboring states' average retail rates for 2009 rank as follows: Kentucky 3rd, Ohio 29th, Illinois 30th, and Michigan 34th.[1]

The State Utility Forecasting Group (SUFG) at Purdue University has been tasked by the legislature to identify and forecast future electric needs in Indiana. According to the SUFG's 2009 forecast,[2] Indiana will need approximately 1,320 MW of additional resources (all types of generating capacity, demand response, efficiency, and transmission to import power) by 2015 to meet expected load growth. This forecast also projects electricity usage to grow at an annual rate of 1.55% over the twenty-year forecast and for peak demand to grow at an annual rate of 1.61%. Although the utilities are required to meet their individual capacity needs through resource planning, the Commission has also developed policies and rules to help them meet their goals.

For example, the Commission issued a landmark order in 2009 that required jurisdictional electric utilities to achieve an annual energy savings goal of 2% within 10 years with interim savings goals for years one through nine. While the utilities are required to offer certain core programs (residential lighting, home energy audit program, low-income weatherization program, energy efficient schools program, and a commercial and industrial program), they are responsible for designing and implementing the actual programs through a third-party administrator. Another third-party administrator will then oversee the evaluation, measurement and verification of the demand-side management (DSM) programs to ensure their effectiveness, and report those results to the Commission. With regard to energy savings as a percentage of utility sales, Indiana ranks 22nd nationally and 4th among the seven Midwestern states. For the amount spent on energy efficiency initiatives, Indiana ranks 31st and 6th, respectively. During the course of the investigation, three Midwestern states, Illinois, Ohio, and Michigan established annual DSM savings targets for electric utilities. Based on the savings goals approved by the Commission, Indiana rivals Illinois and surpasses the other two states.

Generation capacity from renewable resources, including wind and landfill gas, is increasing in Indiana. Renewable resources provide about 1% of the generation capacity serving Indiana customers, and this number continues to increase. In June 2010, the Commission began

[1]Energy Information Administration, Average Retail Price of Electricity to Ultimate Customers by End-Use Sector by State, Table 5.6B, historical result archive.
[2] http://www.purdue.edu/discoverypark/energy/pdfs/SUFG/2009SUFGforecast.pdf

its informal review of net metering practices in Indiana to determine whether the existing rules within the existing Indiana Administrative Code[3] should be changed, and if so, to what extent. Net metering allows customers to supplement their electric usage and mitigate a portion of their cost. According to the current rule, an eligible net metering customer is one in good standing who owns and operates a solar, wind, or hydroelectric generating facility with a capacity of less than or equal to 10 kW on their premises. At a minimum, the five investor-owned utilities (IOU) must offer net metering to residential customers and K-12 schools that install a net metering facility. However, the IOUs, or any other electric utility, may still offer net metering to commercial or industrial customers. The Commission has invited legislators, interested stakeholders and the public to comment on the rules and their experiences with them. The Commission continues to review the feedback received by these participants and estimates that it will take further action this fall.

Another investigation pending before the Commission deals specifically with tree-trimming policies and practices, specific provisions in the utilities' tariffs related to tree-trimming practices, and related customer complaints. Respondents to the investigation include all jurisdictional electric utilities. Although tree trimming is necessary in order for the utilities to provide adequate and reliable service without service interruptions, there are no standardized rules or regulations regarding this issue at the state or federal level. Rather, there are certain federal recommendations and standards. Specific considerations by the Commission include, but are not limited to, the following: proper/reasonable notification practices, debris removal after storm events, adoption of industry standards, and uniform clearance standards. The Commission expects that an order will be issued this fall.

Since 2009, the Commission has worked on rate reviews requested by Northern Indiana Public Service Company[4] (NIPSCO) and Southern Indiana Gas and Electric Company (SIGECO),[5] municipal electric operations for Crawfordsville[6] and Columbia City,[7] municipal steam operations for Citizens Thermal Energy[8] and electric cooperatives including Jackson

[3] *See*, 170 I.A.C. 4-4.2-1
[4] Cause No. 43526
[5] Cause No. 43839
[6] Cause No. 43773
[7] Cause No. 43832-U
[8] Cause No. 43821

County REMC[9] and Harrison County REMC.[10] Even though each of the utility's needs and situations is unique, federal requirements, aging infrastructure, and new capacity needs influence their ability to recover necessary operating and maintenance expenses. The expenditure of Commission time and resources on regular rate cases ensures changing industry conditions are properly reflected in the retail rates on both a company-wide and customer-class specific basis.

Future issues that may affect the electric industry include:

- Regional Transmission Organizations (RTOs) – Because of the importance and pervasiveness of the RTOs' impact for Indiana utilities and their customers, the Commission's involvement with the Federal Energy Regulatory Commission (FERC), as an advocate for Indiana, has increased dramatically.

- Demand-Side Management and Demand Response – This includes energy conservation programs, advanced metering programs, and the "smart grid."

- Regulation of Greenhouse Gases – Potential regulation of carbon emissions continues to be a critical environmental issue and will likely increase in significance for Indiana and the nation depending on the parameters and passage of climate change legislation in Congress.

