

DAVID JOHNSON PRESENTATION

My name is David Johnson, and I am the current Chairman of INDIEC. I am filling in for Jack Wickes, our Executive Director, although I doubt if I will be as entertaining, but maybe that's ok..... we don't need too much of a good thing.

I also realize I am the (or one of the) last speaker(s), so I am between you and the highway, therefore, I will as be brief as possible.

I am here speaking about the impact of energy on our member companies. The Indiana Industrial Energy Consumers organization or INDIEC consists of about 25 member companies, who account for approximately 33% of all energy used in the state of Indiana, and employ many thousands of people in the state. There are few organizations that represent more in terms of either employment or energy use. Our member companies are listed on your handout.

THE MEMBER COMPANIES PRESENT INCLUDE:

- Fred Mazurski, US Gypsum
- Tom Jennings, Rolls Royce
- Paul Ciesielski, AcelorMittal
- Larry Stalica, Linde Group
- Colin Winnie, National Starch
- Jim Edwards, Subaru
- Frank Starbody, Tate & Lyle
- Blake Jeffery, Indiana Cast Metal Association
- And I represent Eli Lilly and Company

Energy cost dramatically affect us all, especially this past year. I am going to speak about 4 specific topics related to high energy costs;

- 1. The electric industry today**
- 2. The breakdown of the regulatory compact**
- 3. Utility Regulation: Is it broken**
- 4. The dark side of Trackers**

I will also propose some options for consideration

The electric industry today

As many of today's speakers have already highlighted, technology is rapidly bringing opportunities and challenges to the energy market, especially in the

electric utility industry. Technology is always a part of change, and it is imperative that we embrace the new technology and allow it to help transform the electric utility infrastructure. This technology will certainly give us more capabilities, but we must also use it to drive cost down. Keeping energy cost low is a key component in keeping Indiana's industry strong and competitive in today's global economy. The advance of technology brings great possibilities, but without careful consideration of the cost and who bears that cost, technology can become a burden on all rate payers.

The state of the electricity utility industry today is in a precarious position. The wave of local utility company consolidations into multi-state mega conglomerates over the past decade is bringing back visions of the pre 1935 era. While we have not gone back to the jungle of power lines cluttering streets and alleys, the new mega utility companies, including some who serve Indiana, are reminiscent of the late 1920's. In that era, 8 large utility holding companies controlled 73% of the nation's electric business. Each of these utility holding companies owned local subsidiaries in different states, but because there was little effective state regulation and no federal regulation, these national holding companies were effectively unregulated. This lack of regulatory oversight allowed utilities to charge anything they wanted, and leaving customers with few options, except for paying the price.

Energy prices are again soaring, even here in Indiana and there are many similarities to the pre 1935 era including the rebirth of the multi-state mega utilities. The question is whether they are delivering the promised cost savings from the current wave of consolidations, or contributing to the increase in prices. While the electric rates for all Indiana's customers have risen about the same percentage overall, industrial rates have steadily moved upward in terms of their national ranking making Indiana less competitive for industrials.

For example, according to the EIA, Indiana industrial rates,
in 2003 were the 5th from the lowest in cost,
in 2005 they had risen slightly to 8th from the lowest
By May of 06, they had jumped to 22nd from the lowest
However in October of 2007, they dropped back down to 11th,
But;
in October 2008, just twelve months later , industrial rates have
moved back up to 18th.

Clearly this trend is moving the wrong way, especially for a very energy intensive state like Indiana.

The breakdown of the Regulatory compact

With the re-invention of the multi-state mega utilities, improving shareholder profits has moved front and center in their strategies. The regulatory compact exchanged exclusive territories for a minimum level of service and the opportunity to earn a limited profit. Utilities were able to deliver that profit by investing in technology that drove efficiency. Utilities were proud of their innovation, and the value they could bring their customers. Technology and economy of scale allowed utilities to continuously lower their rates for many years.

Today, this has changed as local utilities, driven by profit needs, are merging in search of greater returns for their shareholders. Rather than embracing technology as a way to improve service and lower cost, they use it to increase their earnings. Many have forgotten their obligation to deliver energy at the lowest cost possible. All companies must weigh the benefits of upgrading their capability against the cost and the risk that the investment will not pay off. Utilities, on the other hand are uniquely positioned, as they have a guarantee that they will not only be paid for their investment, but earn a profit on that investment too.

For a simple example, one of the speakers today talked about the smart grid. We have been hearing about the capabilities and benefits of this technology for several years now. The smart grid in part is simply upgrading to a better metering technology, and a prudent utility would begin testing the technology when the product was available, and incorporate it into their system when its benefits outweighed its cost. Some of the benefits include the elimination of meter readers and faster identification of customer outages. Unfortunately, utilities want customers to pay for this change up front, rather than first implementing the change, and then filing a rate case to incorporate the cost into the rate base. This is because in a rate case, they have to give a credit for the money they save from meter readers or costs they offset, including normal meter replacement and testing. Think about when you replaced your old furnace with a new modern high efficiency model. You weighed the cost of the furnace against the savings you receive in lower fuel bills. Why shouldn't the utilities do the same?

Utility Regulation: Is it broken?

In the past 10 or 15 years, many consumers have embraced the hope that competition in the electricity market would be the answer to this breakdown and better control electric prices.

What pushed the electric industry toward deregulation is hope that it could solve the many problems attributed to regulation, namely rising prices.

Is regulation broken?

Is deregulation the answer?

From the utility side, delivering value to shareholders is a growing driver. Regulatory lag and the cost of rate cases are often the most pressing issues. Rate cases often take a long time to prepare, and once submitted, require an equally long time to review. When prices for materials and labor are increasing and fuel prices are volatile, this lag can cause great concern for the utilities.

