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POSITION STATEMENT ON INFRASTRUCTURE BUILDING RISK
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Executive Summary

With changing environmental laws and retiring existing generation, Indiana may find itself in a build cycle with regard to utility infrastructure. Unfortunately, this comes at a time when Indiana has lost its advantage with regard to low industrial electricity prices. Today, Industrial electricity prices in Indiana are higher than Illinois, Ohio, and Kentucky. Indiana had the 16th lowest industrial electricity prices in 2010. By 2012, Indiana had fallen to 23rd.

As Indiana considers its utility infrastructure, it should also reflect on lessons learned from our most recent experience of constructing an electric generating facility, at the Edwardsport Integrated Gasification Combined Cycle ("Edwardsport") plant. Indiana's current legal framework allowed the billion and a half dollar cost overrun at the Edwardsport facility to occur – and sets the stage for significant cost overruns to continue.

Indiana's laws regarding consideration and approval of new utility infrastructure are already too generous to utilities. Authorizing new trackers will only exacerbate higher electricity prices in Indiana and worsen the current situation which has already led to significant cost overruns.

Background – Utility Assured of Cost Recovery After Approval of its Estimate

Historically, utility shareholders shouldered all the risk in building new power plants or other investments in infrastructure. Once the new facility was "used and useful," it could be placed into rates during a utility rate case. Once in rates, the utility is allowed to earn a "return on" its investment through a return on equity and a "return of" its investment through depreciation.

Indiana modified its law after experiencing abandoned nuclear generating facilities, and implemented the Certificate of Public Convenience and Necessity ("CPCN") law, Indiana Code §8-1-8.5 for new generation facilities. Indiana has also legislatively authorized a number of tracking mechanisms for other capital improvements, such as SB29 trackers. Accordingly, Indiana has gone from one end of the spectrum, where the utility had all of the risk of building infrastructure, to the one that exists today, where the utility has very little risk. Indiana has socialized risk and privatized reward.

Under Indiana Code §8-1-8-5-5, an application for a CPCN may only be granted after a hearing and the Utility Regulatory Commission makes a finding as to the **best estimate** of construction, purchase or lease costs based on the evidence of record. The utility then elects ongoing review of the construction project by the Commission or may defer that review until the utility's next base rate case. If a utility elects ongoing review, it submits a progress report to the IURC, along with any cost estimate updates. Absent a finding of fraud, concealment or gross mismanagement, the CPCN statute provides that a utility which has requested ongoing review will receive recovery of actual costs which have been incurred in reliance on a CPCN. If a utility revises its cost estimate, the Commission reviews the proposal for the cost increase under a necessary and prudent standard.

The Edwardsport Experience – A billion and a half dollar over-run

Accordingly, under existing law, the utility's interest is in having its estimate approved – after which it is virtually assured recovery of every cent expended. As seen in the Edwardsport case, the estimate may have little relationship to the final cost of constructing the facility. Duke originally discussed that the plant could be built for $1.3 billion, but the estimate presented to, and approved by the IURC, was $1.985 billion. Less than a year later, Duke sought approval for $365 million in cost overruns (an 18% increase over the $1.985 billion). As of January, 2013, the current estimate for the facility is $3.55 billion, a 79% increase over Duke's initial estimate.

Indiana ratepayers would be better served by a framework which more closely mirrors decision-making in the business world. As monopolies, utilities enjoy numerous advantages in recovering their costs. As monopolies, utilities should be held to a higher standard, not a lower one, than in the business world. Not only does Indiana need a framework where the best, most business-like estimate is produced, but one which also imposes financial consequences if the estimate is flawed. Recovery of costs through trackers sets up a system where cost over-runs are more likely to occur and fails to align the monopoly's interests with its ratepayers.

Improve Utility Estimates

INDIEC has a number of ideas for improving utility estimates. The factor which is most likely to improve estimates, however, is the one discussed next, having financial consequences when the estimate is wrong. While all parties have learned from the Edwardsport experience and may be more critical in reviewing utility estimates going-forward, the time-period and resources that the relatively small-staffed state agencies of the IURC and Office of the Utility Consumer Counselor have to review the utility's filing needs to be examined. Utilities frequently look to impose short time-frames for review. In its Edwardsport Order, the IURC noted the sheer volume of information involved the construction of new electric generating facility and that those seeking to review the information can be at an informational disadvantage versus the utility.

Utilities have also strayed from traditional vendor-vendee relationships. Expertise in operating a utility does not equate to expertise in constructing a multi-billion dollar project.

Finally, the utility estimate must adequately include risks and costs unique to the technology. This factor is particularly important as nuclear generation enters into the discussion.

Utilities Must Have "Skin in the Game"

The key to reforming Indiana's framework, however, is for the utilities and their shareholders to have "skin in the game" if their estimate is wrong or with regard to tracked costs. When the Edwardsport facility was initially brought before the IURC, some stakeholders requested that Duke be held to its estimate. Capping recovery of costs at estimates is also equitable, considering, as it was in the Edwardsport case, that there may be more than one technology under consideration. Duke backed a clean-coal generating facility to the exclusion of natural gas or other generation options, which most certainly would have been less expensive than the $3.55 billion cost the plant has turned out to be. The CPCN statute should be modified to expressly permit the Commission to cap costs at the best estimate.

Trackers pose the same problems and risks. A utility has no incentive to manage the costs of a project when every cent is recovered from ratepayers. Proliferation of trackers will unreasonably extend time in-between rate cases, which is the only time that all of the utility's costs and revenues are examined. Lopsided results can occur when a utility seeks approval to track costs which are increasing without considering other cost reductions or revenue increases which would offset the need to recover additional funds from ratepayers.

The guaranteed recovery up to the amount of the estimate is another aspect of Indiana's current framework which is problematic. Perhaps a utility should only be allowed to recover a percentage of costs in the approved estimate until the end of the project. The remaining percent would be authorized once the facility is "used and useful". Another possibility is that the authorized cost recovery is subject to full or partial refund upon completion of the project. If the project never produces a kilowatt of electricity, the utility should not be allowed to recover billions of dollars because it constructed the facility in accordance with its estimate.

As with many things, the framework that you start with dictates the actions of stakeholders and the result. Indiana has an opportunity and must act to improve its framework and reduce the likelihood of cost overruns in the future. Providing utilities with additional trackers will further fuel Indiana's higher electricity prices and erode our manufacturing base.