<u>Natural Gas</u>

During the last eighteen months, natural gas prices have decreased, primarily due to an unprecedented new supply of gas from unconventional sources; a decline in industrial demand; a cooler-than-normal summer in 2009; and the worldwide recession. For 2009, initial pricing started relatively low, in comparison to 2008, and moved even lower. NYMEX gas futures hit bottom on September 3, 2009 at $2.51/Dth[11] and peaked on January 6, 2010 at $6.01/Dth, a spread of $3.50. This is in contrast to 2008's volatile market that had a price spread of roughly $10.00. Before these costs are passed along to customers, the Natural Gas Division must review each request by a utility for a gas cost adjustment (GCA) to ensure that the costs are prudent and

[9] Cause No. 43861
[10] Cause No. 43684
[11] Natural Gas Futures Prices (NYMEX), http://tonto.eia.doe.gov/dnav/ng/ng_pri_fut_s1_d.htm

in the public interest. The Office of Utility Consumer Counselor (OUCC) also reviews the request on behalf of the public. Last year, the Natural Gas Division reviewed 77 GCA petitions.

In 2009, the Legislature passed the "Call Before You Dig" law, requiring anyone undertaking a digging project to call the Indiana Underground Plant Protection Service Center at the toll-free 8-1-1 number before digging. In response to calls received, a trained representative is dispatched to mark the utility lines free of charge. Once the lines are marked, individuals may begin their digging project; however, they must hand dig within two feet of the buried utility line to prevent damage to the underground facilities. If there is a violation of the law, the Commission's Pipeline Safety Division serves as the investigative unit. If a violation is found, the information is then forwarded to the Governor's Advisory Committee, which was formed in 2010.

Upon receiving a recommendation from the Advisory Committee, and after notice and opportunity for a public hearing, the Commission must uphold or reverse the finding; approve or disapprove the recommendation(s) of the Advisory Committee; and/or collect any civil penalties and deposit the penalties in the underground plant protection account. Since July 1, 2009, Pipeline Safety has registered more than 60 possible violations.

Future issues that may impact the natural gas industry include:

- Renewables – Indiana, as well as the nation, has seen an increase in the number of renewable energy sources, including landfill methane gas, renewable natural gas from anaerobic digestion of waste from livestock, and coal bed methane.

- Increased Supply – The emergence of unconventional sources of natural gas supply such as shale gas has dramatically increased the overall supply of natural gas in our country and has contributed to the relatively low prices this past year.

- Distribution Integrity Management Program – As of February 12, 2010, operators must develop and implement written integrity management programs by August 2, 2011. The Commission must then review jurisdictional operators' plans for compliance.

Water/Wastewater

Of all the industries, water/wastewater is the most capital intensive due to high capital costs and relatively low revenues; investing more capital per dollar of revenue earned than any other industry. Costs are increasing for water and wastewater utilities and are driven by the following needs: replacement of aging infrastructure; compliance with U.S. Environmental Protection Agency standards such as water quality and wastewater effluent; growing demand; and the relocation of facilities for city and state road projects. For example, from 1984 to 2008 average water and wastewater treatment cost rose 310% while the consumer price index only rose 207%.[12] A 2003 report[13] issued by the Indiana Advisory Commission on Intergovernmental Relations estimates that statewide wastewater and drinking water infrastructure needs will require $12.4 to $13.9 billion in funding from the year 2000 to 2020.

Many water and wastewater utilities sought rate increases this past year for improvements to existing infrastructure and new projects. One of the most notable rate cases involved IWC, which filed an emergency rate case in early 2009, followed by a standard rate case later that year. The City of Indianapolis, which owns IWC, also announced the potential transfer of its water and wastewater utility to Citizens Energy Group. If approved, the wastewater system would be the first of Indiana's 108 combined sewer systems under Commission jurisdiction. Indiana American Water, the largest investor-owned utility, also sought a rate increase in 2009.

The Commission regulates approximately 116 out of 824 water utilities, and 47 out of 531 wastewater utilities. This is primarily due to an opt out provision in Indiana Code and the fact that the Commission has never had jurisdiction over municipal sewer utilities. When a utility opts out of the Commission's jurisdiction, the IURC no longer oversees its rates and charges or rules and regulations. It also eliminates the agency's ability to provide dispute resolution between utility customers and their utilities. The primary complaint with this arrangement has to do with the difference between inside-city and outside-city customer rates. Many municipalities charge outside-city customers higher rates or a surcharge, with premiums ranging from modest amounts to 100% or in some cases, even higher, than rates paid by inside-city customers for the same service.

[12] "Historical Water Price Trends," Steve Maxwell, AWWA Journal, April 2010
[13] "Financial Needs for Wastewater and Water Infrastructure in Indiana," January 2003

Future issues that may impact the water and wastewater industries include:

- Infrastructure – Indiana's water project-funding needs over the next 20 years are $5.9 billion. The greatest need, $4.5 billion, is for underground infrastructure.