On the other hand, consumers want protection against unfair rates being thrust upon them. Unable to choose an alternate, they must rely on utility commissions to insure costs are fair, however the commissions are outgunned in many ways. First, the cases have become enormous, especially for utilities that don't file a general rate case for 15 or 20 years. Second, utilities expend huge sums of money preparing rate cases, so they tend to be very complex and detailed. Since preparing the rate case is a business expense, utilities can invest almost as much as they want in its preparation. Utility commissions, on the other hand, have limited resources, usually insufficient to completely review the details, nor can they hire as many consultants as used by the utility. Lastly, the tenure of the staff in many commissions isn't long enough to develop the type of expertise needed to fully review the complex issues included in the case.

Unfortunately, there is no free market or open competition for electricity, even in states where deregulation has been attempted, so regulation must continue to be used to validate the prudence of what utilities spend and allocate the cost fairly.

The dark side of trackers

Since deregulation is not the answer, Trackers have become a favorite form of regulation over the past 10 years.

In September of 2007, Chairman Hardy of the IURC spoke to the Regulatory Flexibility Committee of this General Assembly on trackers. In his initial statement, he said that "trackers are not inherently good or bad..." and he went on to say later in the presentation that, "Properly designed, they can be a useful too in achieving a regulatory balance." Actually, many feel trackers appear relatively harmless, but as with many things, looks can be deceiving. They appear to be an easy and a quick way to "track" costs that utility companies are entitled to recover.

So why do industrial customers have such a concern over trackers? First, it appears that trackers have become the preferred alternative to rate cases. But

trackers have a dark side too. At last count, there are some 24 electric trackers in Indiana.

Unfortunately, trackers mask the true rates. For example, very few utilities have increased their base rates in the past 5 years, yet trackers have increased the cost of electricity to Indiana consumers. From 2002 to 2006, over 2 billion of environmental capital costs alone have been paid for through trackers. Were these investments prudent? What about rate base items retired when the upgrades were installed? Was the associated cost removed from the rate base?

INDIEC is not opposed to utilities being paid for prudent investments, and we believe that utilities should be allowed to earn their return on that investment; however trackers circumvent the normal scrutiny of the costs. Trackers tend to be one off rate making. Savings or cost reductions aren't considered when approving a tracker. Trackers seldom pass through cost decreases to the consumer: say for instance, when interest rates fall. In fact, trackers are approved so quickly, that there is hardly any time for review at all. While trackers could go both ways, only a couple of the 24 current trackers refund savings.

Many of the current trackers have been enacted by the legislature as a solution to a problem. In many cases, legislative mandated trackers are being used to implement social change, rather than a tool for utility regulation. Of course, the authority for all regulation is the General Assembly; however wise legislation should limit the use of trackers to the IURC as part of a rate case, where all costs are considered. The legislature should strive to have all policy initiatives to stand on their own merit, rather than buried in legislation that often affects only one utility and their customers.

Trackers also eliminate the utility company's incentive to be efficient. If a utility can be compensated for new investment with a tracker, why should it go through the pain and torture of a rate case and risk the lose of revenue as all costs are considered?

One of the social goals is to become more self sufficient in terms of energy which is critical to the strength and security of America. Many see the use of Indiana or Midwestern coal is an important tool toward that end. INDIEC believes that coal must be part of the answer, at least for the short term. INDIEC also believes that the search for how to utilize coal cleanly must be borne by society as well as coal producers, rather than the customers of only one utility.

For example, Duke Energy's aggressive \$2.35 billion coal gasification project is as much about proving the technology, as it is about supplying 500 megawatts of additional electricity capacity to the customers in Indiana. Because of the legislative mandated tracker, the customers of Duke Energy will disproportionately bear a large portion of the cost for developing this technology. While many will argue that those customers will reap the benefit as they will be further along when carbon costs are imposed, shouldn't the cost of this development be born initially by the utilities, the coal industry and through taxes? Once proven, it could be included in the base rates for those utilities choose to use the technology? The current mandated approach will drive up rates unfairly and potentially force Indiana companies to go out of business or move off shore, causing more lost Indiana jobs.

Another well known Hoosier has made top 10 lists famous, ... or infamous. I had hoped to share that list with you today, but because of time, we have included our version on trackers in your handout. Many of these are from Chairman Hardy's comments at the Reg. Flex committee in 2007.

Needless to say, industrial customers have significant concern about trackers.... But today, there are many serious issues facing us all and we must choose the best alternative to meet everyone's needs. Paying for these through trackers just isn't the way.

CONCLUSION

INDIEC supports keeping energy costs low, so that Indiana companies can be competitive in the local, national and global economy. Careful and comprehensive regulation with limited use of trackers is critical to that goal.

INDIEC supports a clean environment and that the costs should be borne by the consumers, however this is a societal cost. The customers should not bare all the risk, nor should customers of one utility bear the costs of technology development.

INDIEC supports "renewable energy sources", however we believe greater private sector involvement will help speed these technologies to the market and reduce costs to consumers faster than through utility companies alone.

PROPOSAL

The general assembly should consider laws that empower the utility commission to balance the needs of customers and utility companies, rather than tying their hands by mandates.

The IURC should encourage all utilities to use regular rate cases to have their costs reviewed and rates adjusted on a regular basis. The Legislature should allow sufficient funding of the IURC to insure this happens on a timely fashion.

To that end, the utility commission should enact guidelines for rate case submission that allows them to fairly consider both the needs of the consumer and the utility in a timely fashion.