- Troubled Utilities – Small, troubled utilities continue to present regulatory challenges for the Commission, which is actively monitoring select small utilities in an effort to educate owners and prevent utilities from becoming troubled.

- Outside-city Rates – Many municipalities charge customers outside their corporate boundaries higher rates than inside-city customers. This raises questions about whether the city rate is cost-justified and non-discriminatory.

Communications

The year 2010 marked the implementation of the final phase of House Enrolled Act 1279 (HEA 1279), a bill that largely eliminated all regulatory authority over rates and service quality for retail telephone service in Indiana. Per the requirements of the 2006 legislation, the Commission examined its administrative rules and policies and eliminated those that were no longer necessary under the new regulatory framework. The Commission also initiated a rulemaking to modify or repeal sections of the IURC's telecommunications rules located in 170 IAC 7. The Commission then issued a General Administrative Order announcing which sections would no longer be enforced after July 1, 2009. The rulemaking should be complete in the fall of 2010.

While HEA 1279 eliminated many of the Commission's duties, it also added new responsibilities and designated the Commission as the sole video franchise authority in the state as of July 1, 2006. Prior to this date, local franchise authorities, such as counties and municipalities, issued franchises to video service providers. However, this is no longer the case. Providers had the option to remain under the existing agreements until they expire or seek a state-issued franchise from the Commission.

In order to monitor the availability of video services in the state, HEA 1279 tasked the IURC with collecting data regarding video services offered in Indiana's Metropolitan Statistical Areas (MSAs) from 2006 through 2010. In the Commission's Four-Year Study on Video Service

Availability, data shows there has been a steady migration of video service providers in Indiana's MSAs away from local franchise oversight to state-issued franchises. The data also shows the heavy use of technologies such as fiber optic cabling and the use of digital transmission for video signals. There appears to be no correlation between the per capita income in an MSA and number of providers offering service there; however, MSAs with higher population densities have greater numbers of video providers offering service. Most of the infrastructure build-outs undertaken by video service providers from 2006 to 2010 in Indiana MSAs with local franchise agreements occurred without a requirement to do so under the controlling local franchise. The IURC has received no complaints regarding economic redlining under I.C. § 8-1-34-28 by video providers with state-issued franchises.

Another responsibility of the Commission is to monitor and implement area code relief. Two possible remedies are an area code split, which is a geographic split of the existing area code into two or more areas, or an overlay, which would result in 10-digit dialing. According to a recent report by the North American Number Plan Administrator (NANPA), the 812 area code, serving southern Indiana, is projected to exhaust the third quarter of 2013. In order for the Commission to take action, the NANPA must file a petition with the Commission on behalf of the telecommunications industry. The Commission will then hold hearings so that it can receive testimony from the affected stakeholders to determine the best course of action.

Future issues that may impact the communications industry include:

- Competition and Investment – With the deregulation of the communications industry, Indiana has seen competition increase and new technology be deployed in certain areas of the state.

- Indiana Universal Service Fund (IUSF) – The IUSF generates funds that are used to subsidize the rates for services offered by companies in high-cost areas in an effort to keep rates reasonable and affordable.

- Mergers – Since 2008, four mergers were announced that directly affect Indiana providers and consumers. Depending on the companies' business models, this could affect the industry landscape.

Agency Goals

The IURC oversees utility entities with annual revenues of more than $11 billion. It's our hope that the detailed market overview provided herein gives you appropriate insight regarding the importance and complexities of the agency's responsibilities. In addition, the IURC has complied with the Governor's Dashboard directive and in conjunction with OMB has developed agency performance measures. The IURC has three primary performance indicators. First, the IURC tracks and measures the pipeline safety audit score. This annual metric measures the quality of the State's safety program for natural gas pipelines. In 2009, the IURC was just shy of its target 100% score. The IURC scored 98.5%. Second, the IURC monitors the percentage of consumer complaints closed within 25 days of initiation. This performance metric measures how well the Commission is balancing its workload regarding consumer-specific concerns. In 2009, the IURC scored 81% out of a possible 85% - this figure represents an improvement of 13 percentage points from the 2007 results. Third, the IURC tracks the number of agency decisions that are overturned by the Indiana Court of Appeals. This performance metric is one tool that measures the quality of decisions. In 2009, the IURC had no case decisions overturned by a higher court. In fact, three decisions were upheld by the Court of Appeals.

Resource Requirements

The IURC takes the budget process extremely seriously. We fully appreciate the flexibility shown over the years by OMB to recognize our uniqueness and dedicated source of funding that has been designed to enable us to function and serve a very specific and critical purpose within state government.

We take pride in the fact that we are delivering high performance while maintaining a very streamlined approach to costs. As an example, statutorily we can collect from utilities up to 0.0015% of all intra-state revenues; however, we currently run our operation on roughly 0.0012% reducing our maximum collections from utilities by approximately $3.6 million annually.

We look forward to discussing our request in greater detail with you as you deem appropriate. Please do not hesitate to call if you should have questions that we can answer.